The Goals of Antitrust and Competition Policy

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Abstract

I review the goals of U.S. antitrust and EC competition policy, as they have been influenced by legislatures, courts, enforcement agencies, and academic researchers.

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Contents

1 Introduction

This chapter reviews the development of U.S. antitrust policy over six sometimes overlapping time periods: that leading up to passage of the Sherman Act, that leading up to passage of the Clayton Act and the Federal Trade Commission Act, the interwar period, the immediate postwar period through passage of the Celler-Kefauver Act, early applications of the amended Section 7 of the Clayton Act and the Chicago interlude, and afterward. The focus is on what the goals of antitrust have been, and how and why they changed, over time.

The chapter then turns to the shorter but no less intricate development of EU competition policy, discussing the historical European approaches to competition policy, the connection between U.S. antitrust and the competition policy of the European Coal and Steel Community, and contemporary EU competition policy, which has the Treaty of Rome as its foundation.

The penultimate section touches on normative issues, presenting the view that economics as a science does not generate policy recommendations that are independent of value judgments. A final section concludes.

2 United States

The discussion that follows makes clear that certain themes repeat themselves in debates about antitrust policy, although those putting one or another position forward typically show little awareness of their intellectual antecedents. Two types of positions were prominent before passage of the Sherman Act. One was to regulate business where actual competition failed, and leave other sectors of the economy to their own devices. The other was that no government regulation was needed, since potential competition would get good market performance if actual competition did not. These two positions manifested themselves again in policy debates before passage of the Clayton Act and the FTC Act. Although the Clayton Act was viewed in some quarters as government control of business conduct, its motivation was to ensure maximum effectiveness for potential competition, and thereby to minimize any rationale for government control of firm and market structures. This fit well with interpretations of the Sherman Act as embodying the principle of competition that became the lynchpin of antitrust policy.

Advocates of potential competition continued to be heard after World War I, along with those who looked across the Atlantic to the European abuse control approach to interfirm cooperation, an approach that contrasted sharply with the *per se* illegality rule of U.S. antitrust. Antitrust was all right in the bad old days of trusts, but now (1920s) it had been rendered obsolete by international competition. In reaction, some economists, among the most prominent associated with the University of Chicago, began to support the idea of activist government control of market structure.

After World War II, it appeared to some that technological advance (in chemicals and electronics) had now (1950s) rendered antitrust, which might have made sense in the nineteenth century, obsolete. U.S. firms should be allowed to cooperate to face heightened foreign competition. At the same time, support for a structurally-oriented antitrust policy increased, in no small measure because of the perceived involvement of large firms in prewar Germany and Japan as those countries sank into fascism and authoritarianism. A merger control law was adopted with the Celler-Kefauver amendments to Section 7 of the Clayton Act.

Support for the extension of structural antitrust policy to control of existing market structures, not merely mergers, grew through the early 1970s. Just as the calls for relaxation of antitrust in the 1920s laid the foundation for the structural approach of the Celler-Kefauver Act, so merger control and the advocacy of deconcentration measures laid the foundation for a second intellectual generation of Chicago School scholars, who sounded the twin themes that there was no basis in economic science for any antitrust policy beyond a prohibition of competition and that in any case most industries could be treated as if they were perfectly competitive. The Second Chicago School's considerable influence over antitrust gave U.S. antitrust what is called (and may or may not be) an economic approach. The economic approach permits restraints on competition that are thought to improve market performance, and so is a departure from the principle of competition.

The 1980s again saw the argument that foreign competition and technological advance had rendered antitrust obsolete.[1] The theory of contestable markets[2] put forth in elegant form, and one that was not without impact on regulatory policy, the argument that potential competition could be relied upon, at least under some conditions, to get good market performance. By the late 1980s, it was clear that mainstream economics did not hold the view that most industries, most of the time, could be treated as if they were perfectly competitive, and some applications of the economic approach to antitrust invoke arguments that do not seem to be accepted by most economists.

In 2006, it is once again foreign competition and technological advance that render antitrust obsolete.[3]

The review of the development of antitrust policy that follows shows that the goals of antitrust policy have changed over time. That is a useful antidote to claims that antitrust never had anything other than some one particular goal (what goal that might be is, of course, a point on which different authors hold different views). It also documents that economic arguments have been advanced to support almost all sides in the long debate about antitrust policy. The practical import of an economic approach to antitrust would seem therefore to depend very much on which economic bible one reads.

2.1 Run-up to the Sherman Act

[1] Lester C. Thurow, *Lets Abolish the Antitrust Laws* New York Times 19 October 1980, Section 3, page 2, column 3.
[2] William J. Baumol, John C. Panzar, and Robert D. Willig *Contestable Markets and the Theory of Industry Structure* (1982).
[3] Robert Crandall and Clifford Winston *Who Needs Antitrust*. Wall Street Journal 9 March 2006.

2.1.1 Popular literature

Scholarly advice had no direct impact on the legislative process that produced the Sherman Act. Thorelli attributes this regrettable lacuna to the "traditional American distrust of experts."[4] The lack of expert input may also have had something to do with the fact that Senate debate took place on a total of just seven days between 27 February and 9 April, 1890, with but one day of debate in the House of Representatives. Yet the subject had an extremely high profile in both the popular and the scholarly press, a large literature[5] in which economists, political scientists, and lawyers were prominently represented. This is the backdrop against which congressional debate took place.

It was Henry Adams' contribution to this literature that gave economics the distinction between industries with decreasing, constant, and increasing returns to scale technologies. Competition, Adams argued, might satisfactorily organize production in industries of the first two types. Industries of the third type (Adams used railroads as an example) were "by nature monopolies," and needed to be under the control of the state.[6]

Along the same lines, John Bates Clark denied that Adam Smith's invisible hand could be relied upon in important parts of the late-nineteenth-century American economy:[7]

> A startling recent development is the system of combinations by which producers of particular articles have attempted arbitrarily to control the supply and the market value of their respective products. … Toward the close of what we have termed the century of transition, producers' combinations appeared on a large scale; and very lately they have stolen a forced march upon economists. While we slept, as it were, and dreamed of the regulation of values by the automatic flow of capital to the points of highest profit, the principle apparently ceased to operate within very extensive fields.

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[4] Hans B. Thorelli, *The Federal Antitrust Policy* 120 (1955).

[5] Articles on monopolies, trusts, cartels, pools, their relationship with railroads, stockbrokers, speculators, and banks, patent and tariff policy, as well as public utilities and government regulation of business appeared regularly in the *North American Review*, the *Review of Reviews*, the *Atlantic Monthly*, and other general-audience publications. In an age before radio, television, sound-bytes, and "news McNuggets," this type of publication was a vital forum for American popular discourse. See Charles J. Bullock, *Trust literature: a survey and criticism*, 15 Quart. J. Econ. 167-217(1901) for a survey of the literature from 1897 onward, U.S. Library of Congress *List of Books Relating to Trusts, with References to Periodicals* (3rd ed. 1907) for a bibliography, and F. M. Scherer, *Monopoly and Competition Policy* (1993) for a collection that covers much more but includes papers from the early literature.

[6] Henry C. Adams, *Relation of the state to industrial action*, 1 Publications of the American Economic Association 471 (1887) at 526.

[7] John Bates Clark *The limits of competition*, 2 Political Science Quarterly 45 (1887), at 54. On Clark's contributions generally, see Paul T. Homan *John Bates Clark: Earlier and Later Phases of his Work*. 42 Quarterly Journal of Economics 39 (1927); for discussion of his views on trusts, see Joseph Dorfman, *John Bates and John Maurice Clark on Monopoly and Competition* in The Control of Trusts, Augustus M. Kelly Reprints of Economic Classics (1971).

Clark regarded the rise of concentrated market structures in railroads and manufacturing as the outcome of a Darwinian struggle, a process that reduced the number of operating firms and facilitated the formation of pools among survivors:[8]

> The industrial world would seem to be dividing into two portions, in one of which, … agriculture, the principle of individual competition continues…. In the other economic division, embracing transportation and a majority of manufactures, the principle of combination is asserting itself….

In contrast to Clark, George Gunton was sanguine about the impact of industrial combinations, which in his view were the result of efficiency rather than strategic behavior:[9]

> Is it true that the concentration of capital tends to build up monopolies? Much here depends upon what is understood by the term monopoly. If by monopoly is meant merely the exclusive power to produce a commodity, this exclusive power may be either an evil or a great benefit, depending entirely upon the way it is obtained. If it is procured through the arbitrary exclusion of competitors, it will surely be an evil; but if derived from the capacity to make the article more cheaply than others, … then it is a positive advantage to the community.

He acknowledged widespread public concern about monopoly prices:[10]

> Whatever the advantage derived from the concentration of capital in productive industry may be, if it tends to increase the prices of commodities, that would be an evil sufficient to warrant its arrest.

But after a review of the impact of trusts on prices in concentrated industries, Gunton concluded that the impact of large-scale operation on market performance was beneficial, not because of altruism or goodwill but because of the pursuit of self-interest in the face of potential competition: Business has:[11]

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[8] *Ibid*., p. 54. Franklin H. Giddings, in a companion article to Clark, *Limits*, emphasized the importance of potential competition for market performance. Giddings made an argument that was common in Germany with the rise of cartels after the 1873 depression, and which later surfaced in the United States (Giddings, *The persistence of competition*, 2 Political Science Quarterly 62 (1887) at 74): "Combinations are therefore, in their historic origin and in practical limitations, defensive organizations, for mutual protection against a competition that has become, or that threatens to become, predatory and ruinous." A modern elaboration of this notion appears in the empty core literature, for references to which see Abigail McWilliams and Kristen Keith, *The Genesis of the Trusts,* 12(2) Int. J. Ind. Organ. 245-267 (1994).

[9] George Gunton *The economic and social aspect of trusts*, 3 Political Science Quarterly 385 (1888), at 388. On Gunton's contributions, see Jack Blicksilver, *George Gunton: Pioneer Spokesman for a Labor-Big Business Entente*, 31(1) Bus. Hist. Rev. 1-22 (1957).

[10] *Ibid*., p. 390.

[11] *Ibid*., p. 403, emphasis in original. The economic mechanism envisaged here was later referred to as limit pricing.

> a direct interest in keeping prices at least sufficiently low not to invite the organization of counter enterprises which may destroy their existing profits. If the gates for the admission of new competitive capital are always open, the economic effect is substantially the same as if the new competitor were already there; the fact that he *may come* any day has essentially the same effect as if he *had come*, because to *keep him out* requires the same kind of influence that would be necessary to *drive him out*.

Clark, at one end of the spectrum, sees substantial limits to the effectiveness of competition as a resource allocation mechanism in large segments of the economy, specifically those where technology requires large fixed investments. Government regulation, of a kind Clark in 1887 was not prepared to specify, might well be called for to obtain good market performance in such industries. Gunton, at the other end of the spectrum, sees potential competition as being just as effective as actual competition in obtaining good market performance.

2.1.2 Senate debate[12]

It is possible to find discussions of the Senate debate preceding passage of the Sherman Act that pick out a few sets of remarks as a way of buttressing an argument that the Senate that passed the Sherman Act clearly had some one specific purpose. But the Senators who took part in the debate expressed a wide range of concerns, the full nature of which is indicated here.

For Senator Turpie, trusts were formed to raise prices: [13]

> a trust, in the most recent acceptation of the term, is a union or combination, … usually of corporations, dealing in or producing a certain commodity, … with the intention of holding and selling the same at an enhanced price, by suppressing or limiting the supply and by other devices….

Conversely, one of Senator Sherman's complaints was that a trust could engage in anticompetitive local price-cutting:[14]

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[12] For the text of Congressional debates and supporting documents, see Earl W. Kintner, *The Legislative History of the Federal Antitrust Laws and Related Statutes* (Vol. 1, 1978). For discussion of the Senate debates, see among many others Hans B. Thorelli, *The Federal Antitrust Policy* (1955), William L. Letwin, *Congress and the Sherman Antitrust Law: 1887-1890,* 23(2) Univ. of Chicago Law Rev. 221-258 (1956), Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. Law Econ. 7-48 (1966), Earl W. Kintner, *The Legislative History of the Federal Antitrust Laws and Related Statutes* Vol. 1 Introduction (1978), Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice* 48-52 (1994), Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* Vol. I 41-63 (1997).

[13] 21 Cong. Rec. 138.

[14] 21 Cong. Rec. 2457.

> The sole object of such a combination [a trust] is to make competition impossible. It can control the market, raise or lower prices, as will best promote its selfish interests, reduce prices in a particular locality and break down competition and advance prices at will where competition does not exist. Its governing motive is to increase the profits of the parties composing it.

This set of remarks suggests concern with anticompetitive conduct. Sherman also argued that such efficiency gains as occurred under trusts were not passed on to consumers in the form of lower prices:[15]

> It is sometimes said of these combinations that they reduce prices to the consumer by better methods of production, but all experience shows that this saving of cost goes to the pockets of the producer.

Here Sherman objects to the exercise of market power and income transfers from consumers to producers resulting therefrom.

But another exchange suggested that the law would not condemn a single supplier of a good, if that position were earned by competition on the merits. Senator Kenna asked:[16]

> Suppose a citizen of Kentucky is dealing in shorthorn cattle and by virtue of his superior skill in that particular product it turns out that he is the only one in the United States to whom an order comes from Mexico for cattle of that stock for a considerable period, so that he is conceded to have a monopoly of that trade with Mexico; is it intended by the committee that the bill shall make that man a culprit?

Senator Edmunds responded that it would not:[17]

> It does not do anything of the kind, because in the case stated the gentleman has not any monopoly at all. He has not bought off his adversaries. He has not got the possession of all the horned cattle in the United States. He has not done anything but compete with his adversaries in trade, if he had any, to furnish the commodity for the lowest price.

Some senators seemed to conceive of competition in the sense of market structure, if their support for an antitrust law was related in any way to support for competition. They took positions that were protectionist toward small business, and hostile to an unequal distribution of wealth:[18]

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[15] 21 Cong. Rec. 2460.
[16] 21 Cong. Rec. 3151.
[17] 21 Cong. Rec. 3151-2.
[18] Sen. George, 21 Cong. Rec. 2598.

> It is a sad thought to the philanthropist that the present system of production and of exchange is having that tendency which is sure at some not very distant day to crush out all small men, all small capitalists, all small enterprises. … So now the American Congress and the American people are brought face to face with this sad, this great problem: Is production, is trade, to be taken away from the great mass of the people and concentrated in the hands of a few men who, I am obliged to add, by the policies pursued by our Government, have been enabled to aggregate to themselves large, enormous fortunes?

Yet another concern was to promote the dispersal of private economic power:[19]

> If the concentered powers of this combination are intrusted to a single man, it is a kingly prerogative, inconsistent with our form of government, and should be subject to the strong resistance of the State and national authorities. If anything is wrong this is wrong. If we will not endure a king as a political power we should not endure a king over the production, transportation, and sale of any of the necessaries of life. If we would not submit to an emperor we should not submit to an autocrat of trade, with power to prevent competition and to fix the price of any commodity.

At least one Senator took a dim view of the whole enterprise. For Senator Stewart, some combination was inevitable in any society, and it would be difficult to distinguish between the kinds of combination that would be permitted and the kinds that would not.[20]

2.1.3 Overview

In contrast to some antitrust legislation that had been proposed, the Sherman Act does not contain the word "competition." Yet it seems clear that in prohibiting contracts, combinations, and conspiracies in restraint of trade (Section 1) and monopolization (Section 2), Congress sought to promote and preserve competition.[21] Section 1 seeks to promote competition in the sense of independent decision-making, Section 2 to maintain opportunities for potential rivals to come into the market, if they should find it profitable to do so.

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[19] Senator Sherman, 21 Cong. Rec. 2457. See also the remarks of Senator Vest, 21 Cong. Rec. 2463, suggesting that political unrest would follow if nothing were done to control trusts.

[20] 21 Cong. Rec. 2564.

[21] Congressional debate on the Sherman Act initiated the enduring antitrust tradition of failing to distinguish clearly between competition in the sense of structure, of conduct, and of performance. More than one dead-end dialogue about antitrust policy has taken place between one party who has in mind competition in one of these senses and a second party who has in mind competition in another. Contrast Justice Stevens in *National Society of Professional Engineers* 435 U.S. 679 at 695, writing of competition (which leads to certain results) in the sense of conduct, "The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services," with Robert H. Bork, *The Antitrust Paradox: A Policy at War With Itself*, 51 (1978), writing of competition in the sense of performance: " 'Competition,' for the purposes of antitrust analysis, must be understood as a term of art signifying any state of affairs in which consumer welfare cannot be increased by judicial decree."

Congressional votes in favor of the Sherman Act were overwhelming, 242 in favor and none against in the House, 52 in favor and one against in the Senate.[22] Some members of Congress undoubtedly saw Section 2 as promoting the survival of independent rivals of trusts, whether those rivals were more efficient than, as efficient as, or less efficient than a competing trust. Such protectionist purposes at the origin of Section 2 conceive of competition in the sense of structure, not conduct. Competition in the sense of performance appears in the Senate debates mostly by inference: trusts are objected to because they raise price, because they pocket savings (if any) from efficiency gains. Further, some members of Congress thought preservation of small business desirable because this would support the dispersion of political power, a noneconomic goal.

A common element of these diverse themes is the policy of relying, as much as possible, on markets as a resource allocation mechanism:[23]

> While the Sherman Act enlarged the role of the state, the purpose of state intervention was not to promote efficiency but rather, by curbing business practices that constituted restraints of trade and monopolization, to protect the market from itself.

2.2 From the Sherman Act to the Clayton and FTC Acts

2.2.1 Enforcement: a slow start

The U. S. Department of Justice (DOJ) filed 6 antitrust cases in the almost three years of the Harrison administration that followed the signing of the Sherman Act, 7 in the second Cleveland administration (1893-1897), and 3 in the slightly more than four years of the McKinley presidency.[24]

The Sherman Act's start in the courts was not only slow but rocky: the 1895 *Sugar Trust* decision[25] appeared to drive antitrust law into a *cul-de-sac*. The facts of the case, which involved the acquisition of four small independent rivals by the overwhelmingly dominant American Sugar Refining Company, seemed to fit those for which the Sherman Act was popularly thought to have been designed as a hand fits a glove.[26] But federal

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[22] George J. Stigler, *The Origin of the Sherman Act*, 14 J. Legal Studies 1 (1985). As Stigler remarks (5-6) "These votes are hardly eloquent on the distribution of support for the law…."

[23] Owen M. Fiss *The Troubled Beginnings of the Modern State, 1888–1910* 109 (1993); footnotes omitted.

[24] Joseph C. Gallo, Kenneth Dau–Schmidt, Joseph L. Craycraft, and Charles J. Parker *Department of Justice antitrust enforcement, 1955–1997: an empirical study*, 17 Review of Industrial Organization 75 (2000).

[25] U.S. v. E.C. Knight 156 U.S. 1 (1895). For discussions, see Charles W. McCurdy, *The Knight Sugar Decision of 1895 and the Modernization of American Corporate law, 1869-1903*, 53 Bus. Hist. Rev. 304 (1979), Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895-1904* (1985), at 165-166..

[26] For discussion, see Alfred S. Eichner, *The Emergence of Oligopoly: Sugar Refining as a Case Study* (1969).

antitrust authority rests on the commerce clause of the U.S. constitution, which gives the national government the power to regulate *interstate* commerce. In deciding the *Sugar Trust* case, the Supreme Court followed precedent and distinguished between manufacture and commerce:[27]

> No distinction is more popular to the common mind, or more clearly expressed in economic and political literature, than that between manufactures and commerce. Manufacture is transformation - the fashioning of raw materials into a change of form for use. The functions of commerce are different. The buying and selling and the transportation incidental thereto constitute commerce; and the regulation of commerce in the constitutional sense embraces the regulation at least of such transportation.

