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Preface

This book had its genesis in a series of articles, written over the past seven years, dealing with various problems in the legal and economic analysis of antitrust policy. Implicit in these articles, I have come to realize, is a thorough dissatisfaction with the existing state of antitrust and a reasonably detailed blueprint for its overhaul.

During the period in which these articles were appearing, the antitrust laws were achieving a level of prominence in public discussion such as they had not known since the days of Thurman Arnold in the early 1940s. The ITT "scandal," the filing by the Justice Department of well-publicized actions designed to break up IBM and AT&T, the explosion of private antitrust actions exemplified by the judgment (later reversed) of almost $300 million that Telex obtained against IBM, the growing tendency to attribute economic problems—recession, inflation, high gasoline prices, or whatever—to the conspiratorial machinations of Big Business, and the recent amendment to the Sherman Act making violation of the act a felony punishable by up to three years imprisonment and (in the case of corporate defendants) a $1 million fine—all have served to rivet the nation's attention on antitrust policy. But more than notoriety is involved. The reach of antitrust policy has broadened and its thrust has deepened, and in the process confusion about both its aims and methods has grown. The conventional tools of antitrust analysis have not stood up well under the pressures of rapid expansion of the role and importance of antitrust enforcement.

It seems timely, therefore, to try to place a distinctive approach to antitrust before a somewhat larger audience than the readership of the scholarly journals in which my articles on antitrust have appeared. I thought at first that the articles could be reprinted with few changes, but a rereading has convinced me that a collection of the unrevised articles would contain too much detail, too
much repetition, and too many gaps to sustain a coherent argument. What I have done instead is to take portions of some of the articles and revise them, rearrange them, and combine them with new material in order to create what I hope is a cohesive book.

Chapters 1–4 are new, although chapter 2 ("The Costs of Monopoly") draws on ideas developed more fully in an article published recently in the *Journal of Political Economy*; and chapter 4 ("Price Fixing and the Oligopoly Problem") draws heavily on my previous writings on the subject. Chapter 5 ("Breaking Up Large Firms") is a revised version of a previously published article on the subject, with the addition of heretofore unpublished empirical results. Chapter 6 ("Horizontal Mergers, Potential Competition, and Market Definition") reprints with some revisions two parts of a recent *Columbia Law Review* article; the section on market definition is new. Chapter 7 ("Collusion: Two Problems of Characterization") combines a revision of another part of the *Columbia Law Review* article with a previously unpublished analysis of the Supreme Court's decisions dealing with the exchange of information among competitors. Chapter 8 ("Exclusionary Practices, Real and Imagined") is a substantially revised and expanded version of a similarly titled article. Chapters 9 and 10 are entirely new, and the Appendix largely so.

5. However, it incorporates with minor revisions pp. 1598–1601 of my *Stanford Law Review* article, supra note 2.
8. However, the Appendix borrows a few pages from my *Journal of Political Economy* article, supra note 1.


The fundamental approach of the book can be described simply. It is to develop the implications for antitrust policy of the assumption that the proper purpose of the antitrust laws is to promote competition, as that term is understood in economics. This assumption is defended in chapter 2 and elsewhere throughout the book. In many cases the implications turn out to be startling ones. They lead me to propose fundamental changes in the antitrust principles governing collusion, mergers, exchanges of information among competitors, restrictions on competition in the distribution of products, monopolization, boycotts, and other traditional areas of antitrust doctrine. Since I believe that economics is relevant to the administration as well as the substance of antitrust policy, I am led also to propose fundamental changes in the criminal and other remedies by which we seek to obtain compliance with the rules of antitrust law.

The application of economics to antitrust law is of course not new, and much of the ground traversed in the following pages has been covered by other scholars before me. What I have tried to do in this book is to explain, extend, and in places revise the economic approach to antitrust law. Although the presentation throughout the text is nontechnical, the appendix at the end of
the book contains a slightly more technical treatment of a few of
the salient features of the theory of monopoly.
Although many topics are covered, the book is far from a
treatise on the antitrust laws. It does not touch all of the bases
of what has become an enormous field of law, nor does it exhaust
the analysis even of those topics that are discussed. The discussion
is limited to what seem to me to be the major problems in the
antitrust field, and in dealing with them I have attempted to go to
their heart and have ruthlessly ignored the peripheral areas. How-
ever, some topics are discussed in greater detail than others, and
in this respect the book reveals its origin in a series of articles
written for different audiences and occasions. At least one major
contemporary problem in antitrust is almost completely ignored
in the book—that of establishing the boundary between the anti-
trust laws and the other laws, including patent, labor, public-
utility and common-carrier laws, as well as the First Amendment,
that arguably exempt certain activities from the coverage of the
antitrust laws. A proper treatment of the antitrust exemptions
would require a detailed analysis of the purpose and scope of the
laws argued to establish the exemption, and such an analysis
would, I believe, carry author and reader too far away from the
central concerns of this book. Finally, there is only incidental
discussion of the Robinson-Patman Act, a major antitrust statute.
My ideas on antitrust have been greatly influenced over the
years by Aaron Director and George J. Stigler. I want to take this
opportunity once again to acknowledge my intellectual debts to
them while absolving them from responsibility for my conclusions
and recommendations, with which they may disagree. I also want
to thank Kenneth W. Dam, Harold Demsetz, William M. Landes,
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1 Introduction