On this reasoning, manufacture is one thing, commerce another. The federal government has authority over interstate commerce, and it was to such commerce that the Sherman Act applied:[28]

> what the law struck at was combinations, contracts, and conspiracies to monopolize trade and commerce among the several States or with foreign nations; but the contracts and acts of the defendants related exclusively to the acquisition of the Philadelphia refineries and the business of sugar refining in Pennsylvania, and bore no direct relation to commerce between the States or with foreign nations.

After the *Sugar Trust* decision, the Sherman Act was widely perceived as[29] "a dead letter." It is mentioned no more than five or six times in the 626-page proceedings of the 1899 Chicago Conference on Trusts, and is a main subject of two contributions.[30] One of these is entitled "The trust: an institution pronounced by the United States Supreme Court, in 1895, beyond Congressional control."[31] The other points out that the Sherman Act had been applied more vigorously to organized labor than to business.[32]

Widespread debate about public policy toward business continued, reaching a flood tide around the turn of the century.[33] The debate touched on issues of regulation of financial as well as of product markets, and John Bates Clark was an active participant.[34] Clark's analysis led him to contemplate mainly regulation of business conduct.

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[27] Kidd v. Pearson, 128 U.S. 1 at 20.
[28] 156 U.S. 1 at 17.
[29] E. Dana Durand *The trust problem*. 28 Quarterly Journal of Economics 381 (1914a) at 403.
[30] Civic Federation of Chicago. *Chicago Conference on Trusts* (1900; reprinted 1973).
[31] John I. Yellott, Chicago Conference on Trusts 427 (1900).
[32] William H. Tuttle *The legal status of combinations of labor*. Chicago Conference on Trusts 354 (1900).
[33] U.S. Library of Congress (1907) lists 19 articles on trusts appearing in U.S. periodicals in 1898, 80 in 1899, and 115 in 1900. By contrast, it lists 8, 12, and 17 such articles in 1887, 1888, and 1889, respectively.
[34] John Bates Clark *The theory of economic progress*. 1 Economic Studies 5 (1896); *Trusts and the law*, in *The Question of Trusts: A Symposium*, 265 The Independent 4 March 1897; *The Control of Trusts* (1902).

He emphasized that the speculators involved in the formation of trusts exploited investors as much, if not more, than consumers, and urged publicity as a way of protecting investors:[35, 36]

> The trusts must stand the turning of light upon their internal affairs. The public must know what plants they own, what they gave for them, what they are worth at present, for how much they can be duplicated, what appliances they contain, whether antiquated or modern–in short, what is the substantial basis for the value of the stocks and bonds that are placed on the market.

For Clark, the interest of investors in transparency was consistent with consumers' interest in obtaining good market performance. Transparency, which would inform stockholders of the basis for the value of their investment, would also reveal profit opportunities to potential competitors:[37]

> [T]he degree of publicity which will protect the investor will also afford a certain help in protecting the consumer. Among the things that the public must know is the earning capacity of the plants that the trust owns. If this is large, the inducement for capital to enter the same field is proportionately large.

Clark also pointed to predatory price discrimination as the critical element in a trust's ability to falsify competition:[38]

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[35] John Bates Clark *Trusts*. 15 Political Science Quarterly 181 (1900a), at 185. Publicity for corporate accounts was a favorite approach of writers who wanted to avoid too-direct a government role in managing markets, and as we shall see for some time had a following in several European countries. A quite different tack on publicity was taken by Arthur Jerome Eddy in his influential book *The New Competition* (1913), which would now be described as a blueprint for tacit collusion.

[36] In 1899, Henry O. Havemeyer, President of the American Sugar Refining Company (of U.S. v. E.C. Knight fame), testified as follows before the Congressional Industrial Commission (quoted by J. D. Glover *The Attack on Big Business* (1954) at 357):

> Q. You think, then, that when a corporation is chartered by the State, offers stock to the public, and is one in which the public is interested, that the public has no right to know what its earning power is or to subject them to any inspection whatever, that the people may not buy this stock blindly?
>
> A. Yes; that is my theory. Let the buyer beware; that covers the whole business. You can not wet nurse people from the time they are born until the time they die. They have got to wade in and get stuck, and that is the way men are educated and cultivated.
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> Q. Then, you think that they have a right to charter corporations and allow them to offer stock to the people — to the whole community — and that the community then has no right to a knowledge of what the earning power of that stock is?
>
> A. Precisely.

[37] *Ibid*., p. 187.

[38] John Bates Clark *The modern appeal to legal forces in economic life*. 9 Publications of the American Economic Association 9 (1894), at 26.

> The peculiar power of the trust … consists in this ability to make discriminating prices to its own customers; and this power resides entirely in its own hands. It can sell its products in one place more cheaply than it sells them elsewhere. Where a competitor has secured a local trade, it can ruin him by flooding his market with goods sold below the cost of producing them. … If the low prices had to be universal, the powerful corporation would ruin itself as rapidly as it would its rival.

He proposed to prohibit price discrimination, quality discrimination, and restrictive contracts between trusts and distributors (factors' agreements) because, in modern terms, they were strategic devices that raised the cost of entry. He was not hostile toward trusts as such:[39]

> Make the independent competitor safe and let prices be gauged by the cost of the goods that are made in his well-equipped establishment. Let him make a fair living; and if the trust, by real economy, makes a better living, no one will complain.

In 1911 testimony before the Senate Committee on Interstate Commerce, he referred to a policy of breaking up trusts as "radical action." With apparent reluctance he admitted that dissolution might be necessary in a limited number of cases, but thought this could be avoided if small rivals were able to compete and entry a realistic possibility.[40]

In a two-part article published in 1914, E. Dana Durand distinguished three types of public policy toward business:[41]

> There are at bottom only three possible ways of dealing with trusts and pools. We may seek to prevent them from competing unfairly and to deprive them of special privileges giving an advantage over competitors, but otherwise leave them alone. … Second, we may permit trusts and pools to exist but regulate their prices and profits. Third, we may undertake to destroy them. The broad problem before the American people is the choice among these three policies, – *laissez faire*, regulation, and prohibition.

What Durand meant by *laissez faire* is the approach advocated by John Bates Clark. Durand regarded *laissez faire* as insufficient, regulation as impractical, and opted for the third approach, the destruction of trusts.

Durand also wrote of trusts that[42] "[p]ractically no one … would favor the plan of not even placing restrictions upon their methods of competition or seeking to deprive them of

[39] *Op. cit*., p. 195.
[40] *Statement*, in U.S. Senate Committee on Interstate Commerce, *Control of Corporations, Persons, and Firms Engaged in Interstate Commerce* 971 (1913).
[41] *Op. cit*., p. 383.
[42] *Ibid.*

special privileges." Like clockwork there appeared in the *Quarterly Journal of Economics* an invited article in which Robert Liefmann took exactly such a position:[43]

> But since as a rule, a single seller is the cheapest … competition has the tendency, when pushed to its limit, to destroy itself and to be turned into monopoly. Since the cheapest seller can often lower costs by producing the whole supply, it follows that the maximum satisfaction of wants is obtained when there is only one seller, competition remaining latent in the background, effective only when the seller does not employ the most efficient methods of production, or when as a monopolist he appropriates a profit much above the economic marginal return.

Liefmann believed in the importance of increasing returns to scale. Like Clark, he emphasized the importance of potential competition, and the value of publicity for obtaining good financial market performance.

2.2.2 Enforcement: back on track, but which track?

While public debate about policy toward business went forward, a series of decisions at the close of the nineteenth century and the start of the next lay a path around the 1895 *Sugar Trust* decision.

Some Senate debate had suggested that the Sherman Act would do nothing more or less than codify the common law treatment of contracts in restraint of trade. Ruling in early 1898 on a complaint against colluding pipe manufacturers, Circuit Court Judge William Howard Taft reviewed[44] what the common law had to say on the matter. As read by Taft, the common law would enforce agreements in restraint of trade that were ancillary to lawful contracts, otherwise not.[45] In 1899, Taft's views were endorsed by the Supreme Court, giving rise to the *per se* rule against price-fixing:[46]

> It has been earnestly pressed upon us that the prices at which the cast-iron pipe was sold … were reasonable. … We do not think the issue an

[43] Robert L. Liefmann *Monopoly or competition as the basis of a Government trust policy*. 29 Quarterly Journal of Economics 308 (1915) at 314–315. Liefmann was the author of an extensive body of work that appears mainly in German. See Theodore F. Marburg, *Government and business in Germany: public policy toward cartels* 38 Bus. Hist. Rev. 78 (1964) at 85-86. In English translation, see Robert L. Liefmann, *Cartels, Concerns, and Trusts* (1932), (http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/liefmann/trustscartels.pdf .

[44] Some have implied that reinvented would be a better word. See Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice* (1994), at 53-55.

[45] 85 Fed 271 at 281–283. We return to the common law treatment of restraint of trade in Section 3.1.1. See also, among others, Franklin D. Jones, *Historical development of the law of business competition* 35 Yale Law J. 905 (1926); 36 Yale Law J. 42 (1926); 36 Yale Law J. 207 (1926); 36 Yale Law J. 351 (1927), John C. Peppin, *Price-fixing agreements under the Sherman Anti-Trust Law*, Part I 28 Calif. Law Rev. 297 (1940), Part II 28 Calif. Law Rev. 667 (1940), Hans B. Thorelli, *The Federal Antitrust Policy* (1955), Chapter 1, William L. Letwin *Law and Economic Policy in America* (1965), Chapter 2, and Michael J. Trebilcock, *The Common Law of Restraint of Trade* (1986).

[46] Addyston Pipe and Steel Company *v.* U.S. 175 U.S. 211 (1899) at 237–238.

> important one, because … we do not think that at common law there is any question of reasonableness open to the courts with reference to such a contract.

The principle of competition. In the 1904 *Northern Securities* decision,[47] the Supreme Court found a violation of the Sherman Act in the formation of a New Jersey holding company to create common control over two hitherto independent railroads. A narrow majority of the Supreme Court reviewed read into the Sherman Act reliance on competition as a resource allocation mechanism:[48]

> Whether the free operation of the normal laws of competition is a wise and wholesome rule for trade and commerce is an economic question which this court need not consider or determine. Undoubtedly, there are those who think that the general business interests and prosperity of the country will be best promoted if the rule of competition is not applied. But there are others who believe that such a rule is more necessary in these days of enormous wealth than it ever was in any former period in our history. Be all this as it may, *Congress has*, in effect, *recognized the rule of free competition* by declaring illegal every combination or conspiracy in restraint of interstate and international commerce.

This *principle of competition* became central to U.S. antitrust, which on this interpretation relied on actual and potential competition to obtain good market performance.[49] It was reaffirmed as late as 1958 in *Northern Pacific Railway*:[50]

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But

[47] Northern Securities Co. *v*. U.S. 193 U.S. 197. For discussions, see among others James Wilford Garner, *The Northern Securities case*, 24 Ann. Amer. Acad. Polit. Soc. Sci. 125 (1904), Frederick Pollock, *The merger case and restraint of trade* 17 Harvard Law Rev. 151 (1904), J. C. Gray, *The merger case*, 17 Harvard Law Rev. 474 (1904), Victor Morawetz, *The anti-trust act and the merger case*, 17 Harvard Law Rev. 533 (1904), Balthasar Henry Meyer, *A history of the Northern Securities case*, 1 Bull. Univ. Wisc. Econ. Polit. Sci. Ser. 215 (1906), Herbert Pope, *The legal aspect of monopoly*, 20 Harvard Law Rev. 167 (1907), Mark Sullivan, *Our Times Volume II: America Finding Herself* (1940), at 360-370, Thorelli, *Federal Antitrust Policy*, 421-425, 470-475, 560-563, Donald Dewey *Monopoly in Economics and Law*. (1959) at 214-215, Letwin, *Law and Economic Policy in America*, Chapter 6, and Robin A. Prager, *The effects of horizontal mergers on competition: the case of the Northern Securities Company*, 23 RAND J. Econ. 123 (1992).

[48] 193 U.S. 197 at 337; emphasis added.

[49] See Letwin, *Law and Economic Policy in America*, p. 227: "Harlan's opinion served for years as the great synthesis of all previous interpretations of the statute. The rule, as it now stood, was that 'restraint of trade' meant any *direct* interference with *competition*."

[50] 356 U.S. 1 (1958) at 4.

> even were that premise open to question, the policy unequivocally laid down by the Act is competition.

Holmes' dissent. The majority opinion in *Northern Securities* laid down the principle of competition. In its own way, the dissenting opinion of Oliver Wendell Holmes in the same case is as noteworthy. Holmes argued that the common law made a distinction between contracts in restraint of trade and combinations and conspiracies in restraint of trade. A contract in restraint of trade limited the range of action of a party to the contract, but such contracts were not condemned at common law so long as the result fell short of monopoly.[51]

Conspiracies in restraint of trade, joint actions to prevent competition from those outside the agreement, were another matter:[52]

> [T]hey were regarded as contrary to public policy because they monopolized or attempted to monopolize some portion of the trade of commerce or the realm.

The common law as read by Holmes did not object to combinations that did not interfere with the ability of those outside the combination to compete. The implied policy – allow firms to merge, forbid them to interfere with the ability of others to compete on the merits, and let market processes determine which firms prosper and which firms do not – is essentially that advocated by John Bates Clark, and subsequently embodied in the 1914 Clayton Act.

The rule of reason. The rise of the Standard Oil Company was widely believed to typify the kind of conduct at which the Sherman Act was aimed.[53] The government's Sherman Act Section 2 challenge to Standard Oil gave the Supreme Court the opportunity to comment on why the Sherman Act had been passed, and when it did so it pointed to concerns that included income transfers from consumers to producers ("the vast accumulation of wealth in the hands of corporations and individuals"), objections to size for its own sake ("the facility for combination which [corporations] afforded"), and reductions in the welfare of consumers ("the widespread impression that [the trusts'] power had been and would be exerted to oppress individuals and injure the public generally.").[54] The Court reaffirmed the principle of competition, specifically mentioning price increases as motivation for the antitrust law:[55]

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[51] 193 U.S. 197 at 404. Letwin, *Law and Economic Policy in America*, p. 233 states flatly that Holmes' reading of the common law is "an error." But Letwin then discusses common law findings referring to what we would now call cartels. Holmes' references to "partnerships" and "the firm" makes clear that his comments included the common law treatment of what we would now call merger.

[52] 193 U.S. 197 at 404.

[53] It is now known that the Standard Oil Company owed its dominant market position to the fact that it benefited from discriminatorily low railroad rates. See Elizabeth Granitz & Benjamin Klein, *Monopolization by 'raising rivals' costs': The Standard Oil case*, 39 J. Law Econ. 1 (1996). This was precisely the kind of strategic effect that John Bates Clark thought price discrimination could have.

[54] 221 US 1 at 50.

[55] 221 US 1 at 58.

> [T]he dread of enhancement of prices and of other wrongs which it was thought would flow from the undue limitation on competitive conditions caused by contracts or other acts of individuals or corporations, led, as a matter of public policy, to the prohibition or treating as illegal all contracts or acts which were unreasonably restrictive of competitive conditions…

Thus was born the rule of reason, which became the fundamental (if amorphous) standard for application of the Sherman Act:[56]

> The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed … to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.

A widespread reaction was that the rule of reason was quite unreasonable. It was said that it would leave antitrust rules subject to interpretations that would vary with the membership of the Supreme Court. A 1913 Senate Committee report stated:[57]

> The committee has full confidence in the integrity, intelligence, and patriotism of the Supreme Court of the United States, but it is unwilling to repose in that court, or any other court, the vast and undefined power which it must exercise in the administration of the statue under the rule which it has promulgated. It substitutes the court in the place of Congress, for whenever the rule is invoked the court does not administer the law, but makes the law.

2.2.3 Backlash

1912. Antitrust policy and the rule of reason were major themes of the Progressive movement and the 1912 presidential election. Leaving the bluster of campaign speeches aside, the positions of the three major candidates differed more in detail than in nature. Ex-President Theodore Roosevelt, running as the candidate of the Bull Moose party, wished to distinguish between good trusts and bad, and would have limited government action to bad trusts. Democratic Party nominee Woodrow Wilson, similarly, wrote[58] "I am for big business, and I am against the trusts." The incumbent, Republican William

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[56] 221 US 1 at 63-64. See Alexander M. Bickel, *The judiciary and responsible government 1910—21*, Part One, Volume IX, Oliver Wendell Holmes Devise History of the Supreme Court of the United States (1984), Chapter 3.
[57] Senate Committee on Interstate Commerce, *op. cit*., at 10-11.
[58] Woodrow Wilson *The New Freedom* (1913) at 180.

Howard Taft, would have required "something more" than size before finding a violation of the Sherman Act:[59]

> There must, in other words, be an element of duress in the conduct of its business toward the customers in the trade and its competitors before a mere aggregation of plants becomes an unlawful monopoly.

Beneath these surface similarities lay one of the enduring fault lines of antitrust policy. Roosevelt and Taft accepted the technological basis of big business in many industries.[60] Wilson, under the influence of Louis Brandeis, did not.[61]

New legislation. Economists were directly involved in designing the Clayton Act. In 1911, John Bates Clark and Jeremiah Jenks were members of a four-person committee that drafted a preliminary version of what became the Clayton Act.[62] The provisions of the Clayton Act closely followed Clark's views: regulate strategic practices that would interfere with competition on the merits, after which, accept the outcome of market processes.[63, 64] Section 2 of the Clayton Act prohibited price discrimination "where the effect … may be to substantially lessen competition or tend to create a monopoly in any line of commerce," allowing however for price differences based on differences in grade, quality, or quantity, and also allowing good-faith price discrimination to meet competition. Section 3[65] prohibited tying, exclusive dealing, and requirements contracts,

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[59] William Howard Taft, speech of 19 August 1907, from David H. Burton and A. E. Campbell *The Collected Works of William Howard Taft*, Volume I (2001). A letter of Taft to Victor Morawetz, 11 October 1910, however, suggests a willingness to base Sherman Act decisions on structural considerations alone (Alexander M. Bickel, *The judiciary and responsible government 1910—21, Part One*, Volume IX, Oliver Wendell Holmes Devise History of the Supreme Court of the United States 95-96 (1984):

> The prohibition against monopolizing trade or commerce is not applied to a simple lessening of competition leaving in existence reasonably competitive conditions; but it does apply to a concentration of control of the preponderating part of the commerce in any article, though competition be not wholly destroyed.

[60] As, in varying degrees, did Henry Adams, John Bates Clark, George Gunton, and Robert Liefmann. Alfred Marshall *Industry & Trade* 4th ed. (1923) at 515 thought that trusts generally owed their positions to economies of scale in marketing, not production.

[61] Ellis W. Hawley *The New Deal and the Problem of Monopoly* (1966) at 49.

[62] Gabriel Kolko, *The Triumph of Conservatism: A Reinterpretation of American History, 1900-1916* (1963) at 258-259, James Weinstein, *The Corporate Ideal in the Liberal State: 1900-1918* (1968) at 88, Martin J. Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916* (1988) at 288-290. The committee was set up by Chicago National Civic Federation. On the legislative process leading up to the Clayton Act, see Earl W. Kintner, *The Legislative History of the Federal Antitrust Laws and Related Statutes* Volume 2 (1978) at 989-1023.

[63] Section 4 of the Clayton Act reaffirmed the treble-damages principle for private antitrust suits; Section 5 establishes that the result of a public antitrust suit may be used as evidence in a private antitrust suit; Section 6 provided that the antitrust laws did not apply to organized labor.

[64] The policy was also very much in line with the common law approach to conspiracies in restraint of trade laid out in Holmes' *Northern Securities* dissent: allow firms to merge, do not allow them to interfere with the actual or potential rivals.

[65] Inspired among other sources by commercial practices of the United Shoe Machinery Corporation.

once again “where the effect … may be to substantially lessen competition or tend to create a monopoly in any line of commerce.”

Section 7, which was described in congressional debate as a “holding company” provision, made mergers carried out by manipulations of financial shares illegal “where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” Frequent subsequent statements notwithstanding, Section 7 was not intended as a general merger control provision: its purpose was to block covert acquisitions of control, to avoid situations in which firms that appeared to be independent in fact served a common master.[66] In other words, it embodied a publicity approach to business regulation.

The Federal Trade Commission, created by the Federal Trade Commission Act (with its prohibition of unfair methods of competition) as successor to the Bureau of Corporations, inherited among its other responsibilities the Bureau’s publicity-promoting duties.[67]

2.3 Between the Wars

If the period up to passage of the Clayton and FTC Acts is thought of as the childhood of U.S. antitrust, the following is not too much of a caricature of the kind of description of antitrust’s extended adolescence that can be found in the literature:

> Before Clayton Act enforcement and the FTC could really take off, antitrust was set aside for the duration of World War I. It is true that Brandeis clarified the rule of reason in *Chicago Board of Trade*[68] and that the *per se* rule was reaffirmed in *Trenton Potteries*.[69] The kinds of information-gathering and -disseminating activities that trade associations could and could not engage in were sorted out, and this was a substantive contribution.[70] But the *U.S. Steel* decision[71] called a halt to Section 2 developments for a generation. Economists, who had been lukewarm about the Sherman Act, came to love the antitrust laws;[72] just why is a puzzle.[73] Antitrust was set aside under the National Recovery

[66] See Brown Shoe Co., Inc. *v.* U.S. 370 U.S. 294 at 313–314.

[67] See Gerard C. Henderson, *The Federal Trade Commission* (1968), F. M. Scherer, *Sunlight and sunset at the Federal Trade Commission*, Admin. Law Rev. Volume 42 (1990), reprinted in F. M. Scherer (ed.), *Monopoly and Competition Policy* (1993).

[68] Board of Trade of the City of Chicago *v.* US 246 U.S. 231 (1918).

[69] U.S. *v.* Trenton Potteries 273 U.S. 392 (1927).

[70] American Column & Lumber Company *et al. v.* United States 257 U.S. 377 (1921); U.S. *v.* American Linseed Oil Company *et al.* 262 U.S. 371 (1923); Maple Flooring Manufacturers Assn. *et al. v.* US 268 U.S. 563 (1925).

[71] U.S. *v.* United States Steel 251 U.S. 417 (1920).

[72] Frank A. Fetter, *Economists' Committee on Anti-Trust Law Policy* 22 American Economic Review 465 (1932b).

[73] George J. Stigler *The economists and the problem of monopoly*. 72 American Economic Review 1 (1982).

> Administration in the depths of the Great Depression, and once again for the duration of World War II. From the immediate postwar period through the mid-1960s, antitrust came to be dominated by fools and knaves,[74] from whom it was rescued by economists and lawyers trained at the University of Chicago.

There is, however, considerably more coherence to the ebbs and flows of antitrust in this sixty-year period than is usually recognized. The depression-era National Recovery Administration Act, the United States' only flirtation to date with corporatism, was not the aberration it is usually made out to be. It was the high-water mark of sustained efforts by substantial parts of the U.S. business community to replace U.S. antitrust's prohibition of collusion with the cartel control approach common in other industrialized countries. The opposition of U.S. economists to those efforts cemented their support for the antitrust laws. As the campaign to relax the antitrust prohibition of collusion continued through the 1930s, economists' support for structural antitrust (the approach that the Clayton Act eschewed) grew.

The efforts to relax the antitrust prohibition against collusion resumed after World War II, much as they had a generation before. Mainstream economists sought an antitrust policy that would support workable competition. The Celler-Kefauver amendment to Section 7 of the Clayton Act was in part a political reaction against the perceived role of cartels in Germany and Japan in the run-up to World War II and in part a political reaction to the little-man-who-wasn't-there concentration movement described by the Federal Trade Commission in the late 1940s. But it also reflected mainstream economists' increased tendency to conceive of competition in terms of structure rather than conduct. Like the Robinson-Patman Act of 1936, the amended Section 7 opted for the specific approach of the original Clayton Act rather than the general approach of the Sherman Act and the FTC Act. The key antitrust decisions of the Warren Court, much-maligned as they have been, were generally faithful to the legislation upon which they were based. The work of academic commentators, mainstream as well as those subscribing to the tenets of the Chicago School, was the essential background to later decisions that reconciled those highly specific elements of antitrust law with the general principles embodied in the "charter of freedom" made up by the body of antitrust.

2.3.1 Post-World War I

The American business community emerged from World War I with the benefits of cooperation immediately behind it and fear that postwar deflation was immediately in

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[74] Robert H. Bork, *The Antitrust Paradox: A Policy at War With Itself* (1978)); see also the remarks of Stephen G. Breyer (Robert B. Shapiro, Robert H. Bork and Stephen G. Breyer *Judicial precedent and the new economics*, pp. 5–21 in Eleanor M. Fox and James T. Halverson, editors *Antitrust Policy in Transition: the Convergence of Law and Economics*. (1984), at 19-20):

> Over a broad range of policy choices, economics and economists seem to disagree. Thus, I do not agree with [Judge Bork's] basic characterization of the problem we are discussing–as if on one side there were truth, light and intellectual economists, while on the other side there were the judges, lawyers and a few Luddite anti-intellectual Harvard professors.

front of it.[75] The result was a business campaign that sought to roll back the antitrust prohibition of overt collusion.[76]

One theme sounded by advocates of antitrust reform was that antitrust was outmoded and would handicap the United States on world markets. For example, Francis Sisson wrote in 1919:[77]

> [W]e cannot adequately coöperate outside of the United States if we are compelled to indulge in costly and wasteful competition within our own borders. Our existing anti-combination legislation, in fact, is not only out-of-date but is a positive menace to our industrial and commercial future. We shall deny ourselves the full advantages of the Webb Law unless we repeal the Sherman Anti-Trust Law.

The "Webb Law" is the 1918 Webb-Pomerene Act, which gives antitrust immunity to U.S. firms that collude for sales on export markets, provided there are no anticompetitive repercussions on the U.S. domestic market.

Another theme was to contrast the U.S. principle of competition with the abuse control policy followed particularly in Germany, but also England, Canada, Australia, and elsewhere.[78] The abuse control approach, to which we return in Section 3.1.4, took the view that cartels were a normal part of the industrial landscape. Rather than being prohibited, which in any case would not be successful, they should be permitted but monitored to ensure acceptable conduct. In the fullness of time, it became clear that the record of cartel control was not as positive as it was portrayed in the 1920s and 1930s.[79]

Yet another complaint was that the antitrust laws were so vague and ambiguous that businessmen could not know what would violate the law and what would not.[80]

One commonly suggested change was to give a federal agency (the FTC was often mentioned) the authority to vet business arrangements in advance. "Pre-approved"

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[75] Sumner H. Slichter *The period 1919–1936 in the United States: its significance for business-cycle theory.* 19 Review of Economics and Statistics 1 (1937).
[76] Robert F. Himmelberg *Business, antitrust policy, and the Industrial Board of the Department of Commerce, 1919* 42 Business History Review 1 (1968), at 3.
[77] Francis H. Sisson *The world-wide trend toward cooperation*. 82 Annals of the American Academy of Political and Social Science 143 (1919), at 146.
[78] Sisson, *Ibid*., Felix H. Levy, *The Sherman Act is outworn, it should be amended*, 13 Virginia Law Rev. 597 (1927), James Harvey Williams, *The Sherman Act to-morrow*, 116 Atlantic Monthly 412 (1928b), National Industrial Conference Board *Rationalization of German Industry* (1931), and John Wolff *Business monopolies: Three European systems in their bearing on American law*, 9 Tulane Law Rev. 325 (1935), as well as Section 3.1.
[79] Heinrich Kronstein & Gertrude Leighton, *Cartel control: A record of failure*, 55(2) Yale Law J. (1946).
[80] The complaint may simply have been a smokescreen. Levy, *op. cit*., p. 600, writes that "The real trouble is that our Anti-Trust laws are clear enough, but that they … have been extended into the domain of private business so as to prevent any and every form of co-operation among merchants."

arrangements would receive partial or complete immunity from prosecution under the antitrust laws.[81]

Another suggestion was that there should be a change in the objective of antitrust policy. Felix Levy contrasted the principle of competition unfavorably with the approaches of other nations:[82]

> In this country, the principle of competition has been emphasized and enforced solely from the mistaken standpoint that the interests of *consumers* are alone to be considered, and that consequently all co-operative agreements affecting the important elements of prices and production are regarded as calculated to increase prices to consumers and therefore unlawful. In Great Britain, Australia and Canada a different principle prevails. In those countries the interests of the *public as a whole* constitute the standard by which the subject is governed.

2.3.2 Depression and NIRA

The prospect of post-World War I deflation had moved business circles to seek relaxation of the principle of competition. The reality of depression was an even stronger incentive, and the campaign to change the antitrust laws went forward with renewed vigor.[83] Cartelization was now presented as a remedy for economic crisis, with the U.S. approach once again contrasted with the ``advanced'' abuse control approach:[84]

> Now a price decline naturally suggests the remedy of price-fixing or production restriction by agreement, which are the essential features of the cartel, but to the American producer this in turn suggests unwelcome attention from the Department of Justice and the alleged harshness of our government policy as compared with the more liberal, not to say friendly, attitude of some of the more advanced European countries.

For economists, this kind of argument confused cause and cure. In a statement published in the *American Economic Review* , 127 economists pointed to "the greatly increased extent of monopolistic control of commodity prices" as a major cause of the depression. They opposed modification of the Sherman Act.[85]

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[81] B. M. Anderson, Jr. *Competition and combination*. 82 Annals of the American Academy of Political and Social Science 201 (1919); Rush C. Butler The Sherman anti-trust law and readjustment 82 Annals of the American Academy of Political and Social Science 215 (1919); William G. Shepherd *Today's trust buster*. 8 Collier's (23 February 1929).

[82] Levy, *op. cit*., p. 601; see similarly Williams, *op. cit*., p. 418.

[83] See the *Annals of the American Academy of Political and Social Science* 147, January 1930 (The Anti-Trust Laws of the United States), Handler (1932), Harriman (1932), Fields (1933), and Himmelberg (1976).

[84] Louis Domeratzky *Cartels and the business crisis*. 10 Foreign Affairs 34 (1931) at 35.

[85] Fetter, *Economists' Committee*, p. 467. See also Frank A. Fetter *The Masquerade of Monopoly* (1931, Chapter 27); *Remarks*," in Milton Handler, *The Federal Anti-Trust Laws* (1932a, pp. 14–19); The truth about competition. 165Annals of the American Academy of Political and Social Science 93 (1933).

Nonetheless, a relaxation of the Sherman Act was embodied in the National Industrial Recovery Act, which was signed into law on June 16, 1933.[86] The theory behind the NIRA was to take the country out of depression by raising wages faster than prices, permitting aggregate demand to increase, which in turn would stimulate investment. To persuade business to go along, the NIRA authorized trade associations to formulate codes of fair competition. The codes were subject to Presidential approval, which carried with it immunity from the antitrust laws. Code violations were declared to be an unfair method of competition under Section 5 of the Federal Trade Commission Act; code violations could thus be prosecuted by the FTC.

Business interests dominated the codes, which became a cover for price-fixing.[87]

This experiment did not last long: the Supreme Court declared the NIRA to be unconstitutional in May, 1935.[88] But it had enduring consequences. The NIRA, and the business campaign that preceded it, shifted economists' views on antitrust policy, away from the conduct-oriented approach to antitrust policy of John Bates Clark and the 1914 Clayton Act and toward support for the maintenance of a competitive market structure.[89]

Henry Simons of the University of Chicago would have allowed the Federal Trade Commission to regulate business size:[90]

> Operating companies must be limited in size, under special limitations prescribed for particular industries by the Federal Trade Commission, in accordance with the policy of preserving real competition.

Simons' goals were as much, if not more, political than economic: he thought that a failure to maintain competitive market structures would lead to a descent into authoritarian government.[91] He was willing to sacrifice productive efficiency, if need be, to maintain competitive market structures:[92]

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[86] See Hawley, *New Deal and the Problem of Monopoly*, Part I.
[87] Arthur M. Schlesinger, Jr. *The Coming of the New Deal* 125 (1959). On the influence of business circles at the FTC during this period, see Davis, G. Cullom *The transformation of the Federal Trade Commission, 1914–1929*. 49 Mississippi Valley Historical Review 437 (1962).
[88] Schechter Poultry Corp. v. United States, 295 US 495 (1935).
[89] George J. Stigler (in *Roundtable on cost functions and their relation to imperfect competition* 30 American Economic Review 400 (1940) at 402) criticized the theoretical rationale for a conduct-oriented antitrust policy: "…I question the general importance of potential competition as a limitation on monopoly prices. I would argue that (1) low prices per se will not discourage potential rivals, who may expect a quota, and (2) if such a quota is refused, and the existing firms will not tolerate new rivals, there are cheaper methods of communicating this intention to potential rivals than by setting low prices."
[90] Henry C. Simons *The requisites of free competition*. 26 American Economic Review 68 (1936), at 71. See also Henry C. Simons *A Positive Program for Laissez Faire* (1934), reprinted in Henry C. Simons *Economic Policy for a Free Society* (1948; page references are to reprint). On Simons' contributions, see J. Bradford de Long *In defense of Henry Simons' standing as a classical liberal* 9 Cato Journal 601 (1990).
[91] *Ibid.*, p. 68.
[92] *Ibid.*, p. 71.

> If there are cases where real production economies require units too large for effective competition among them, some sacrifices ought to be made in both directions; indeed, one finds here a reason for proposing the generally objectionable expedient of an administrative authority with some discretionary power.

This view, like one theme in Senate debates and parts of the Standard Oil decision, takes it for granted that the appropriate role for antitrust is not confined to some definition of efficiency in a strictly economic sense.

Simons held, however, no illusion about the efficacy of government as an activist regulator of economic activity. He thought there was no viable alternative to government ownership of railroads, but that extensive public involvement in private sector activity would lead to what we would now call a rent-seeking society:[93]

> every venture in regulation creates the necessity of more regulation; and every interference by government on behalf of one group necessitates, in the orderly routine of democratic corruption, additional interference on behalf of others. The outcome along these lines is: an accumulation of governmental regulation which yields, in many industries, all the afflictions of socialization and none of its possible benefits; an enterprise economy paralyzed by political control; the moral disintegration of representative government in the endless contest of innumerable pressure groups for special political favors; and dictatorship.

2.3.3 Robinson-Patman

Section 2(a) of the Clayton Act banned price discrimination. It was intended to ban practices such as the discriminatorily low railroad rates received by the Standard Oil Company on its way to domination of the U.S. oil industry. It thus sought to stop the strategic exclusion of firms that would have been cost-efficient except for price discrimination in favor of a rival. The intent to protect the ability of equally-efficient firms to compete on the merits was confirmed by a qualifying condition that allowed price differences "on account of differences in the grade, quality, or quantity of the commodity sold."

The Robinson-Patman Act of 1936 amended Section 2(a). The first draft of the Robinson-Patman Act was written a lawyer for the United States Wholesale Grocers' Association.[94] It was frankly protectionist of small merchants whose market positions were eroding under the competitive pressure of low prices offered by large distributors and chain stores.[95]

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[93] *Ibid*., p. 75.
[94] Earl W. Kintner *The Legislative History of the Federal Antitrust Laws and Related Statutes*, Volume 4 (1978) at 2895.
[95] Frederick M. Rowe *Price Discrimination Under the Robinson-Patman Act* (1962) at 3.

The amended Section 2(a) of the Clayton Act limited the scope of the quantity-discount justification for price differences. It now provides that[96]

> the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits … where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce.

Purchases above the quantity limits established by the FTC cannot be used as justification for price differences.

By providing protection for firms that are not able to compete on the merits, the amended Section 2(a) of the Clayton Act does not seek to promote good market performance. In its origins, therefore, it is at odds with the main orientations U.S. antitrust policy.[97]

2.4 Post-World War II through Celler-Kefauver

The post-World War II debate about antitrust was in many ways a rerun of that which had taken place after World War I. On one side, there were calls for a relaxation of antitrust and a switch to a cartel control policy.[98] Once again, a recurring theme was the prevalence of cartels outside the United States and the disadvantages foreseen if American business could not adopt similar tactics. The antitrust laws were once again decried as being out of date:[99]

> the basic governmental business policies and the everyday enforcement of the antitrust laws are still based largely upon prejudice created by abuses long since corrected, upon an antiquarian's portrait of another America, not the America of the midtwentieth century…

The main factor making the antitrust laws obsolete was technical progress:[100]

> The New Competition can be traced to a number of factors, but the central one is the amazing technical advance in American industry due to scientific research and engineering development. The last decade's achievements of the chemical industry and in electronics are perhaps the most spectacular illustrations of how science and technology have

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[96] 15 U.S.C. § 13.

[97] Judicial interpretation has narrowed the distance between the amended Section 2(a) and the rest of antitrust; see, for example, *Brooke Group* 509 U.S. 209 (1993) at 221 and Volvo *v.* Reeder-Simco 546 U.S. ___ (2006), 126 S. Ct. 860 (2006).

[98] Frederick Haussmann and Daniel J. Ahern *The international control of cartels–past and future* 20 Thought 85 (March 1945); George P. Comer *The outlook for effective competition*. 36 American Economic Review 154 (1946).

[99] David E. Lilienthal *Big Business: A New Era* (1952) at 5.

[100] *Ibid*., p. 68.

> intensified competition, and thereby increased the range of free choice that men now have, as contrasted with thirty to fifty years ago. The same thing applies, however, to many other industries.

The goals of economic policy, it was argued, should be changed. There should be:[101]

> a broad declaration of public policy that the prime concern of Congress is not with competition, per se, nor with competitors, but with productivity and the promotion of an ethical and economic distribution of this productivity.

Opposition to these arguments for retreat from the principle of competition came from those who supported adoption of a structural orientation for antitrust policy. Just before United States' entry into World War II, the Temporary National Economic Committee recommended amending Section 7 of the Clayton Act to cover asset acquisitions.[102] Mainstream lawyers and economists supported structural remedies. Writing in the University of Chicago law Review, Edward Levi suggested that courts might turn to the Federal Trade Commission to fashion effective structural remedies in monopolization cases.[103] George Stigler suggested rules that would permit mergers leading to market shares of 5 to 10 per cent, prohibit mergers leading to market shares of 20 per cent or more, and leave mergers between these levels to the attention of enforcement agencies.[104] The TNEC recommendation was reinforced by a Federal Trade Commission analysis depicting a merger movement and massive increase in industrial concentration in the late 1940s:[105]

> No great stretch of the imagination is required to foresee that if nothing is done to check the growth in concentration, either the giant corporations will ultimately take over the country, or the government will be impelled to step in and impose some form of direct regulation.

It is now generally accepted that there was no such general increase in concentration.[106] But Congressional debate over the 1950 Celler-Kefauver Act, amending Section 7 of the Clayton Act along the lines recommended by the Temporary National Economic Committee, indicated a clear concern for the political implications of concentration of economic power. In Senator Kefauver's often-quoted words:[107]

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[101] *Ibid*., p. 185.
[102] Temporary National Economic Committee (TNEC) *Final Report and Recommendations*. (1941), at 38.
[103] Edward H. Levy *The antitrust laws and monopoly*. 14 University of Chicago Law Review (1947) 153 at 182–183.
[104] George J. Stigler *Mergers and preventive antitrust policy*. 104 University of Pennsylvania Law Review 176 (1955), at 182.
[105] Federal Trade Commission *The Merger Movement: A Summary Report* (1948) at 68.
[106] John Lintner and J. Keith Butters *The effect of mergers on industrial concentration, 1940–1947* 32 Review of Economics and Statistics 30 (1950).
[107] Senator Kefauver, 96 Congressional Record 16452, 1950. On the legislative history, see David Dale Martin *Mergers and the Clayton Act*. (1959), Chapter 7..

> The control of American business is steadily being transferred … from local communities to a few large cities in which central managers decide the policies and the fate of the far-flung enterprises they control. … Through monopolistic mergers the people are losing power to direct their own economic welfare. When they lose the power to direct their economic welfare they also lose the means to direct their political future.