To the layman a “law” is a rule written down in a book somewhere. The lawyer, however, realizes that the matter is frequently a good deal more complex. There are federal antitrust statutes, and they are quite brief and readable compared to the Internal Revenue Code. But their operative terms—“restraint of trade,” “substantially to lessen competition,” “monopolize”—are opaque; and the congressional debates and reports that preceded their enactment, and other relevant historical materials, only dimly illuminate the intended meaning of the key terms. The courts have spent many years interpreting, or perhaps more accurately supplying, their meaning, but the course of judicial interpretation has been so marked by contradiction and ambiguity as to leave the law in an exceedingly uncertain and fluid state. What is more, the rules of law as they are articulated and as they are applied to alter behavior are often, as is true in this instance, two quite different things. The rules in practice, as distinct from the theory, are critically affected by sanctions, by procedures, and by the policies and incentives of enforcers. Thus the situation in antitrust law is fluid and uncertain and is frequently in conflict with the legal theory, such as it is.

The antitrust field is in need of a thorough rethinking of both its substantive and administrative aspects, and the essential intellectual tool for this process of rethinking, I believe—besides simple logic and common sense, which are scarce commodities in this as in most fields—is the science of economics. The basic concern of the antitrust laws is with monopoly, which for many years economists have been studying intensively, free of the entanglements of precedents and legalism that prevent lawyers from rethinking a field of law from the ground up. The work of the economists provides at least a starting point for analysis. Since, unfortunately, they are not unanimous on the essential points of
the theory of monopoly, a necessary first step is to thread one's way through the doctrinal controversies that have surrounded and continue to affect the development of the theory. I will spare the reader the details of these controversies and will say simply that chapter 2 presents a version of the economic theory of monopoly that seems, to me at least, to represent its common core. Legal policy-makers should focus on the core, rather than try to pick and choose among the warring factions in the science. But that is not always possible, and I am well aware that the economic views presented in this book are in places highly controversial.

Chapter 2 argues that economic theory provides a firm basis for the belief that monopoly pricing, which results when firms create an artificial scarcity of their product and thereby drive price above its level under competition, is inefficient. Since efficiency is an important, although not the only, social value, this conclusion establishes a prima facie case for having an antitrust policy. It also implies the limitations of that policy: to the extent that efficiency is the goal of antitrust enforcement there is no justification for carrying enforcement into areas where competition is less efficient than monopoly because the costs of monopoly pricing are outweighed by the economies of centralizing production in one or a very few firms. Nor is there justification for using the antitrust laws to attain goals unrelated or antithetical to efficiency, such as promoting a society of small tradespeople.

Of course it does not necessarily follow that, because efficiency is an important social goal, it should be the only goal of antitrust law. But chapter 2 argues that it should be, because the only competing goal suggested with any frequency or conviction—the protection of small business—whatever its intrinsic merit cannot be attained within the framework of antitrust principles and procedures. The small businessman is, in general, helped rather than hurt by monopoly, so unless the antitrust laws are stood completely on their head they are an apt vehicle (compared, say, to tax preferences) for assisting small business.

Having established that the goal of antitrust law should be to promote efficiency in the economic sense, I next proceed to develop the implications for the law of adopting this view of its purpose. The focus is on price-fixing agreements among competing firms and the related problem of oligopoly pricing, which appear to be the principal nongovernmental sources of monopolistic pricing. After a brief overview of the antitrust laws in chapter

3, designed to orient the general reader to the remaining chapters, I argue in chapter 4 that the basic reform necessary to the control of price fixing and oligopoly is to redirect the enforcement of section 1 of the Sherman Act from its present obsession with proving the fact of a conspiracy or attempt to fix prices, in the criminal-law sense of these terms, to a search for evidence, economic in character, of collusive price behavior in the market. Whether there is a lurid conspiracy in the conventional sense of secret hotel meetings, elaborate bid-rotation schemes, and such should be less important than whether the actual price behavior of the market indicates collusion, which may be undetectable by the traditional and very crude tests derived from experience with ordinary criminal conspiracies. I indicate the kinds of economic evidence that might be used both to identify markets prone to collusion and to demonstrate the actual existence of collusion in those markets.