For Senator Kefauver, a loss of public faith in the legitimacy of the market system would lead, in one way or another, to collapse of democratic government:[108]

> … the history of what has taken place in other nations where mergers and concentrations have placed economic control in the hands of a very few people is too clear to pass over easily. A point is eventually reached, and we are rapidly reaching that point in this country, where the public steps in to take over when concentration and monopoly gain too much power. The taking over by the public always follows one or two methods and has one or two political results. It either results in a Fascist state or the nationalization of industries and thereafter a Socialist or Communist state.

This view, like that of Henry Simons, sees a role for antitrust that goes beyond market performance in an economic sense.

The Celler-Kefauver Act extended Section 7 to cover asset acquisitions. It made the test of legality the likely impact of a merger on competition "in any line of commerce in any section of the country," not the likely impact of the merger on competition between the parties to the merger. Further, Congressional debate made clear that Congress adopted an incipiency approach, intending a tougher approach to mergers than that of the Sherman Act.[109]

As noted above, discussions of the Celler-Kefauver Act often portray the original Section 7 of the Clayton Act as an antimerger provision that went astray because Congress inexplicably settled on wording that covered acquisitions of control by purchase of shares of stock but not by purchase of assets. In fact, the original Section 7 was what it was intended to be: a holding company provision. The change effected by the Celler-Kefauver amendment was much more fundamental than simply "plugging a loophole." It ratified a shift in the basic philosophy of the antitrust laws, from setting rules for conduct and relying on market forces as long as those rules were obeyed, to proactive control of changes in market structure.[110]

2.5 Warren Court Antitrust, Structuralism, and the Chicago Backlash

It fell to the Supreme Court, in a series of decisions starting in 1962, to apply the amended Section 7 of the Clayton Act. While it did so, advocates of a structurally-

[108] *Ibid*.
[109] See Brown Shoe Co., Inc. v. U.S. 370 U.S. 294 (1962) at 318, footnote 33.
[110] Alfred R. Oxenfeldt *Industrial Pricing and Market Practices* (1951), at 406–407.

oriented antitrust policy put forward a series of deconcentration proposals to go beyond merger control and permit government control of market structure, however arrived at. The equal and opposite reaction to the rise of structural antitrust was a campaign by a new generation of scholars associated with the University of Chicago to narrow the scope of antitrust.

2.5.1 The Warren Court

The Supreme Court's first interpretation of the amended Section 7 of the Clayton Act came in the 1962 *Brown Shoe* decision.[111] Here, to begin with, the Court recognized the noneconomic goals that motivated the law controlling changes in market structure:[112]

> Other considerations cited in support of the bill were the desirability of retaining "local control" over industry and the protection of small businesses. Throughout the recorded discussion may be found examples of Congress' fear not only of accelerated concentration of economic power on economic grounds, but also of the threat to other values a trend toward concentration was thought to pose.

At the same time, however, the Court's reading of the requirements of the amended Section 7 was one of the main routes by which economic analysis moved to center stage in antitrust policy. In close succession, the Court wrote that

(a) Congress intended mergers to be viewed in the context of the industries involved;[113]
(b) An evaluation of effect of a merger on competition had to take into account not only market share but also the "structure, history, and probable future" of the market involved;[114]
(c) Congress intended a merger control policy that would protect competition, not competitors.[115]

An evaluation of the effects to be expected from a merger on these terms can only be made using economic analysis. The Court viewed itself as relying on economic analysis in reaching its opinion.[116]

Not quite a year later, the Court retreated from an insistence on detailed market analysis and gave priority to market structure as main factor to be taken into account in evaluating the effect of a merger:[117]

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[111] Brown Shoe Co. *v*. U.S. 370 U.S. 294 (1962).
[112] 370 U.S. 294 at 315, footnote omitted.
[113] 370 U.S. 294 at 321–322.
[114] 370 U.S. 294 at 322.
[115] 370 U.S. 294 at 322.
[116] Thus Stigler, *Mergers and preventive antitrust policy* (1955), is cited in footnotes 56 and 61 in support of taking a trend toward concentration into account in evaluating the probably effect of a merger.
[117]U.S. *v*. Philadelphia National Bank & Trust 374 U.S. 321 at 362–363; footnotes omitted, emphasis added.

> We noted in Brown Shoe Co. … that "the dominant theme pervading congressional consideration of the 1950 amendments [to § 7] was a fear of what was considered to be a rising tide of economic concentration in the American economy." *This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects.*

The italicized sentence is a change from *Brown Shoe's* indication that market share statistics are but one factor to be considered in evaluating the probable effect of a merger.

To bolster its view that a focus on market shares was consistent with economic theory, the Court cited (in footnote 38) Stigler,[118] Markham,[119] Kaysen and Turner,[120] and Bok.[121] It also wrote of competition in a structural sense (footnote omitted):[122]

> That "competition is likely to be greatest when there are many sellers, none of which has any significant market share," is common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute.

With *Von's Grocery*, the shift to antitrust pursuit of competition in a structural sense seemed complete:[123, 124]

> Congress sought to preserve competition among many small businesses by arresting a trend toward concentration in its incipiency before that trend developed to the point that a market was left in the grip of a few big companies. *Thus, where concentration is gaining momentum in a market, we must be alert to carry out Congress' intent to protect competition against ever-increasing concentration through mergers.*

2.5.2 Dissolution proposals

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[118] *Mergers and preventive antitrust policy* (1955).

[119] Jesse W. Markham *Merger policy under the new Section 7: a six-year appraisal* 43 Virginia Law Review 489 (1957).

[120] Carl Kaysen and Donald F. Turner *Antitrust Policy: An Economic and Legal Analysis* (1959).

[121] Derek C. Bok *Section 7 of the Clayton Act and the merging of law and economics*. 74 Harvard Law Review 226 (1960).

[122] 374 U.S. 321 at 363.

[123] 383 U.S. 270 at 277, emphasis added.

[124] Robert H. Bork (*The Antitrust Paradox: A Policy at War With Itself*. (1978) at 7) writes that "the Supreme Court has introduced conflicting goals" into antitrust "the primary one being the survival or comfort of small business." Yet he later (*Ibid*., p. 17) acknowledges that it was Congress that introduced the idea of "*incipiency* – the idea that courts could identify and catch anticompetitive activity in its very early stages, before its effects had become serious."

Mainstream economists continued to urge a structural orientation for antitrust.[125] George Stigler presented arguments that were consistent with those of Henry Simons in 1934, when he wrote that few disinterested persons would deny the facts that:[126]

1. Big businesses often possess and use monopoly power.
2. Big businesses weaken the political support for a private-enterprise system.
3. Big businesses are not appreciably more efficient or enterprising than medium-size businesses.

Stigler described dissolution of large companies as the obvious, minimum, and conservative solution to the problems raised by big business.[127]

Kaysen and Turner advanced a similar proposal:[128]

> The logic of our policy goal … calls for a widespread application of dissolution remedies, on the ground that an increase in numbers and reduction of concentration is the surest and most durable way of reducing market power.

The White House Task Force on Antitrust Policy advocated adopting such legislation,[129] and Senator Philip Hart introduced such a bill (Senate Bill 1167) in 1967.[130]

2.5.3 The Chicago School of Antitrust Analysis

Students of what Posner described as the "Chicago School of antitrust analysis" severely criticized structural antitrust policy.[131] This criticism included the advancement

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[125] A notable exception is Joel B. Dirlam and Alfred E. Kahn, who reject the idea of an antitrust policy based on structure alone. Their position (*Fair Competition*. (1954), p. 39), "The essential task of public policy in a free enterprise system is to preserve the framework of a fair field and no favors, letting the results take care of themselves," is consistent with that of John Bates Clark.

[126] George J. Stigler *The case against big business* Fortune 123 (May 1952). Stigler later regarded his 1952 position as mistaken (*Memoirs of an Unregulated Economist* (1988) at 97–108)).

[127] Stigler, *Case against big business*, p. 164.

[128] *Op*. *cit*., pp. 113–114.

[129] White House Task Force on Antitrust Policy *Report* ("Neal Report") 2 Antitrust Law & Economics Review 11 (1968–69).

[130] The text of the Hart bill is reproduced in Harvey J. Goldschmid, H. Michael Mann, and J. Fred Weston, editors. *Industrial Concentration: the New Learning* (1974) at 444–448.. For discussion, see Note *The Industrial Reorganization Act: an antitrust proposal to restructure the American economy*. 73 Columbia Law Review 635 (1973).

[131] Richard A. Posner *The Chicago School of antitrust analysis*. 127 University of Pennsylvania Law Review 925 (1979).See David Dale Martin *Industrial organization and reorganization* Chapter 13 in Warren J. Samuels, editor, The Chicago School of Political Economy (1976), Melvin W. Reder *Chicago economics: permanence and change* 20 Journal of Economic Literature 1 (1982), Edmund W. Kitch *The fire of truth: a remembrance of law and economics at Chicago, 1932–1970* 26 Journal of Law and Economics 163 (1983) and *Chicago school of law and economics* in Peter Newman, editor, 1 The New Palgrave Dictionary of Economics and the Law 227 (1998), and Stephen Martin *Remembrance of things*

of a disingenuously-defined notion of "consumer welfare" as the unique antitrust goal ever intended by Congress and the assertion that the economics of structural antitrust advocates was not economics at all. The Chicago critique made itself felt in a series of amendments to Department of Justice *Merger Guidelines*, in Supreme Court decisions that turn away from the principle of competition, and in predation decisions, rationalized in the name of economic theory and evidence, that reflect a funhouse-mirror view of what it is economics has to say about strategic anticompetitive behavior.

Chicago antitrust economics. The fundamental economic premise of Chicago antitrust analysis was that most real-world prices and quantities, most of the time, could be treated as if they were long-run perfectly competitive equilibrium values. Reder calls this the "good approximation assumption."[132] From this premise, which has never been accepted by mainstream industrial economists,[133] follow conclusions inimical not only to a structurally-oriented antitrust policy, but also to broad swaths of conduct-oriented antitrust as well.[134] If one accepts the good approximation assumption, practices like price discrimination, tying and bundling, exclusive dealing contracts, loyalty discounts, and resale price maintenance must improve market performance or, at least, not worsen it.[135] Nor could mergers, horizontal or otherwise, worsen market performance (as long as

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past: antitrust, ideology, and the development of industrial economics in Vivek Ghosal and Johan Stennek, editors *The Political Economy of Antitrust* (forthcoming. 2007). For expositions of (Richard A. Posner *Antitrust Law* (second edition, 2001 at 194, footnote 2) "orthodox" Chicago School positions, see Ward S. Bowman, Jr. *Patent and Antitrust Law; a Legal and Economic Appraisal* (1973), Bork, *Antitrust Paradox*. The relation of Richard A. Posner *Antitrust Law* (first edition, 1976) and Bork, *Antitrust Paradox* is in some ways like the relation of Edward H. Chamberlin *The Theory of Monopolistic Competition* (1933) and Joan Robinson *The Economics of Imperfect Competition* (1933). Posner, *Antitrust Law* (1976) and Bork, *Antitrust Paradox*, are often cited together. Posner is generally careful to distinguish their work, as Chamberlin was careful to distinguish his work from that of Robinson.

[132] *Op. cit*. Donald Dewey *Antitrust and economic theory: an uneasy friendship*. 87 Yale Law Journal 1516 (1978) at 1518 writes of "the strange notion held by the most influential Chicagoans years ago that all one needed in order to study market structures was a theory of perfect competition (partial equilibrium variety) and a theory of monopoly. If one theory did not work well, the other would."

[133] For example, Kenneth J. Arrow *Toward a theory of price adjustment*, in Moses Abramovitz *et al*. The Allocation of Economic Resources: Essays in Honor of Bernard Francis Haley 41 (1959) at 49:

> There has been a position strongly held in recent years that the American economy is basically competitive… The present model suggests that the evidence, to the extent that it is valid, relates only to equilibrium and, therefore, to long-run situations. Such long-run competitiveness is not incompatible … with considerable short-run monopoly powers in transitory situations.

See also Stephen Martin, *Remembrance*.

[134] Many of those who published arguments along these lines have acknowledged the influence of Aaron Director, on whom see Ronald H. Coase *Aaron Director* in Peter Newman, editor 1 The New Palgrave Dictionary of Economics and the Law 601 (1998), Stephen M. Stigler *Aaron Director remembered* 48 Journal of Law and Economics 307 (2005), and Sam Peltzman *Aaron Director's influence on antitrust policy* 48 Journal of Law and Economics 313 (2005). Among his few published works are Aaron Director and Edward H. Levi *Law and the future: trade regulation* 51 Northwestern University Law Review 281 (1956) and Aaron Director *Review: United States v. United Shoe Machinery Corporation: An Economic Analysis of an Anti-trust Case* 24 University of Chicago Law Review 606 (1957).

[135] Thus Robert H. Bork (*The rule of reason and the per se concept: price fixing and market division* 75 Yale Law Journal 373 (1966)) reviews and dismisses arguments found in the literature suggesting that

they were not mergers to monopoly). Any antitrust activity that went beyond the prohibition of collusion was anticonsumer.[136]

Consumer welfare[137] The Chicago "proconsumer" label is often traced to Robert H. Bork and *The Antitrust Paradox*. At pages 7 and 51 of this work, Bork describes the maximization of consumer welfare as the only legitimate goal of antitrust. At page 17, he writes that maximization of consumer welfare was the dominant goal of early antitrust. At pages 50–51, he writes that "The only legitimate goal of American antitrust law is the maximization of consumer welfare," and that this "goal can be derived as rigorously as any theorem in economics."[138] It is only on page 110 of *The Antitrust Paradox* that Bork gives his definition of consumer welfare, which is that consumer welfare is (to use the standard economic term) net social welfare, the sum of producer surplus and consumer surplus.

Discussing congressional intent behind the Sherman Act, Bork writes:[139]

> Some people suggest that the legislative intent was not really unfocused, that Congress really intended to sacrifice consumers to small business, but found it politically expedient to phrase the statutes in the language of competition. Courts, it seems to be suggested, should rely not upon the straight-faced statutory command but upon the discreet congressional wink. *But the purpose of a wink is to indicate the opposite of what one is saying in order to deceive a third party who hears only the words.*

Bork's proconsumer antitrust policy is itself "consumer welfare with a wink and a nod," using words which in either their lay or professional economic meaning would be taken to designate the welfare of consumers to mean the sum of the welfare of consumers and producers.[140]

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resale price maintenance and exclusive dealing contracts may worsen market performance. He then writes (at 414) "It seems true, nevertheless, that manufacturers, singly or in concert, do sometimes maintain prices and require their resellers not to handle the goods of rival manufacturers. An explanation is required but a further study of actual cases will be necessary to supply it."

[136] Even as regards collusion, the extreme Chicago position is that while it may be attempted, it is doomed to fail. Posner, who accepts the possibility of collusion but would rather that antitrust not distinguish between overt and tacit collusion (*Antitrust Law*, 1976, 2001), writes (*Chicago School*, p. 932) "Partly, perhaps, for tactical reasons (not to seem to reject antitrust policy in its entirety), the members of the Chicago school would sometimes denounce price fixing. But it is unlikely that they regarded even price fixing, let alone oligopoly, as a serious problem."

[137] The topic introduced here is continued, from a slightly different perspective, in Section 4.

[138] Since there is no such theorem in economics, Bork presumably was comparing methodologies of proof rather than results. Dewey (*Antitrust and economic theory*, p. 1524) finds "Bork's effort at such a demonstration … determined, ingenious, and unconvincing."

[139] Robert H. Bork *The goals of antitrust policy* 57 American Economic Review 242 (1967) at 245; footnote omitted, emphasis added.

[140] Some reviewers of *The Antitrust Paradox* picked up on the subterfuge; others may not have. Donald Dewey (*Antitrust and economic theory*, pp. 1516–1517) and Richard S. Markovits (*Monopolistic competition, second best, and 'The Antitrust Paradox': a Review Article* 77 Michigan Law Review 567 (1979) at p. 578) saw through the wink. It is not clear from Joseph E. Fortenberry's (*Book review* 78 Columbia Law Review 1347 (1978), footnote 6) discussion of Bork's concept of consumer welfare that

It should not be thought that an antitrust policy that aims to maximize the welfare of consumers would give zero weight to the welfare of those whose income includes an element of economic profit. It would give full weight to the utility enjoyed by such individuals *when they consume the goods on which they spend their income*. If the owner of shares in the Microsoft Corporation purchases software, an automobile, dinner at a fine restaurant, …, a consumer welfare standard would take account of that person's welfare in measuring consumer surplus in the software market, in the motor vehicle market, in the appropriate regional restaurant market, …, but not as part of producer surplus in the software market.[141]

One often encounters the claim that U.S. antitrust has adopted a consumer welfare standard, and in a context which suggests that this is evidence of the influence of the Chicago school of antitrust analysis. A careful reading of some Supreme Court decisions suggests that what has triumphed is the term "consumer welfare" rather than the accompanying wink.

Confusion on this point is total in Reiter *v.* Sonotone,[142] where Chief Justice Burger, writing for a unanimous court, cites Bork in the name of "consumer welfare" as supporting a position that Bork specifically rejects:[143]

> Respondents engage in speculation in arguing that the substitution of the terms "business or property" for the broader language originally proposed by Senator Sherman was clearly intended to exclude pecuniary injuries suffered by those who purchase goods and services at retail for personal use. None of the subsequent floor debates reflect any such intent. On the contrary, they suggest that Congress designed the Sherman Act as a "consumer welfare prescription." R. Bork, The Antitrust Paradox 66 (1978). Certainly the leading proponents of the legislation perceived the treble-damages remedy of what is now § 4 as a means of protecting consumers from overcharges resulting from price fixing. E.g., 21 Cong. Rec. 2457, 2460, 2558 (1890).

Fortenberry understood that for Bork, if the economy is not at an efficient point, the appropriate welfare measure is the sum of producer and consumer surplus. M. A. Adelman addresses the issue at most tangentially, writing (*Book review* 17 Journal of Economic Literature 127 (1979) at 128, bold emphasis added) "Bork is on sounder ground in arguing that **consumer welfare, or greater production**, *ought to be* the only object of the antitrust law." The 1987 National Association of Attorneys General Horizontal Merger Guidelines remarks (p. 6, fn. 15) "For the unwary judge or practitioner stumbling upon this term it is important to understand … that 'consumer welfare', when used in this manner, has nothing to do with the welfare of consumers."

141 The distinction between the economic role of an individual when acting as a producer and the economic role of the same individual when acting as a consumer appears in the standard circular flow diagram. See also George H. Hildebrand *Consumer sovereignty in modern times* 41 American Economic Review 19 (1951) at 20.

142 Reiter *v.* Sonotone Corp. *et al*. 442 U.S. 330 (1979).

143 442 U.S. 330 at 343, footnote omitted

Under a net social welfare standard, as explicitly stated by Bork, the pecuniary injury of consumers who purchase at retail for personal use (which seems clearly to distinguish them from producers "who are also consumers") is not a concern:[144] "The consumer welfare model, which views consumers as a collectivity, does not take this income effect into account." Under a net social welfare standard, it is deadweight welfare loss that is the social welfare loss from price-fixing, not income transfers from consumers to producers.

Again, for Justice Stevens in *Jefferson Parish Hospital* tying[145] "can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie. …" But under a net social welfare standard, increased monopoly profit due to price discrimination is not a social cost of monopoly: quite the opposite. Output with price discrimination typically exceeds nondiscriminatory levels, thus increasing[146] net social welfare. And since according to this decision it is the consumer *who purchases* that the antitrust laws were designed to serve and not the producer, who in the words of Bork "is also a consumer,"[147] it seems clear that here the Supreme Court conceived of the antitrust laws as promoting the welfare of consumers, not net social welfare.

Merger guidelines. Enforcement practice contributed to focusing merger policy under the amended Section 7 of the Clayton Act on economic rather than non-economic goals. These developments can be traced in successive Department of Justice merger guidelines.

The 1968 Merger Guidelines[148] were faithful to early interpretations of the amended Section 7, the purpose of which was "to promote and preserve market structures conductive to competition." Market shares and market concentration, as measured by the four-firm seller concentration ratio, were given primary significance in deciding which horizontal mergers would be challenged. There was some indication of willingness to allow a failing firm exception for a merger that would otherwise be challenged. But the 1968 Guidelines were skeptical toward an efficiency justification for horizontal mergers, and this on three grounds. The first was that, under the Guidelines, mergers that would allow small firms to realize economies of scale were unlikely to be challenged. The second was that efficiencies not related to economies of scale "could normally be realized through internal expansion." The third was that it would typically be difficult to document the nature of alleged merger-related efficiencies.

As for vertical mergers, in the 1968 Guidelines saw foreclosure, either of suppliers or of distribution outlets, and the consequent increase in entry cost, as their primary vice. Market shares were the primary indicator, followed by entry conditions, as to the kind of vertical mergers that might be challenged. Conglomerate mergers that would eliminate a potential entrant or raise the prospect of reciprocity were also singled out for attention,

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144 *Antitrust Paradox*, p. 110.
145 Jefferson Parish Hospital Dist. No. 2 *v.* Hyde 466 U.S. 2 (1984) at 14–15, footnote omitted.
146 Leaving aside qualifications that may arise if the product is differentiated.
147 *Antitrust Paradox*, p. 110.
148 U.S. Department of Justice, 30 May 1968.

and once again, market shares were a primary indicator of the kind of conglomerate merger that was likely to be challenged.

The 1968 Guidelines are 17 pages in length, and contain a discussion of market definition that runs just over two pages. Normal commercial practice and interchangeability in use are the standards cited for product market definition, while a region will be considered a geographic market if firms make significant sales there.

The 1982 Guidelines[149] introduced the "hypothetical monopolist" or "hypothetical cartel" as a conceptual framework for market definition: given buyers' perceptions of substitutability, what sources of supply would need to be controlled to sustain a five per cent price increase for a year? The structural approach is present, but in modified form. Market concentration is measured in terms of the Herfindahl-Hirschman index rather than the four-firm seller concentration ratio, and the standards for horizontal mergers that are likely to be challenged are moderately relaxed from those of the 1968 Guidelines. The 1982 Guidelines maintain a skeptical attitude toward an efficiency justification for mergers that would otherwise be challenged. They consider vertical and conglomerate mergers in the combined category of nonhorizontal mergers, and indicate that although such mergers have no immediate effect on the structure of any market "they are not invariably innocuous."[150]

An otherwise modest 1984 updating of the Merger Guidelines[151] included a different view of efficiencies and mergers. Instead of the skeptical attitude toward the prospect of merger-related efficiencies that were present in the 1968 and 1982 Guidelines, for the 1984 Guidelines the potential for such efficiencies was[152] "[t]he primary benefit of mergers to the economy…." The Guidelines also indicated that[153] "[i]f the parties to the merger establish by clear and convincing evidence that a merger will achieve [significant net] efficiencies, the Department will consider these efficiencies in deciding whether to challenge the merger." The willingness to consider efficiency justifications for mergers contained in the 1984 Merger Guidelines, which seemed to contradict explicit statements in Supreme Court decisions,[154] did not endure: no corresponding indication appears in the 1992 Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (2 April 1992).[155]

[149] U.S. Department of Justice, 14 June 1982. See F. M. Scherer *Merger policy in the 1970s and 1980s* in Robert J. Larner and James W. Meehan, Jr., editors Economics and Antitrust Policy 83 (1989) at 91–93 and the symposium in 71 *Antitrust Law Journal* (2002).
[150] *1982 Guidelines*, p. 29.
[151] U.S. Department of Justice, 14 June 1984.
[152] *1984 Guidelines*, p. 35.
[153] *Ibid*., pp. 35–36.
[154] For example, FTC *v.* Procter & Gamble Co. 386 U.S. 568 at 580 (1967).
[155] Section 4 of the 8 April 1997 revision of the Horizontal Merger Guidelines indicates a willingness to take verified merger-specific efficiencies not related to output or service reductions into account in evaluating a proposed merger.

Thus enforcement agencies, along with the legislature, academic commentators, and the judiciary, shape the interpretation of antitrust law. The 1982 and 1984 Merger Guidelines show the influence of the Chicago School.[156]

Vertical restraints. Structuralism and economic analysis came in the antitrust door with the early decisions applying the amended Section 7 of the Clayton Act. A series of decisions, largely involving vertical restraints, ushered structuralism out the antitrust door, and with it, at a fundamental level, the principle of competition as well. In place of reliance on competition to ensure good market performance and use of structural indicators to assess the impact of business practices on competition, antitrust has, when in doubt, substituted explicit analysis of the impact of business practices on performance.

In U.S. *v.* Arnold, Schwinn & Co.,[157] the Supreme Court relied on the principle of competition to decide the legality of vertical restraints imposed by a manufacturer on distributors:[158]

> Our inquiry is whether, assuming nonpredatory motives and business purposes and the incentive of profit and volume considerations, the effect upon competition in the marketplace is substantially adverse.

The Court found restraints permissible if the manufacturer retained ownership of the product, impermissible if not:[159]

> Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. … Such restraints are so obviously destructive of competition that their mere existence is enough. If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale.

It should be admitted, as often it is not, that this approach is entirely logical *if one wishes to rely on rivalry between independent firms to obtain good market performance.*

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[156] The willingness to consider efficiency justifications for mergers contained in the 1984 Merger Guidelines, which seemed to contradict explicit statements in Supreme Court decisions (for example, FTC *v.* Procter & Gamble Co. 386 U.S. 568 at 580 (1967)), did not endure: no corresponding indication appears in the 1992 Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (2 April 1992). Section 4 of the 8 April 1997 revision of the Horizontal Merger Guidelines indicates a willingness to take verified merger-specific efficiencies not related to output or service reductions into account in evaluating a proposed merger.

[157] 388 U.S. 365 (1967). There are many discussions of the chain of vertical restraints decisions leading up to *Schwinn*; see, for example, Lawrence J. White *The revolution in antitrust analysis of vertical relationships: how did we get from there to here?*, in Robert J. Larner and James W. Meehan, Jr., editors *Economics and Antitrust Policy* 103 (1989) or Stephen Martin *Industrial Economics*. (1994), Chapter 17.

[158] 388 U.S. 365 at 375.

[159] 388 U.S. 365 at 379.

The *Continental TV* Court retrospectively interpreted the *Schwinn* dichotomy in terms of intrabrand competition (seen as being harmed by restrictions that limited dealers' discretion over the disposition of owned products) and interbrand competition (promoted by dealer restrictions where the dealer had not taken title). Just five years after declaring in *Topco* that:[160]

> *Our inability to weigh*, in any meaningful sense, *destruction of competition in one sector of the economy against promotion of competition in another sector* is one important reason we have formulated *per se* rules.

and[161]

> … the freedom guaranteed each and every business, no matter how small, is *the freedom to compete* - to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster. Implicit in such freedom is the notion that it *cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important sector of the economy*,

the *Continental TV* Court gave pride of place to interbrand competition:[162]

> *Interbrand competition* is the competition among the manufacturers of the same generic product - television sets in this case - and *is the primary concern of antitrust law*.

There is little if any prior indication that antitrust law regards interbrand competition as being of primary concern. Certainly the modern economic perspective is that intrabrand competition and interbrand competition interact to determine equilibrium market performance. The gist of the Hart and Tirole analysis is that restrictions on competition among distributors may be necessary for a manufacturer to exercise market power.[163] Thus while it is correct that interbrand competition checks the exercise of intrabrand market power, the reverse also correct: when intrabrand competition exists, it provides a significant check on the exploitation of interbrand market power.[164]

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[160] 405 U.S. 596 at 609—610, emphasis added.

[161] 405 U.S. 596 at 610, emphasis added.

[162] 433 U.S. 36 at 52, footnote 19, emphasis added.

[163] Oliver Hart and Jean Tirole *Vertical integration and market foreclosure* Brookings Papers on Economic Activity: Microeconomics 205 (1990).

[164] There are well-known examples of restraints on intrabrand competition used by a manufacturer to shackle interbrand competition. See Alfred S. Eichner's discussion (*The Emergence of Oligopoly: Sugar Refining as a Case Study* (1969) at 191) of the American Sugar Refining Company, approached in 1891 to police a wholesale grocers' cartel and as a *quid pro quo* implementing what were effectively exclusive dealing arrangements, enforced by a loyalty rebate scheme, that raised distribution cost to rivals through much of the eastern United States.

With *Continental TV*, the Court returned nonprice vertical restraints to the category of practices treated under the rule of reason. In applications, it indicated, the assessment of the impact of a restriction on performance in the marketplace should be based on the net impact of such restraints in reducing intrabrand competition and promoting of interbrand competition. This approach turns antitrust away from reliance on competition to obtain good market performance and toward an explicit evaluation of the net impact of a challenged practice on market performance in an economic sense.[165] A restraint on competition will now be accepted if a court concludes that economic theory and evidence show that the restraint will improve market performance in an economic sense.

Predation. The legal treatment of predation has also highlighted the role of economic analysis in the application of antitrust policy, and in ways that raises the question of the legal system's appreciation of what it is economic analysis has to say about strategic anticompetitive behavior.

Some developments in this area were engendered by the *Utah Pie* decision, where it can be argued that the majority looked at increased competition in a regional market and saw predation.[166] Other developments were tied to a lively academic debate about the Areeda-Turner rule.[167] The diehard Chicagoan[168] position is that predatory pricing has never happened,[169] and that it could not happen.[170] If something that superficially resembled predation seemed to result in the exit of an active firm, continuing firms could not on that account raise price to recoup the cost of predation: since there are no barriers to entry,[171] any price increase would simply result in new firms coming into the market. Some comfort is given to this position in *Matsushita*, [172] somewhat less in *Cargill*.[173]

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[165] The modified *per se* rule for tying that emerges from *Jefferson Parish Hospital* is a move in the same direction.
[166] Utah Pie Co. *v.* Continental Baking Co. 386 U.S. 685 (1967). Robinson-Patman issues were also present; see Kenneth G. Elzinga and Thomas F. Hogarty *Utah Pie and the consequences of Robinson-Patman* 20 Journal of Law and Economics 427 (1978).
[167] See among others Philip Areeda and Donald F. Turner *Predatory pricing and related practices under Section 2 of the Sherman Act* 88 Harvard Law Review 697 (1975), F. M. Scherer *Predatory pricing and the Sherman Act: comment* 89 Harvard Law Review 869 (1976), Oliver E. Williamson *Predatory pricing: a strategic and welfare analysis* 87 Yale Law Journal 284 (1977), William J. Baumol *Quasi-permanence of price reductions: a policy for prevention of predatory pricing* 89 Yale Law Journal 1 (1979), Paul L. Joskow and Alvin K. Klevorick *A framework for analyzing predatory pricing policy* 89 Yale Law Journal 213 (1979), Janusz A. Ordover and Robert D. Willig *An economic definition of predation: pricing and product innovation* 91 Yale Law Journal 8 (1981) and Frank H. Easterbrook *Predatory strategies and counterstrategies* 48 University of Chicago Law Review 263 (1981).
[168] The term is due to Posner *Chicago School*, p. 932.
[169] John S. McGee *Predatory price cutting: the Standard Oil (N.J.) case* 1 Journal of Law and Economics 137 (1958).
[170] The target of alleged predation would be able to get financial resources either from capital markets or from far-sighted consumers, hence would be able to survive a predatory campaign. Since a predatory campaign would be bound to fail, it would never be tried.
[171] Harold Demsetz *Barriers to entry* 72 American Economic Review 47 (1982).
[172] 475 U.S. 574 at 589: "…there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful."
[173] 479 U.S. 104 at 121: "While firms may engage in [predatory pricing] only infrequently, there is ample evidence suggesting that the practice does occur."

The requirement to show that an alleged predator stood a reasonable chance of recoupment entered the antitrust framework with *Matsushita*[174] and *Brooke Group*.[175] Few economists will quarrel with the concept; most are troubled by the application:[176]

> A powerful tension has arisen between the foundations of current legal policy and modern economic theory. The courts adhere to a static, non-strategic view of predatory pricing, believing this view to be an economic consensus. This consensus, however, is one most economists no longer accept.

2.6 Two Roads Diverged

The panglossian views bolstered by the "good approximation theory" were never accepted by mainstream industrial economists, who rejected the view that the model of perfect competition could be used to analyze imperfectly competitive markets.[177] The results of mainstream research, generally in the structure-conduct-performance tradition, were cited in Supreme Court decisions. Students of the Chicago approach then attacked the mainstream as being something other than economics. The arguments that bolstered received antitrust analysis[178] "contradicted economic theory." And, indeed, they did contradict the neoclassical theory of perfectly competitive markets.[179]

The diehard Chicagoan view that predation and other types of strategic behavior are impossible, as a matter of theory, is not accepted by economists.[180] The position that tying and bundling cannot, as a matter of theory, worsen market performance, is now known to be incorrect.[181] Theoretical models rationalize predation for signaling or

[174] Matsushita Electrical Industrial Co., Ltd, et al. *v.* Zenith Radio Corp. *et al.* 475 U.S. 574 (1986).
[175] Brooke Group Ltd. v. Brown &Williamson Tobacco Corporation 509 U.S. 209 (1993).
[176] Patrick Bolton, Joseph F. Brodley, and Michael H. Riordan *Predatory pricing: strategic theory and legal policy* 88 Georgetown Law Journal 2239 (2000) at 2242.
[177] See Martin (2006, Table 5.1 and the accompanying text).
[178] Posner, *Chicago School*, p. 929.
[179] Thus Corwin D. Edwards (*Can the antitrust laws preserve competition?* 30 American Economic Review 164 (1940) at 164–165, emphasis added):

> Doubtless economists have been predisposed to believe that competition was collapsing because the neoclassical theory of competition, *which had once been regarded as a sufficient tool of economic analysis*, was obviously doing so.

[180] Indeed, it has been rejected for some time (Timothy F. Bresnahan *Comment* Brookings Papers on Economic Activity Microeconomics 226 (1991) at 227):

> Around 1975 the Chicago consensus had, largely, won. There wasn't any market power in the economy because cartels always broke down and because barriers to entry, predation and such, could not be equilibrium phenomena. We now know this argument cannot be established by theory.

[181] Stephen Martin *Strategic and welfare implications of bundling* 62 Economics Letters 371 (1999), Barry Nalebuff *Bundling as an entry barrier* 119 Quarterly Journal of Economics 159 (2004).

creation of a reputation as something that may occur in equilibrium, and the literature has documented episodes of predation.[182]

Faced with the development that *formal* economic theory now rejects the main conclusions of the diehard Chicago School (as did also discursive structure-conduct-performance theory), the approach of Chicago advocates has been to reject the use of mainstream economic theory:[183]

> What concerns me is that the economists have rather lapped the bar and the courts. Quite frankly, I do not want them back in the courts talking about new and not well-understood justifications for intervention, some of which sounds [sic] like the half-baked oligopoly theories of twenty years ago (although they are not).

Although the positions associated with the Chicago School never completely overturned mainstream antitrust, and (as suggested by the Supreme Court's use of the term "consumer welfare") have not been fully understood by U.S. courts, they retain more influence on antitrust law than they ever had in economics. The reaction of the mainstream economist, faced with the argument that the neoclassical theory of perfectly competitive markets rules out strategic welfare-reducing conduct in markets that are imperfectly competitive, must be to mutter (with Galileo), "Nevertheless, it moves," and carry on with the use of theoretically appropriate models to analyze the imperfectly competitive markets with which, by and large, antitrust is concerned.

3 European Union

U.S. antitrust policy arose within an existing federal governmental structure. European Community (EC) competition policy arose in vastly different circumstances. It was adopted in the immediate aftermath of the second European civil war in a generation, by independent nations with mature industrialized economies, as one element in a project of economic integration. The immediate goal of that project, promoting economic prosperity, was ancillary to its fundamental political purpose, which was[184] "to substitute for age old rivalries the merging of … essential interests; to create, by establishing an economic community, the basis for a broader and deeper community among peoples long divided by bloody conflicts." The economic goal of EC competition policy, undistorted competition, was not established for its own sake but as a means toward the ultimate goal of integration *tout court*, not merely economic integration.

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[182] For references and discussion, see Joel M. Podolny and Fiona M. Scott Morton *Social status, entry and predation: the case of British shipping cartels 1879–1929* 47 Journal of Industrial Economics 41 (1999).
[183] William F. Baxter *Reflections upon Professor Williamson's comments* 27 St. Louis University Law Journal 315 (1983), at 320. Contrast Jonathan Baker (*Recent developments in economics that challenge Chicago School views* 58 Antitrust Law Journal 645 (1989)) with Malcolm B. Coate and Jeffrey H. Fischer (*Can post-Chicago economics survive Daubert* 34 Akron Law Review 795 (2001)), Michelle M. Burtis (*Modern industrial organization* 12 George Mason Law Review 39 (2003)).
[184] The words are from the founding document of the immediate predecessor of the European Community, the European Coal and Steel Community (ECSC) Treaty..

For the most part, the authors of the treaties were neither economists nor particularly familiar with market processes.[185] But the EC is a vehicle for *economic* integration. Implicit in the treaties and the competition rules they lay down are visions, implicit models, of the ways markets work. U.S. antitrust — the conduct-oriented antitrust of the interwar period — was one of three sources that influenced these implicit models. The other two were a native European *abuse control* approach that arose between the wars and the German *Ordoliberal School*, which came to prominence in the immediate postwar period. The words of the treaties, which reflect these underlying visions, have remained relatively unchanged through a series of incarnations. But the application of competition policy by the Commission and the Courts has meant an ongoing reinterpretation of those words as the institutions of the Community come to grips with the exigencies of the imperfectly competitive nature of the markets with which competition policy has to deal.

3.1 Member State Backgrounds

European nations went through the changes caused by the first industrial revolution at different times, and with backgrounds that differed both one from another and from that of the pre-Civil War United States. [186] Despite these differences, their policies toward business behavior developed in ways that had much in common, and differed from the prohibition approach of U.S. antitrust. Some legacy of these approaches remains present in EU competition policy.

3.1.1 UK

England, which led the first (steam, iron, and steel) industrial revolution, relied largely on free trade and the force of potential foreign competition to obtain good market performance. A series of late-nineteenth-century judicial decisions established that for British law, freedom to trade included the freedom to make contracts in the reasonable self-interest of the parties to the contract. Among these decisions was *Mogul*

[185] See Alan S. Milward, *The European Rescue of the Nation State* 105 (1992): "Monnet, as all who worked with him in the ECSC agree, had little interest in or knowledge of the details of the coal, iron and steel industries. For him, they were merely instrumental to his higher political goals."

[186] See in a large literature Francis Walker *Policies of Germany, England, Canada and the United States towards combinations* 42 Annals of the American Academy of Political and Social Science 183 (1912), Henry R. Seager and Charles A. Gulick, Jr. *Trust and Corporation Problems* (1929), Fritz E. Koch *Methods of regulating unfair competition in Germany, England, and the United States* 78 University of Pennsylvania Law Review 693 and 854 (1930), Robert L. Liefmann, Cartels, Concerns, and Trusts (1932), John Wolff *Business monopolies: three European systems in their bearing on American law* 9 Tulane Law Review 325 (1935), Edward H. Chamberlin, editor. *Monopoly and Competition and Their Regulation* (1954), John Perry Miller, editor *Competition Cartels and Their Regulation* (1962), Corwin D. Edwards *Control of Cartels and Monopolies. An International Comparison* (1967), Giuliano Amato *Antitrust and the Bounds of Power* (1997) David J. Gerber *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (1998), and Christopher Harding and Julian Joshua *Regulating Cartels in Europe* (2003). For reasons of space, I limit discussion here of national European competition policies to France, Germany, and the United Kingdom. See also, particularly, David J. Gerber's treatment of Austrian competition policy (*The origins of European competition law in fin-de siècle Austria*. 36 American Journal of Legal History 405 (1992) and *Law and Competition*).

Steamship,[187] which led to an 1889 House of Lords decision that (Lord Justice Bowen's opinion):

- it was doubtful that cartels could be successful in a country that practiced free trade, unless granted a legal monopoly;

- it was not clear that cartels were always harmful to the public;

- the common law rule was that agreements in restraint of trade were not criminal, but that such agreements could not be enforced in courts of law; and

- it was not the place of courts to condemn "peaceable and honest combinations of capital for the purposes of trade competition;" if this were to become public policy, it would require legislation, to replace the common law rule.

Thus, moving into the twentieth century, the rule was that English courts would neither condemn nor enforce cartel agreements. Firms were free to make and break cartel agreements at will; a defecting cartel member could not be sued by its fellow for breach of contract.

Like the governments of other World War I belligerent nations, however, the British government found it convenient to use trade associations in the management of its wartime economy. Business experience with this wartime cooperation carried over into the postwar period, as trade associations provided an infrastructure for informal and formal collusive schemes:[188] "restrictive practices were judged legal if they were intended to forward the trade and no other wrong was committed. No wider public interest was acknowledged. Cartels and related organisations therefore had a free hand."

Britain lagged behind Germany in the second (chemical and electrical) industrial revolution. As the Great Depression dragged on, the British mood turned away from use of markets as a resource allocation mechanism.[189]

3.1.2 France

Stepping back from its *dirigiste* image, which of course has a basis in reality, nineteenth-century French policy toward business can be described as "competition

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[187] *Mogul Steamship Co.* v. *McGregor, Gow & Co. et. al.* 54 L.J.Q.B. 540 (1884/1885); 57 L.J.K.B. 541 (1887/1888); 23 Q.B.D. 598 (C.A.)(1889); [1892] A.C. 25. As is well known, at issue was predatory collusion by members of a southeast Asian shipping cartel to drive a rival from the market for shipping tea from China.

[188] James Foreman-Peck *Industry and industrial organisation in the interwar years* in Roderick Floud and Donald McCloskey, editors. *The Economic History of Britain Since 1700. Volume 2: 1860–1939* 386 (1994) at 404.

[189] John Jewkes *British monopoly policy 1944–56* 1 Journal of Law & Economics 1 (1958).

policy *manqué*." There is a series of French laws that might have become the basis for a vigorous competition policy, but did not.

A March 1791 law aimed to eliminate the privileges enjoyed by guilds under the *ancien régime*, and guaranteed that "[a]ny person shall be free to carry on such business, or to exercise such profession, art or trade as he considers desirable… ". A July 1793 law provided penalties including confiscation and death for combinations that acted to alter price from the level that would have occurred under free competition. In 1810, the provisions of this law, with reduced penalties (fines, imprisonment of one month to a year, or police supervision), were incorporated in Articles 419 and 420 of the French penal code, where they remained, unchanged, for more than a century.

With such legislation, much depends on the meaning given to the phrase "the price that would have occurred under free competition." French courts read a distinction between bad trusts, to which the prohibitions of the law applied, and good trusts, to which they did not, into Articles 419 and 420:[190]

> … "good" trusts were defensive coalitions against ruinous competition, intended to stabilize the market and to avoid overproduction. … "Bad" trusts, in this view, were offensive coalitions, with a double goal of speculation and driving out competitors.

As in the U.K., and for the same reason, cartels became more common during and after World War I. In December, 1926, Articles 419 and 420 of the penal code were amended to make clear that collusion was not, in and of itself, illegal; it was combinations of firms that sought monopoly profits that were forbidden. Cartels proliferated in France with the arrival of the Great Depression in 1931.

3.1.3 Germany

Prussia industrialized in the 1850s and 1860s, and unified Germany by 1870. Cartels had a long history in German-speaking areas of Europe, but the modern era of German cartels began with the Great Depression of 1873.[191] The German civil code prohibited contracts that were "contrary to good morals." This rule applied to cartel contracts as it did to other types of contracts. Under German law, contracts to collude were on the same legal footing as other kinds of contracts, enforceable in courts of law.

The 1888 *Bavarian Brickmakers* decision[192] determined that what later came to be called *crisis cartels* were not contrary to good morals in the sense of German law. The case involved an agreement, reached during an economic downturn, to restrict output, to set minimum prices, and to fine contracting parties that might break the agreement. One

[190] Robert O. Paxton *The calcium carbide case and the decriminalization of industrial ententes in France, 1915–26* in Patrick Fridenson, *The French Home Front, 1914–1918* 153 (1992) at 154.
[191] As noted above (fn. 8), German cartels were therefore often described as "children of bad times," although they were by no means present only during economic downturns.
[192] Oberstes Landesgericht, Bavaria, April 7, 1888, Entsch. des Ob. L. G. 12, 67.

of the cartel members did indeed break the agreement, and the cartel sued to compel payment of the fine. The defector responded, without success, that the contract was against good morals and therefore void:[193]

> Since there was no statute specifically directed against such agreements, the court had to apply the ordinary principles of civil laws. The main pertinent principle in German law was that contracts *contra bonos mores* [against good morals] are void. The court, looking at the face of the by-laws, found no fault with the purpose there stated. It held that "it was not *contra bonos mores* for business men belonging to a branch of industry which is suffering from a depression to get together and enter into agreements regulating the ways and means of operating their industry with a view to promoting recovery. *On the contrary such course of action would seem to be incumbent upon prudent business men*."

Similarly, the 1897 *Saxon Woodpulp* decision found collusion to be socially beneficial:[194]

> When the prices of the products of an industry fall to an unreasonably low level, and the successful operation of the industry is thereby endangered or made impossible, the resulting crisis is detrimental not only to the individuals affected but to society at large. Therefore, it is to the interest of society that prices in any given industry should not remain long at a level that is below the cost of production. … it cannot be simply and generally contrary to the public welfare that producers interested in a given branch of industry should unite in order to prevent or to moderate price-cutting and the consequent general decline in the prices of their products. On the contrary, when prices are for a long time so low that financial ruin threatens the producers, their combination appears to be not merely a legitimate means of self-preservation, but also a measure serving the interests of society.

Post-World War I German hyperinflation led many industry associations to fix common selling terms in a way that had the effect of placing the burden of currency depreciation on buyers.[195] This caused a popular reaction against collusion on selling terms and led to adoption of the first specific German cartel law, the Cartel Ordinance of November 2, 1923. Many of the selling-terms cartels dissolved after the 1924 Dawes Plan stabilized the German currency, but the Cartel Ordnance, and with it the formal possibility of government supervision of cartels, remained.

[193] Wolff *Business monopolies*, p. 328, footnotes omitted, emphasis added by Wolff.
[194] Entscheidung des Reichsgerichts in Civilsachen vol. xxxviii, pp. 156-158. Translation of Seager and Gulick, *Trust and Corporation Problems*, pp. 552–553, footnote omitted.
[195] Karl Pribram *Cartel Problems* (1935) at 255.

The 1923 Ordinance was an *abuse control* measure:[196] it permitted courts to declare that a cartel agreement was null and void. If, after such a declaration, firms adhered to the agreement anyway, no further legal measures were possible. A severe depression hit Germany in April 1925, and this was followed[197] "by revival of cartel activity…". The bulk of the literature takes the view that the 1923 Ordnance was ineffective.[198]

Ordoliberalism. The Ordoliberal School, one of the three principal roots of postwar West German competition policy,[199] developed at the University of Freiburg during the interwar period and continued to develop throughout the war.[200] The Ordoliberal approach was shaped by experience with the effects of private economic power exercised by cartels under the Weimar Republic and with the public exercise of power, economic and otherwise, under national socialism.

Competition policy was central to Ordoliberal theory. Like Henry Simons' *A Positive Program for Laissez Faire*,[201] ordoliberals saw government's role as one of maintaining conditions under which market prices, freely arrived at, would allocate resources.

Franz Böhm, one of the leaders of the Ordo school, described the resource misallocation resulting from controlled prices in occupied Germany:[202]

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[196] Franz Böhm *Monopoly and competition in Western Germany* in Edward H. Chamberlin, editor. *Monopoly and Competition and Their Regulation* 141 (1954) at 161.

[197] Pribram, *op. cit*., p. 256.

[198] Wernhard Möschel (*Competition policy from an Ordo point of view* in Alan Peacock and Hans Willgerodt, editors German Neo-Liberals and the Social Market Economy 142 (1989) at 143) writes that it stabilized the cartel movement "by generally sanctioning cartels." Gerber (*Law and Competition*, pp. 134–136) argues that it may nonetheless have had an important informal impact.

[199] As we shall see, the other two were U.S. antitrust and the abuse control approach, both of which impacted postwar German policy directly and indirectly through the European Coal and Steel Community.

[200] In addition to Böhm *Monopoly and competition in Western Germany*, Henry M. Oliver, Jr. *German Neoliberalism* 74 Quarterly Journal of Economics 117 (1960), and Möschel *Competition policy*, see Carl J. Friedrich The political thought of neo-liberalism 49 *American Political Science Review* 509 (1955), Konrad Zweig *The origins of the German social market economy* (1980) (http://www.adamsmith.org/policy/publications/pdffiles/social-market-economy.pdf), David J. Gerber Constitutionalizing the economy: German neo-liberalism, competition law and the "new" Europe 42 American Journal of Comparative Law 25 (1994), Wernhard Möschel *The proper scope of government viewed from an Ordoliberal perspective: the example of competition policy* 157 Journal of Institutional and Theoretical Economics 3 (2001) and comments by David J. Gerber *Economic constitutionalism and the challenge of globalization: the enemy is gone? Long live the enemy* 157 Journal of Institutional and Theoretical Economics 14 (2001), Ulrich Kamecke *The proper scope of government viewed from an Ordoliberal perspective: the example of competition policy* 157 Journal of Institutional and Theoretical Economics 23 (2001). See also Marie Laure Djelic *Exporting the American Model: the Postwar Transformation of European Business* (1998), Lawrence A. Sullivan and Wolfgang Fikentscher *On the growth of the antitrust idea* 16 Berkeley Journal of International Law 197 (1998), and Hannah L. Buxbaum German legal culture and the globalization of competition law: a historical perspective on the expansion of private antitrust enforcement Issues in Legal Scholarship, Richard Buxbaum and German Reintegration (2006) Article 10 (http://www.bepress.com/ils/iss9/art10).

[201] The similarity of Ordoliberalism and Simons' work is noted by Oliver, *German neoliberalism* , p. 118.

[202] Böhm, *Monopoly and Competition*, p. 143.

> This mixture of free and controlled prices has great economic disadvantages, particularly as officially controlled prices are at present, in Western Germany, consistently lower than they would be in a free market. As a result, economic planning in factories or in private households is vitiated. The demand for goods with officially controlled prices is artificially inflated, with the result that they are squandered. The profitability of the works producing these goods is artificially lowered, and their equipment is neither renewed nor improved. A scarcity of these goods then results, bottlenecks appear, and the government sees itself forced to ration such goods. On the other hand, profits are high in the industries where prices are uncontrolled, profits are reinvested in these industries - chiefly those producing consumption goods - whereas the basic industries suffer from a notable lack of capital. Intervention is therefore needed to divert the flow of capital from the consumption industries to the basic ones…

Ordoliberals also recognized that intrusive government involvement in the marketplace would lead to rent seeking:[203]

> The experience of the First World War and of the years 1936 to 1948 showed that in a system of economic control carried out with the help of [industry] associations, competition and attempts to establish monopolies take on a somewhat different character. Competition takes place no longer in the market, but in the antechambers of government departments, and attempts at monopoly are also made partly via these ante-chambers and partly through the concentration of enterprises…

In the Ordoliberal view, the overriding goal of competition policy was to maintain individual freedom; efficiency in an economic sense was an implied, but subsidiary, purpose:[204]

> [C]ompetition policy is primarily oriented to the goal of securing individual freedom of action, from which the goal of economic efficiency is merely derived.

Government's role was, and was only, to maintain property rights and enforce contracts, excepting contracts inconsistent with the role of free decisions in markets as a resource allocation mechanism. The Ordoliberal program would have given this limited government role constitutional standing.

3.1.4 Abuse Control

During the interwar period, abuse control became the mainstream European approach to cartel control.[205] At its 1930 meeting, the Interparliamentary Union adopted a resolution

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[203] *Ibid.*, p. 150.
[204] Möschel, *Competition policy*, p. 142.

to the effect that cartels were natural economic institutions that could not be effectively prohibited. Instead, governments should require cartels to register and take action if, but only if, a cartel engaged in abusive conduct.[206] It was this approach to cartel control that seemed so attractive to U.S. business circles in the 1920s, and it is exactly the policy that was adopted by many European countries.

The Ordoliberal School did not stand entirely apart from the abuse control approach. Recognizing that competition might of necessity be imperfect in some markets, Leonhard Miksch[207] articulated the "as-if" approach to competition policy: if equilibrium market structure was inherently imperfectly competitive, or in situations involving legal grants of monopoly (as, for example, intellectual property rights), the Ordo solution was to oblige firms to act is if they did not have market power:[208]

> … competition law was to provide a standard of conduct for the firms involved. …It required that economically powerful firms act *as if* they were subject to competition - i.e., as if they did not have monopoly power.

Miksch, regrettably, was cut down at the age of 49, little more than a year after taking up a professorship at the University of Freiburg. According to Goldschmidt and Berndt, the logic of Miksch's proposal was that public policy was justified in expecting firms to behave as they would if competition were free:[209]

> It is apparent that Miksch's approach requires a specific type of competition law to implement "regulated competition" and to regulate monopolies. "Any satisfying management of the monopoly issue and of 'regulated competition' requires the state to practice at least part of the rigor which markets, organized in freedom, would practice themselves" … As a consequence, market orders must be formed in a way so that the exchange process is emulated where it does not work: "This objective justifies us to speak of an economic policy as-if" …

This recommendation amounts to extending the abuse approach from cartels to single-firm conduct.

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[205] Arthur L. Please *Some aspects of European monopoly legislation* 2 Journal of Industrial Economics 34 (1954) at 36–37; Hans B. Thorelli *European antitrust policy* 8 Law School Record 1 (1959) and *Antitrust in Europe: national policies after 1945* 26 University of Chicago Law Review 222 (1959).
[206] Interparliamentary Union *Resolution on the control of international trusts and cartels* Compte rendu de la XXVIe Conférence 33 (1931). For discussion, see William Boserup and Uffe Schlichtkrull *Alternative approaches to the control of competition* in John Perry Miller, editor *Competition Cartels and Their Regulation* 59 (1962). On the Interparliamentary Union itself, see Interparliamentary Union and the United States Group *General information and history of the Interparliamentary Union and the United States Group*, 99th Congress. Washington, D.C.: Interparliamentary Union, United States Group, United States Congress, 1985.
[207] Leonhard Miksch *Die Wirtschaftspolitik des Als Ob* 105 Zeitschrift für die Gesamte Staatswissenschaft 310 (1949).
[208] Gerber, *Constitutionalizing the economy*, p. 52.
[209] Nils Goldschmidt and Arnold Berndt *Leonhard Miksch (1901–1950)* 64 American Journal of Economics and Sociology 973 (2005) at 978.

For Goldschmidt and Berndt[210] "Miksch succeeds in reminding us that any economic policy measure needs a normative reference point to uncover and restrict private market power."

A pertinent question, and one to which Miksch might very well have come if more time had been permitted to him, is whether free and perfect competition is an appropriate normative reference point for markets which, given freedom of action by agents on both sides of the market, are (in noncooperative equilibrium) structurally imperfectly competitive. First, there is a real question whether government can be competent to determine whether firms are behaving as if they operated in a perfectly competitive market. Second, to oblige firms to depart from imperfectly competitive noncooperative equilibrium and mimic perfectly competitive behavior must, of necessity, involve precisely the type of government intervention and opportunity for rent seeking of which the Ordoliberals were so distrustful.[211]

3.2 The European Coal and Steel Community[212]

The competition policy provisions of the European Coal and Steel Community are fundamental predecessors of those of the European Union. The ECSC grew out of a May 1950 proposal of French Foreign Minister Robert Schuman for the creation of a West European common market in coal and steel. This *Schuman Plan* had been developed by Jean Monnet and a small team collaborators. It led to the April 1951 Treaty of Paris, which established the European Coal and Steel Community for a period of 50 years.[213] Although it is no longer with us, the ECSC's heritage lives on, among other places, in EC competition policy.

The competition policy provisions of the ECSC Treaty embodied a prohibition approach that was (on the surface) substantially different from the mainstream European approach. Article 60 of the ECSC Treaty prohibited unfair competitive practices, including what would now be called predatory pricing and price and sales condition discrimination, particularly discrimination based on nationality. Article 65(1) prohibited agreements among firms that would distort competition within the common market. This basic prohibition of agreements that distort competition is without effective precedent in Europe.

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210 *Ibid*.

211 It is not clear that the Ordo School embraced perfect competition as a normative standard (Gerber, *op. cit*., footnote 86).

212 See Stephen Martin *Coal and steel: first steps in European market integration* (2004) (http://www.krannert.purdue.edu/faculty/smartin/vita/EI5060D.pdf and and ecscfig.pdf).

213 With the expiration of the ECSC Treaty in July, 2002, the coal and steel sectors of EC member states became subject to the market rules that apply to all EC markets.

Article 66(1) required prior authorization of mergers - interfirm acquisitions of control, or concentrations – by the executive organ of the ECSC, High Authority. The High Authority's merger control powers were at that time without precedent anywhere.[214]

But the influence of the abuse control approach is seen in Articles 65(2) and 66(7). Article 65(2) gave the High Authority, the right to permit certain types of agreements that were prohibited by Paragraph 1, if specified conditions were met. The kinds of agreements that could be permitted were agreements to specialize in production and agreements for joint buying and selling. The conditions that had to be met were essentially that the agreement would improve market performance, that the agreement be necessary to improve market performance, and that the agreement would not give the firms involved power over price or interfere with competition from firms not party to the agreement. Article 66(7) gave the High Authority the right to consult with a national government if a private or public enterprise used a dominant position in ways contrary to the purposes of the Treaty. After such consultation, if need remained, the High Authority was to take measures to prevent such use of a dominant position.

This combination of the prohibition and abuse control approaches was arrived at through a complex interaction of French strategic interests, changing Allied intentions regarding the postwar structure of West German industry, and German pursuit of a restored place among the community of nations. This interaction had a ripple effect on postwar German competition law, which in turn had its own direct effect on EC competition policy.

In the immediate postwar period, deconcentration of German industry – breaking up large firms in general and the vertically-integrated coal and steel firms of the Ruhr region of Germany in particular – was a goal of the occupation forces,[215] because of a widespread perception that German heavy industry had played a role in leading Germany, and the world, into war.[216]

The initial U.S. desire to put in place a less vertically integrated and a less horizontally concentrated supply-side market structure in the Ruhr suited French interests. Breaking the link between Ruhr coal and steel operations would ensure that France would have access to German coal to fuel its steel plants. Deconcentrating the Ruhr steel sector would make it easier for French steel firms to market processed steel in Germany.[217]

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[214] The U.S. Celler-Kefauver Act was signed five months before the ECSC (Paris) Treaty, but it was an ex post merger control measure.

[215] See Djelic, *Exporting the American Model*, pp. 81-86.

[216] Comments by Senator Kefauver to this effect, during debate on the Celler-Kefauver amendments to Section 7 of the Clayton Act, are quoted above. See also Walter Adams *Public policy in a free enterprise economy* in Walter Adams, editor, The Structure of American Industry (1961, pp. 533-563, and in later editions).

[217] See Haas, *The Uniting of Europe: Political, Economic and Social Forces 1950-1957* (1958), p. 242, and Lynch *Resolving the paradox of the Monnet Plan: national and international planning in French reconstruction* 37 Economic History Review 37 229 (1984).

Looking backward, a modern economist would be inclined to remark that market structure and firm structure are both endogenous, determined by economic forces. It seems likely that a strong efficiency case could be made for vertical integration of Ruhr coal and steel. Lower costs would be expected to give the firms enjoying such costs a competitive advantage, precisely the kind of advantage that a market system is expected to facilitate.[218]

On a parallel track, the initial reaction of many American observers was that the proposed Coal and Steel Community would simply be a cover for the revival of pre-war cartels. American support was essential to get the ECSC going; American hard currency was essential for French domestic investment programs. To placate American concerns, Monnet drew upon the services of Robert Bowie, an American with antitrust expertise serving as General Counsel to the American High Commissioner for Germany. Bowie wrote the first draft of the two competition law articles of the Treaty of Paris, Articles 65 and 66, based on the American experience concerning restrictive commercial practices, cartels, and monopoly.[219] Bowie's drafts were rewritten in French by Maurice Lagrange.[220] Bowie says (1981, p. 6) "Lagrange … put them into French treaty language." In retrospect, it seems evident that more than mere translation was involved. Abuse control exceptions, of the type that appear in Article 81(3), were unknown to U.S. antitrust.

Monnet needed the competition policy provisions to address American concerns. Germany would not agree to the competition policy provisions until the decartelization and vertical dis-integration decrees were settled.[221] This impasse was resolved, under intense American pressure, when Germany accepted an agreement calling for some

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[218] This is not the place for a comprehensive discussion of the workings of the ECSC (for one such effort, see Martin, *First steps*). But, as modern theories of trade in imperfectly competitive markets suggest, it appears that firms in different ECSC member states specialized in the production of different types of steel; whatever cost advantage Ruhr firms might have had did not permit them to take over the entire supply side of the ECSC steel sector (Michael Adler *Specialization in the European Coal and Steel Community* 8 Journal of Common Market Studies 175 (1969–70).).

[219] Albert Coppé (*Welcoming remarks* in American Bar Association Proceedings Conference on Antitrust and the European Communities 238 (1963)) states that Articles 65 and 66 "were written in Washington and exported with Marshall Aid around 1951." For Volker R. Berghahn (*The Americanisation of West German Industry 1945–1973* (1986) at 144) "It is certain that Washington, represented by McCloy and his cartel expert Robert Bowie of Harvard insisted more than once on a particular wording of individual articles." See also Pierre Uri *Penser Pour l'Action*. (1991).

[220] Robert R. Bowie *Interview, 15 June 1981*. Transcript on file at the Fondation Jean Monnet pour l'Europe, Lausanne and *Réflexions sur Jean Monnet* in Témoignages à la mémoire de Jean Monnet 81 (1989); Maurice Lagrange *Interview, 23 September 1980* Transcript on file with the Fondation Jean Monnet Pour l'Europe, Lausanne; William Diebold *A personal note* in K. Schwabe editor Die Anfänge des Schumanplanes 1950/51. The Beginnings of the Schuman Plan 23 (1988).

[221] Griffiths *The Schuman Plan Negotiations: the economic clauses* in K. Schwabe (ed), Die Anfänge des Schumanplanes 1950/51. The Beginnings of the Schuman Plan 35 (1988); Lynch *The role of Jean Monnet in setting up the European Coal and Steel Community* in K. Schwabe (ed), Die Anfänge des Schumanplanes 1950/51. The Beginnings of the Schuman Plan 117 (1988); Schwabe *»Ein Akt konstrucktiver Staatskunst« -- die USA und die Anfänge des Schuman-Plan* in K. Schwabe (ed), Die Anfänge des Schumanplanes 1950/51. The Beginnings of the Schuman Plan 211 (1988); Djelic *Exporting the American Model: the Postwar Transformation of European Business* (1998)..

vertical dis-integration, a limitation of self-supply by remaining vertically-integrated Ruhr firms, and abolition of the Deutscher Kohlen-Verkauf, the major Ruhr coal joint sales agency. Monnet got the competition policy provisions that he and the Americans wanted, and Germany got international agreement that its firms would operate according to the same rules as all other firms in the Coal and Steel Community.

3.3 Postwar German Competition Policy[222]

Monnet later wrote of the ECSC competition articles[223] "For Europe, they were a fundamental innovation; the extensive antitrust legislation now applied by the European Community essentially derives from those few lines in the Schuman Treaty." But the competition policy clauses of the ECSC Treaty, related as they were to U.S. antitrust, were not the only influence on EC competition policy.

The Ordo School was active in immediate postwar efforts to put a German competition policy into place. In 1949, a committee that included Franz Böhm among its members proposed a competition law that would prohibit cartels, control mergers, and authorize an independent government agency to make and implement deconcentration measures.[224] The ensuing legislative debate pitted adherents of the Ordo School against supporters of an abuse policy.[225] It resulted in the Law against Limitations on Competition (*Gesetz gegen Wettbewerbs-beschränkungen*), adopted in July 1957 and effective (like the Treaties of Rome) from 1 January 1958. Out of political necessity, it combined Ordo and abuse control themes:[226]

> In contrast to Franz Böhm's draft, the Law Against Restraints of Competition which was, in fact, enacted in July 1957 … was a compromise. It contains in Section 1 a general proscription of horizontal arrangements in restraint of trade, but this proscription is significantly watered down by the exemptions in Sections 2-8. The most important exemptions concern export cartels, specialization cartels and forms of cooperation between small and medium-size firms.

As regards single-firm exercise of market power, the link to the interwar European approach is evident:[227] "…while U.S. law prohibits firms from deliberately attaining (or attempting to attain) monopolistic power, the GWB condemns only the abusive use of market-dominant power."

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[222] See Theodore F. Marburg *Government and business in Germany: public policy toward cartels* 38 Business History Review 78 (1964), Gerber, *Law and the abuse*, Wendy Asbeek Brusse and Richard T. Griffiths *The management of markets: business, governments and cartels in post-war Europe* in Ulf Olsson, editor Business and European Integration since 1800 162 (1997), Sullivan and Fikentscher, *On the growth*, and Buxbaum, *German legal culture*.
[223] Jean Monnet *Mémoires* (1976) at 413; English translation (1978) at 353.
[224] Möschel, *Competition policy,* pp. 149–150.
[225] Brusse and Griffiths, *op. cit*., p. 177
[226] Möschel, *Competition policy*, p. 150; see also Marberg, *Government and business in Germany*, p. 91.
[227] Buxbaum, *German legal culture*, p. 7.

3.4 European Economic Community

3.4.1 The Spaak Report

The integration process embodied by the ECSC went off track with the 1954 rejection of the European Defense Community and consequent failure of the European Political Community.[228] It came back on track with the 1956 Spaak Report,[229] which prepared the way for the 1957 Treaties of Rome, the EEC, and Euratom.

The Spaak Report carried over from the ECSC Treaty a condemnation of discrimination in price and other contractual terms, now based on hostility toward market division along national lines:[230]

> Le marché commun ne conduirait pas par lui-même à la repartition la plus rationnelle des activités si les fournisseurs gardaient la possibilité d'approvisionner les utilisateurs à des conditions différentes, en particulier suivant leur nationalité ou le pays de leur residence. C'est dans ces termes que se pose le problème de la discrimination.

The economic model implicit in the Spaak Report was that to the extent that market integration would bring competition, it would eliminate the possibility of discrimination. Discrimination would remain an issue, therefore, to the extent that there was joint or single-firm[231] exercise of market power:[232]

> …l'élimination des obstacles aux échanges fera disparaître les possibilités de discrimination d'entreprises en concurrence entre elles. Le problème ne subsiste que du fait des entreprises qui, soit par leurs dimensions, soit par leur spécialisation, soit par les ententes qu'elles auraient conclues, jouissent d'une position de monopole. L'action contre la discrimination rejoint donc celle qui sera nécessaire contre la formation de monopoles à l'intérieur du marché commun.

Thus, the Spaak Report concluded, an economic community would need a competition policy able to deal with both joint and single-firm market power.

Just as price discrimination might give one firm an artificial advantage over another, so might targeted state aid. In the name of undistorted competition in the common market, therefore, state aid would be subject to community competition policy:[233]

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[228] Richard T. Griffiths *Europe's first constitution: the European Political Community, 1952–1954* in Stephen Martin, editor. The Construction of Europe: Essays in Honour of Emile Noël 19 (1994).
[229] Comité Intergouvernemental créé par la Conférence de Messine *Rapport des Chefs de Délegation aux Ministres des Affairs Etrangères* (*Spaak Report*) (1956).
[230] *Ibid*., p. 53.
[231] Here I use the term "firm" to designate an activity, public or private, on the supply side of a market.
[232] *Ibid*., p. 55.
[233] *Ibid*., p. 57.

> La règle générale est que sont incompatibles avec le marché commun les aides, sous quelque forme qu'elles soient accordées, qui faussent la concurrence et la répartition des activités en favorisant certaines entreprises au certaines productions.

3.4.2 The EC Treaty: Competition, Integration, Freedom.

The Spaak Report recommendations were reflected in the provisions of the EC Treaty. Article 81(1)[234] prohibits agreements that affect trade between the Member States and have the object or effect of preventing, restricting, or distorting competition on the ground that they are incompatible with the common market. Article 81(3) allows exceptions to the Article 81(1) prohibition for agreements that improve production or distribution, or promote technical or economic progress, provided among other conditions that a fair share of the benefits generated by the agreement goes to consumers.

Article 82 prohibits abuse – by one or more firms – of a dominant market position. This provision is very likely a combination of provisions in the ECSC Treaty (dominant position) and the draft German competition law (abuse).[235] The nonexhaustive list of examples of abuse given in the treaty includes imposing unfair trading conditions, limiting production or technical development "to the prejudice of consumers," discrimination that places some trading parties at a competitive disadvantage, and conditioning contractual agreement on the acceptance of terms which "by their nature or according to commercial usage" are not connected with the object of the contract.

Articles 86, 87, and 88 of the EC Treaty set rules for actions of the Member States toward the business sector. Article 86 specifies that EC competition policy applies to public enterprises and to private enterprises that are given specific missions by a Member State. Article 87(1) prohibits Member State aid to business, if the aid distorts or threatens to distort competition. Article 87(3) allows exceptions to the Article 87(1) prohibition for aid that promotes regional and other specified types of development.

In 1963, EC Competition Commissioner Hans von der Groeben highlighted three purposes of EC competition policy: to prevent firms or member states from erecting barriers to trade to replace those dismantled by the EC, to promote integration, and[236] "to safeguard an economic and social order based on freedom" for businessmen, consumers, and workers. He saw these three goals – competition, integration, and freedom – as mutually consistent. The Commission has similarly emphasized the efficiency aspects of free competition:[237]

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[234] I refer to the paragraphs of the EC Treaty as renumbered by the 1997 Treaty of Amsterdam.

[235] L. Focsaneanu *La notion d'abus dans le système de l'article 86 du traité instituant la Communauté Économique Européenne* in J. A. van Damme, editor Regulating the Behavior of Monopolies and Dominant Undertakings in Community Law 324 (1977).

[236] Hans von der Groeben *The role of competition in the Common Market* in American Bar Association Proceedings Conference on Antitrust and the European Communities 14 (1963) at 18.

[237] EC Commission *First Report on Competition Policy* 11 (1972).

> Competition is the best stimulant of economic activity since it guarantees the widest possible freedom of action to all. An active competition policy …makes it easier for the supply and demand structures continually to adjust to technological development. Through the interplay of decentralized decision-making machinery, competition enables enterprises continuously to improve their efficiency, which is the *sine qua non* for a steady improvement in living standards and employment prospects within … the Community.

The place given to maintaining freedom of action, by Commissioner von der Groeben and by the Commission, shows the impact of Ordoliberal thinking on EC competition policy. The Article 81(1) prohibition of agreements that distort competition shows the U.S. influence. The discretionary exceptions to the Article 81(1) prohibition show the presence of the abuse control approach (as does Article 87(3)).

With effect from 1 May, 2004, Regulation 1/2003 establishes[238] a decentralized framework for enforcement of Articles 81 and 82. This change provided an occasion for the Commission to update policy statements on the content and administration of the Treaty provisions.

The Commission's Guidelines on the Application of Article 81(3)[239] include, in paragraph 13, a statement of the general purposes of Article 81:

> The objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. Competition and market integration serve these ends since the creation and preservation of an open single market promotes an efficient allocation of resources throughout the Community for the benefit of consumers.

Here we find – as one would expect based on the Treaty provisions themselves – protection of competition, consumer welfare, and promotion of market integration ("an open single market"). The paragraph that follows includes a reaffirmation of the Ordoliberal commitment to freedom of action:[240]

> A general principle underlying Article 81(1) which is expressed in the case law of the Community Courts is that each economic operator must determine independently the policy, which he intends to adopt on the market.

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[238] In place of the prior notification approach embodied in Council Regulation No. 17/62 OJ 13/204 21 September 1962, as variously amended.

[239] OJ C 101 27 April 2004, pp. 97–118.

[240] Footnote omitted. The European Court of Justice finds the same purpose in EU competition policy (*Suiker Unie* [1975] ECR 1663 at 1942): "The criteria of coordination and cooperation … must be understood in the light of the concept inherent in the provisions of the Treaty relating to competition that each economic operator must determine independently the policy which he intends to adopt on the common market."

Regarding the Article 81(3) exemption, which the Regulation makes directly applicable, the Guidelines show its abuse control ancestry:[241]

> Agreements that restrict competition may at the same time have pro-competitive effects by way of efficiency gains. … When the pro-competitive effects of an agreement outweigh its anti-competitive effects the agreement is on balance pro-competitive and compatible with the objectives of the Community competition rules. The net effect of such agreements is to promote the very essence of the competitive process, namely to win customers by offering better products or better prices than those offered by rivals. … Article 81(3) … expressly acknowledges that restrictive agreements may generate objective economic benefits so as to outweigh the negative effects of the restriction of competition.

Community practice treats interbrand and intrabrand competition as both important in determining market performance. The Commission's Vertical Restraints Guidelines state in paragraph 6 that:[242]

> For most vertical restraints, competition concerns can only arise if there is insufficient inter-brand competition, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels. *If there is insufficient inter-brand competition, the protection of inter- and intra-brand competition becomes important.*

The Vertical Restraints Block Exemption Regulation[243] defines categories of vertical contracts that qualify for the Article 81(3) exemption. The exemption is generally available to firms that are sufficiently small, with size measure in terms of turnover or market share. But the block exemption does not apply to vertical contracts that restrict a distributor's right to set its own prices or the areas/customers to which it may sell.

Similarly, the block exemption regulation for technology transfer agreements[244] exempts certain categories of technology transfer agreements from the Article 81(1) prohibition, subject first to market share limitations and second provided that clauses unduly limiting the freedom of action of a licensee (price fixing, for example, or restrictions on a licensee's options in licensing improvements to the licensed technology) are absent.

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[241] Paragraph 33; footnotes omitted.

[242] OJ C 291/1 13 October 2000, emphasis added. See also, in the *First Report on Competition Policy*, ¶ 46): " … parallel imports … should constitute a corrective factor for excessive prices imposed by an exclusive concession holder. … The possibility of parallel imports helps to ensure that users will have a fair share of the advantages accruing from exclusive dealing…."

[243] Commission Regulation (EC) No 2790/1999 of 22 December 1999 OJ L 336/21 29 December 1999.

[244] Commission Regulation (EC) No 772/2004 of 27 April 2004 OJ L 123/11 27 April 2004.

Regarding dominant firm behavior, in its *United Brands* decision,[245] the European Court of Justice wrote that Article 82 serves the Community goal of instituting "a system ensuring that competition in the Common Market is not distorted," and that:[246]

> The dominant position referred to in [Article 82] relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.

A year later, in *Hoffman-La Roche*, the Court essentially repeated its characterization of dominance from United Brands, and added:[247]

> [A dominant] position does not preclude some competition, … but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment.

One of the reasons United Brands found itself dealing with EC competition authorities was that it charged different wholesale prices to distributors located in different member states, although the record suggested that the costs of supplying the different markets were comparable. For the European Commission, these price differences were themselves an abuse of a dominant position. United Brand's reaction was that ([1978] ECR 207 at 249):

> It is important to understand what is really involved in the Commission's argument that [United Brands] have committed an abuse in this respect. What it amounts to is that it is the duty of an undertaking in a dominant position to create a single market out of the existing national markets and that if it fails to act accordingly it is guilty of an abuse.

Essentially, United Brands argued that it was simply acting as a profit-maximizing firm in distinct local markets. The European Court of Justice agreed that it was not the responsibility of United Brands to establish a single market.[248] But it also wrote that the interplay of supply and demand should take place at each vertical level in the distribution chain: at a lower level between United Brands and distributors, at a higher level between distributors and final consumers. As a dominant firm, UBC committed an abuse if it imposed terms that gave it, rather than distributors, most of the available profit.

One interpretation of the ECJ's ruling is the one that United put forward: it was obliged to act as if it operated in a single market. Another interpretation is that it was

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[245] United Brands Company and United Brands Continental BV *v*. EC Commission 1978 ECR 207.
[246] 1978 ECR 277.
[247] 1979 ECR 520.
[248] 1978 ECR 207 at 298.

obliged, under Article 82, to act as if it were supplying a market competitive enough so that it could not engage in price discrimination. The latter interpretation suggests a link between EC competition policy and the Ordo "as-if" approach.

Hoffman-La Roche, on the other hand, found itself defending fidelity rebate contracts that made the rebate to which a client was entitled a function of the client's combined purchases of a number of different vitamins, each of which constituted a different product market. For the European Court of Justice, one reason such contracts were an abuse of a dominant position was because they limited the client's freedom of action:[249]

> Obligations of this kind … are incompatible with the objective of undistorted competition within the Common Market because … they are not based on an economic transaction which justifies this burden or benefit but *are designed to deprive the purchaser of or restrict his possible choices of sources of supply* and to deny other producers access to the market.

The impact on entry conditions was a distinct element of abuse:[250]

> … Article [82] … covers not only abuse which may directly prejudice consumers but also abuse which indirectly prejudices them by impairing the effective competitive structure as envisaged by Article 3(f) of the Treaty.

A dominant firm may commit abuse in violation of Article 82, even absent price discrimination or exclusionary behavior, if it charges unfair prices. The Commission, for example, condemned British Leyland for charging substantially higher license fees to UK customers importing vehicles from the continent than to purchasers of corresponding vehicles in the UK. The European Court of Justice upheld the Commission decision on the ground that a firm in a dominant position committed an abuse if it charged[251] "fees which are disproportionate to the economic value of the service provided."

Characterization of a price as unfair requires a normative standard.[252] It is not clear that any standard other than a noncooperative price – price set or output decided independently – can be effectively administered.[253] The Commission has recognized

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[249] 1979 ECR 540, emphasis added.
[250] 1979 ECR 553.
[251] British Leyland Ltd v. Commission [1986] ECR 3263; here the Court refers to an earlier statement in General Motors Continental v. Commission 1975 ECR 1367.
[252] See the discussion, above, of Leonhard Miksch's contributions to the Ordoliberal School.
[253] Here I simply sketch some of the issues. If in a perfectly competitive market, all firms have identical U-shaped cost curves, each firm maximizes profit in the short-run by producing an output that makes its marginal cost equal to a market price which, in the model, is determined by a Walrasian auctioneer. Most real-world markets operate without institutions that are functionally equivalent to such an auctioneer. In such markets (as emphasized by Arrow, *Toward a theory*), firms must set and change prices, at least out of equilibrium. Given this behavior by firms, consumers will search before they buy. The properties of search models are often quite different from those of the standard model of perfect competition. Even with identical U-shaped cost curves, short-run competitive equilibrium prices may differ from average cost, and

some of these difficulties.[254] In a discussion of the relation between competition policy and inflation, the Commission wrote:[255]

> [M]easures to halt the abuse of dominant positions cannot be converted into systematic monitoring of prices. In proceedings against abuse consisting of charging excessively high prices, it is difficult to tell whether in any given case an abusive price has been set for there is no objective way of establishing exactly what price covers costs plus a reasonable margin.

It would be possible to define prices set jointly by firms, some of which individually or all of which in combination enjoy a dominant position, as unfair and abusive in the sense of Article 82. The setting of such prices would presumably offend Article 81 as well as Article 82.

In application, therefore, Treaty competition policy provisions toward business behavior combine something very much like U.S. antitrust's principle of competition with abuse control and elements of Ordo thought. The maximization of consumer welfare and the pursuit of market integration are seen as being broadly consistent, and both are served by a policy of promoting competition.

3.4.3 State Aid

The bases for control of State aid by the European Commission are Articles 87–89 of the EC Treaty. Article 87(1) declares that Member State aid which distorts competition and affects trade among Member States is incompatible with the common market. Mandatory exceptions (among which, aid motivated by natural disasters) to this rule are provided for in Article 87(2), with discretionary exceptions in Article 87(3). These include, subject to Commission approval, aid to promote economic development, aid for projects of common European interest, and aid to promote culture.

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price-taking firms may make economic profits or economic losses. It seems doubtful that the "undistorted competition" of the EC Treaty should be taken to mean a perfectly competitive market.

If in a perfectly competitive market firms have U-shaped cost curves but those cost curves are not identical, the equilibrium price is the marginal cost of the least efficient firm with positive output. The accounting profit of some or all inframarginal firms will consist, in part, of Ricardian efficiency rents that are not economic profit. Thus a dominant firm that is asked to set a short-run competitive equilibrium price would require information about rivals' cost functions in order to do so. One might be tempted to cut through these issues by requiring a firm in a dominant position to set a price equal to marginal (or perhaps average, for reasons of practicality) cost. But marginal *economic* cost includes a normal rate of return investment, which will vary across markets with, for example, risk. Etc.

[254] As have others, for example Joan Bodoff *Competition policies of the US and the EEC: an overview* 5 European Competition Law Review 51 (1984), Eleanor M. Fox *Monopolization and dominance in the United States and the European Community: efficiency, opportunity, and fairness* 61 Notre Dame Law Review 981 (1986), and Erik Pijnacker Hordijk *Excessive pricing under EC competition law; an update in the light of Dutch developments* in Barry Hawk, Editor International Antitrust Law and Policy 463 (2002). See also Gerber, *Law and the abuse*, who emphasizes the German experience.

[255] *Fifth Report on Competition Policy* 13 (1976).

The Community authority to control state aid is seen as essential for the market integration process. Competition on the merits among rival firms based in different Member States would be upset if some such firms were to benefit from operating subsidies by their home governments.[256] At the same time, market integration requires adjustments in market structure. Aid for such adjustment, to firms and to their employees, may serve to spread adjustment costs throughout society. Permitting state aid in such circumstances is akin to the abuse control approach to interfirm cooperation.

3.4.3 Merger Control

Despite the strict merger control regime that was part of the ECSC Treaty, the EC Treaty had no specific merger control provision. The Commission called for merger control powers as early as its *Third Report on Competition Policy*. In so doing, it recognized the endogeneity of market structure, that the process of market integration would in itself lead to an increase in supply-side concentration, and highlighted its own responsibility to maintain undistorted competition:[257]

> [T]he process of industrial concentration is on the increase. The causes lie largely in the desire and need of Community firms to adapt constantly to the new scale of their markets and to improve their competitiveness on the world market. Many mergers, as a result of the structure of the markets in which they occur, in no way lessen competition but, on the contrary, can increase it. However, the Commission cannot overlook that the EEC Treaty … requires it to preserve the unity of the common market, to ensure that the market remains open and ensure effective competition. *Excessive* concentration is likely to obstruct these aims.

The Commission's particular concern was for mergers that would create dominant positions, for the impact such positions would have on market performance and for the strategic entry-deterring behavior they would make possible (1974, p. 32):[258]

> The effects of mergers are particularly serious because the merger brings about an irreversible alteration of the structure of the market. Once a dominant position is attained, then substantial competition from the remaining firms on the market is not as a rule to be expected . . . Furthermore, dominant firms are often in a position to prevent new competitors from entering the market.

The Council of Ministers, representing the interests of the Member States, was more interested in promoting European champions than in having the Commission police EC market structures. But as market integration went forward, the advantages of a one-stop

[256] The economic arguments are similar to those that arise in the strategic trade policy literature. See Stephen Martin and Paola Valbonesi *State aid to business* in Patrizio Bianchi and Sandrine Labory, editors, International Handbook on Industrial Policy. Edward Elgar, 2006.
[257] *Third Report on Competition Policy* 28–29 (1974), emphasis in original.
[258] *Ibid*., p. 32.

merger control shop became apparent to European business, which found itself in the position of having to obtain clearance for cross-border mergers from multiple national competition authorities. Further, the European Court of Justice made clear that Articles 81 and 82 could, under some circumstances, be applied to mergers (concentrations).[259]

Faced with business support for Community-level merger control and with the reality that the Commission had some merger-control authority in any case, the Council endorsed a specific merger control regulation on 21 December 1989. In the *19th Report on Competition Policy*, the Commission described the purposes of the Merger Control Regulation (MCR) by emphasizing the same factors that it had 16 years before:[260]

> The process of restructuring European industry has given rise and will continue to give rise to a wave of mergers. Although many such mergers have not posed any problems from the competition point of view, it must be ensured that they do not in the long run jeopardize the competition process, which lies at the heart of the common market …

As one element in a broad modernization package, the 1989 Merger Control Regulation (which had been amended several times) was replaced in January 2004.[261] The new MCR expands the coverage of EC merger control by adding a “significant lessening of competition” test to the focus on dominance. The new Merger Control Regulation provides, in Article 2(3), that

> A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market.

Use of the significant lessening of competition test is intended to extend the coverage of EC merger control to cases in which a merger will eliminate a significant competitive constraint without creating a dominant position, reinforcing an existing dominant position, or permitting joint oligopoly dominance.[262]

The importance of a commitment to competition is evident in the Merger Control Regulation, as it is in the Treaty competition policy provisions.

4 Normative Issues[263]

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[259] See Simon Bulmer *Institutions and policy change in the European Communities: the case of merger control* 72 Public Administration 423 (1994), Tim Büthe and Gabriel T. Swank *The politics of antitrust and merger review in the European Union: institutional change and decisions from Messina to 2004* (1 December 2005).
[260] 1990, at 33–34.
[261] Council Regulation (EC) No 139/2004 of 20 January 2004 OJ L 24/1 29 January 2004.
[262] Phillip Lowe *Current issues of EU competition law – the new competition enforcement regime* 24 Northwestern Journal of International Law and Business 567 (Spring 2004) at 577.
[263] For discussions, see Paul Streeten *Appendix: recent controversies* in Gunnar Myrdal The Political Element in the Development of Economic Theory 208. Translated from the German by Paul Streeten

The discussion to this point has been positive: What have the goals of antitrust been? Here the discussion turns to the normative: What does economics, as a science, say about what the goals of antitrust should be?

Returning for concreteness to the discussion of welfare standards in Section 2.5.3, one might write a generalized static measure (G) of the performance of a particular industry as a weighted sum of consumer surplus (CS) and economic profit (π):[264, 265]

$$G = \theta_1 CS + \theta_2 \pi. \qquad (2)$$

If the weights used are $\theta_1 = \theta_2 = 1$, G is the net social welfare standard that was advocated by Bork (*Antitrust Paradox*) under another name. If $\theta_1 = 1$, $\theta_2 = 0$, G measures performance by consumer welfare in the sense of the welfare of consumers.

Despite substantive anticipations,[266] the modern literature relevant to this topic[267] begins with Robbins.[268] Looking back on his seminal contribution, Robbins emphasized

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(1965) and Jules L. Coleman *Efficiency, utility, and wealth maximization* 8 Hofstra Law Review 512 (1979).

264 (2) is a simplification that serves to frame the issues. Even confining attention to a static context, a competition authority considering a proposed merger might wish to give some weight to efficiency effects. The welfare impact of a merger would then be measured by (with "Δ" denoting a change in the indicated variable and C the change, attributable to the merger, in the cost of production of the post-merger output):

$$\theta_1 \Delta CS + \theta_2 \Delta \pi + \theta_3 \Delta C. \qquad (1)$$

If cost savings due to a merger are considered an efficiency rent, they would be part of accounting profit but not of economic profit. $\theta_1 = \theta_2 = 1$, $\theta_3 = -1$ would give all welfare changes equal weight. (Recall that for a cost saving, ΔC is negative.)

For many, if not all, market performance issues, a dynamic perspective is essential (this is certainly true for questions relating to the overlap between antitrust/competition policy and intellectual property policy, to R&D joint ventures, and to the (alleged) Schumpeterian tradeoff between static market performance and the rate of technological progress). To deal with such matters would require working with performance measures that are the expected present-discounted value of (2) or (1).

265 There is also the point that one might wish to measure market performance in different ways for different purposes. To assess the impact of a prospective merger of two firms that operate in the same industry, one wants in the first instance some measure of the performance of that industry. This explains the partial equilibrium focus that dominates models of applied industrial economics. But a competition authority deciding how to allocate scarce enforcement resources across different industries must compare the expected marginal improvement in performance from devoting an additional unit of enforcement resources to different industries. A global (general equilibrium) performance measure is then called for. Simply adding partial equilibrium performance measures, industry by industry, will not do, as such a procedure would lead to a form of double counting, the profit of the owners of firms being counted once in the industries where the profit is earned and any consumer surplus being counted in industries where the profit is spent (see footnote 76).

266 See John S. Chipman and James C. Moore *The new welfare economics 1939-1974* 19 International Economic Review 547 (1978), footnote 2, for references.

267 This literature is not directly concerned with the consequences of the private exercise of market power or with government policy toward such private conduct. It discusses mainly means of evaluating the impact of government policies on market performance. The recurring example is the consequences of the repeal of the Corn Laws for the welfare of landowners as opposed to welfare of other groups and of society as a

the distinction between positive economics, statements about what is, and normative economics, statements about what ought to be. For Robbins, the positive statements of economics are value neutral, normative statements are not:[269]

> How desirable it would be if we were able to pronounce as *a matter of scientific demonstration* that such and such a policy was good or bad. Take, for example, the removal of the protective tariff. Given information about the elasticities of demand and supply of the immediate past, we can certainly make guesses, in price and income terms, about the gains to consumers and the losses to producers of the probably outcome. … the guesses, such as they are, are on an objective plane. But as soon as we move to the plane of welfare, we introduce elements which are not of that order. … we are assuming that comparisons between prices and incomes before and after the event can be made a verifiable basis for comparisons between the satisfactions and dissatisfactions of the different persons involved. And that, I would urge, is not warranted by anything which is legitimately assumed by scientific economics.

Robbins did not urge that economists should refrain from making value-laden policy recommendations. His view was that normative statements inherently involved positions about values (in the case of (2), views on the values of θ_1 and θ_2), and that the positions underlying a normative statement should be made explicit.

Kaldor pointed out that if repeal of the Corn Laws reduced landowners' incomes and increased the incomes of other producers, the government could restore the original income distribution by taxing those whose income had gone up and using the receipts to make up the landowners' losses. If other producers' income was higher even after the taxes, the net effect was positive:[270]

> In all cases, therefore, where a certain policy leads to an increase in physical productivity, and thus of aggregate real income, the economist's case for the policy is quite unaffected by the question of the comparability of individual satisfactions; since in all such cases it is possible to make everybody better off than before, or at any rate to make some people better off without making anybody worse off.

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whole. For a partial exception, see J. R. Hicks *The rehabilitation of consumers' surplus* 8 Review of Economic Studies 108 (1941).. Damien J. Neven and Lars-Hendrik Röller *Consumer surplus vs. welfare standard in a political economy model of merger control* 23 International Journal of Industrial Organization 829 (2005) present a principal-agent model of merger control, in which a competition authority is given either a net social welfare or a consumer welfare objective function. They assess performance by an expression for net social welfare that includes lobbying costs (their equation (2)).

[268] Lionel Robbins *An Essay on the Nature and Significance of Economic Science* (1932); see also *Interpersonal comparisons of utility: a comment* 48 Economic Journal 635 (1938).

[269] *Economics and political economy* 71 American Economic Review 1 (1981) at 4.

[270] Nicolas Kaldor *Welfare propositions of economics and interpersonal comparisons of utility* 49 Economic Journal 549 (1939) at 550.

Hicks argued the side of the compensation approach, but stood back from the question whether compensation should in fact be made:[271]

> I do not contend that there is any ground for saying that compensation ought always to be given; whether or not compensation should be given in any particular case is a question of distribution, upon which there cannot be identity of interest, and so there cannot be any generally acceptable principle.

His purpose in advancing what has come to be called the Potential Compensation Principle was to separate questions of value and questions of distribution:[272]

> If measures making for efficiency are to have a fair chance, it is extremely desirable that they should be freed from distributive complications as much as possible.

The position of Robbins (and others) was that no such separation was possible. An extensive dialog followed. It is summarized and extended by Chipman and Moore, who write:[273]

> The basic tenet of the New Welfare Economics, as put forward by Kaldor and Hicks, seems to have been that compensation tests could provide a valid basis for making policy recommendations that were free of value judgments, even though the contemplated compensation payments might not actually take place. Unfortunately … the welfare criteria suggested by Kaldor and Hicks, even with the qualifications added by Scitovsky and Kuznets, could not escape the possibility of giving rise to an inconsistent sequence of policy recommendations, unless either the distribution of income and wealth or the forms and degree of dissimilarity of consumers' preferences were assumed to be suitably restricted.

and conclude:[274]

> After 35 years of technical discussions, we are forced to come back to Robbins' 1932 position. We cannot make policy recommendations except on the basis of value judgments, and these value judgments should be made explicit.

Like Robbins, the argument I make here is not that economists should not give policy advice; nor is it that economists should not give policy advice to competition authorities

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[271] J. R. Hicks *The foundations of welfare economics*. 49 Economic Journal 696 (1939) at 711. EC control of aid by the Member States may be viewed as a way of regulating actual compensation for group or sectoral welfare losses resulting from market integration. Of course, there are other ways to view state aid.
[272] *Ibid*., 712.
[273] *Op. cit*., 578.
[274] *Op. cit*., 581. Murray C. Kemp and Paul Pezanis-Christou *Pareto's compensation principle* 16 Social Choice and Welfare 441 (1999) at 441 refer to "ill-fated … principles of hypothetical compensation."

based on giving equal weight to consumer and producer surplus. It is that (a) whatever weights are given to consumer and producer surplus (or to non-economic variables thought to enter into the enforcement agency's objective function) should be made explicit, and (b) a specification of equal weights may be justified on ethical or other grounds, but cannot be justified as a result of economic science.

Economics simply has nothing to say, as a science, about whether antitrust enforcers should seek to maximize consumer welfare or net social welfare, whether antidumping rules should favor some producers at the expense of other producers and consumers, or whether there should be programs of agricultural subsidies that lead to mountains of corn dotting the Midwest United States, lakes of wine in Europe, and deny less developed countries the benefits that trade on the merits might otherwise bring.[275] The economist as scientist can analyze the consequences of such policies for the welfare of various groups and for society as a whole. The economist as individual may, and very likely will, have personal preferences about such policies. But those are individual preferences, not professional conclusions.

5 Conclusion

Motivations behind passage of the Sherman Act included cynical political opportunism, nostalgia for a Jeffersonian golden age that never was, a concern to protect consumers from prices that included an element of economic profit, and a desire to obtain the benefits of large-scale enterprise (where it offered such benefits) while maintaining opportunities for efficient firms, small and large, to prosper if they were able to do so. The Clayton Act was conduct-oriented: largely based on the advice of John Bates Clark, it prohibited conduct thought to permit firms to exercise market power by interfering with the opportunity of other firms to submit themselves to the test of the marketplace. It intentionally excluded a structural approach to public control of private enterprise. Where the provisions of the Clayton Act were specific, those of the Federal Trade Commission Act, with its prohibition of unfair competition, are general.

The rule-setting role of government was accepted grudgingly, if at all, by the private sector. The 1920s saw a concerted effort to replace the *ex ante* prohibition approach of antitrust with an *ex post* abuse control approach. The approach failed, although the reaction against it both cemented economists' support for antitrust and shifted antitrust from a conduct to a structure orientation. The structural orientation was reinforced by the Celler-Kefauver Act, which instructed courts to block incipient anticompetitive concentration trends. Early and reasonably faithful applications of this congressional mandate evoked the reaction that courts had blocked mergers which were not, in and of themselves, anticompetitive. Perhaps because it would have been impolitic to argue that Congress and the President had adopted a poorly conceived economic policy, the Warren Court was often given credit for introducing policies that were in fact fully intended by Congress. A sequence of structurally-motivated antitrust decisions and academic

[275] Arnold C. Harberger *Three basic postulates for applied welfare economics: an interpretive essay* 9 Journal of Economic Literature 785 (1971) at 785.

criticism played itself out, with one result that both the Robinson-Patman Act and the Celler-Kefauver Act were reined back into a mainstream antitrust that pursues performance goals by focusing much more on conduct than performance. Another result is that mainstream antitrust decisions, while proclaiming their faithfulness to economic analysis, harbor a significantly distorted view of what it is that mainstream economic analysis has to say about the issues with which antitrust is concerned.

Antitrust seems now clearly to be a policy that aims at promoting the welfare of consumers. It is often assumed that other purposes are consistent with the maximization of the welfare of consumers. The legacy of the principle of competition remains strong:[276]

> While antitrust law may be moving in the direction of being construed as a "pure" consumer protection measure, cases such as *Otter Tail* strongly suggest that in the natural monopoly area, at least, the Supreme Court has not embraced this approach. The Court has instead stressed that the antitrust laws seek to protect competition … as well as to protect those activities that will promote competition. … The antitrust laws are concerned with the competitive process, and their application does not depend in each particular case upon the ultimate demonstrable consumer effect. A healthy and unimpaired competitive process is presumed to be in the consumer interest.

But the line of development followed by the vertical restraints cases suggests that if a case can be made that a restraint on competitive conduct will improve consumer welfare, antitrust will permit the restraint.

At the start of the European Economic Community, competition policy was seen as serving three roles:

- to prevent firms or member state governments from erecting barriers to trade in place of those dismantled by the Treaty of Rome;
- to allow market integration to proceed as a result of business decisions, not government directives;
- to safeguard "an economic and social order based on freedom" of businessmen, of consumers, and of workers.

To prevent firms from erecting barriers to competition was a purpose of U.S. antitrust, and remains such a purpose, with a sometime exception if the Supreme Court can be convinced that a restraint of competition improves market performance. The third goal of EC competition policy was certainly one of the original goals of U.S. antitrust; whether it continues as such is a subject of ongoing debate. In contrast, it is not part of U.S. antitrust policy, operating as it does within a federal system, to prevent states from erecting barriers to trade.

[276] Fishman *v*. Estate of Wirtz, 807 F.2d 520 at 536, footnotes omitted.

The abuse control elements of EC competition policy provide an indication of what an economic approach to US antitrust might become. Abuse control is only one aspect of EC competition policy, however, and its scope has always been limited by the overarching commitment to the promotion of market integration.

One way to view the differences between U.S. antitrust and EC competition policy is that they result primarily from life-cycle effects: U.S. antitrust began serving a range of goals, some economic in a narrow sense and some rooted more in political economy. As the U.S. economy matured, antitrust minimized its political and social goals and emphasized pursuit of good market performance in strictly economic senses. So, in the fullness of time, one might then expect, will EU competition policy.

Another view is possible, however. It is that public policy toward private enterprise inherently involves questions of political economy. In this view, what some students of U.S. antitrust present as an exclusive focus on economic welfare in fact amounts to taking one set of positions on questions of political economy. Some such positions, for example, give priority to competition among manufacturers over competition among distributors, deny the strategic consequences of decisions by dominant firms that raise rivals' costs, and favor strong property rights over narrowly defined pieces of intellectual property (in the face of compelling evidence that such an approach discourages innovation).

In this second view, it is EC competition policy that remains closer to the visions of John Bates Clark, Henry Simons, and the Ordoliberal School of a public policy toward business behavior that sets rules for private rivalry, and then lets that rivalry run its course.