Chapters 5 and 6 discuss two methods of dealing with price fixing, and especially oligopoly pricing, that appeal to people who—unlike myself—despair of dealing directly with the problem of collusive pricing. The first is the dismemberment of the leading firms in oligopolistic industries. Chapter 5 argues that, even if there were no other way of dealing with the problems of collusion and oligopoly, dismemberment would be a bad solution; experience suggests that it would be futile and, if not futile, prohibitively costly both directly and in the perverse incentives that it would create. Chapter 6 examines the major Supreme Court cases that have attempted to prevent the emergence of conditions that favor collusion or oligopoly pricing by forbidding mergers between competing or potentially competing firms, and argues that the luxuriant prohibitions that these decisions have created need to be pruned. In particular, I propose that the judicially created doctrine of "potential competition" be discarded as wholly unworkable. Because market shares are often so decisive a factor in deciding the outcome of a merger case (and of many other types of antitrust case as well), this chapter also examines the crucial step in the litigation of determining which sellers shall be included in and which excluded from the market; a number of changes in the existing approach to market definition are suggested. This chapter also introduces an important subsidiary theme of the book— the extraordinary unwillingness or inability of most Supreme Court justices to apply economics or any other body of systematic thinking to antitrust problems.
Chapter 7 examines, with respect to two specific practices—resale price maintenance and the exchange of price information among competing sellers—the problem of locating the boundary between collusive practices that should be forbidden and apparently similar practices that should be permitted, and the Supreme Court's deficient solutions. My conclusion is that resale price maintenance should be considered presumptively lawful rather than per se unlawful and that the exchange of price information among competitors should be permitted unless it is proved that they are expressly or tacitly fixing prices.

The grand theme of chapters 4 through 7 is the high price that society has paid for the failure of the antitrust enforcement system to develop a genuinely economic approach to the problem of collusive pricing. The inability to determine the existence of collusive pricing directly has led to all sorts of indirect approaches, most of them deeply flawed in either conception or execution, such as the criminalization of the price-fixing rule, the deconcentration proposals, the excessively stringent restrictions on mergers between competitors and between potential competitors, and the inept handling of the problems of restricted distribution and of exchanges of information among competitors.

The focus of the book shifts in chapter 8 to "exclusionary practices." There is an important distinction, both in economics and in law, between practices by which competing firms voluntarily agree not to compete with each other and practices by which a firm or group of firms seeks to obtain or maintain a monopoly by coercing, intimidating, destroying, or otherwise excluding competitors or potential competitors from the market. The economic theory of monopoly was developed to explain practices of the first sort and has relatively little to say about practices of the second sort. This has led the economists and lawyers of the "Chicago School" to the view that there is no economic basis for concern with the exclusionary practices—perhaps they do not exist at all, and, if they do, they must be so rare as not to be worth worrying about. In my opinion, although this view contains a great deal of truth it is overstated. There is an economic basis for concern with at least some exclusionary practices, in at least some circumstances; and a few practices that are not exclusionary (though so classified in the law), like persistent price discrimination, may still be undesirable on strictly economic grounds. Chapter 8 attempts to develop a set of practical rules, grounded in economic analysis, for regulating the alleged exclusionary practices. Among its proposals are a new definition of predatory pricing and drastic curtailment of the prohibitions against tie-in agreements, vertical integration, exclusive dealing, and boycotts.

Chapter 9 asks how the antitrust statutes, and the major judicial doctrines based (often loosely) on them, can be tidied up, both to eliminate the inconsistencies and redundancies of existing antitrust doctrine and to conform to the specific proposals advanced in chapter 8 and earlier chapters. I argue that the doctrines of monopolization and of attempts and conspiracies to monopolize have no proper place in a sound system of antitrust policy and, indeed, that every antitrust provision except section 1 of the Sherman Act could be repealed without serious loss. However, although there would be some value in a sweeping statutory revision along the lines suggested in chapter 9, most of the doctrinal reforms suggested elsewhere in the book could be implemented without statutory change. The body of antitrust doctrine is largely the product of judicial interpretation of the vague provisions of the antitrust laws and thus can be changed by the courts within the very broad limits set by the statutory language and what we know of the intent behind it. What is required is judicial recognition that many of the existing judge-made rules of antitrust are inconsistent with the fundamental, and fundamentally economic, objectives of the antitrust laws.

Finally, chapter 10 discusses the administration of the antitrust laws. It advances a number of patently unrealistic and impolitic, but seriously intended, suggestions for administrative reform, including the abolition of prison sentences for antitrust violators, the elimination of treble damages for most antitrust violations, the award of attorneys' fees to winning defendants, and the radical simplification of the antitrust trial.
The Costs of Monopoly

In addition to furnishing a definition of monopoly, economic analysis offers reasons—some firmly rooted in economic theory, some more conjectural—why monopoly reduces economic efficiency in some (not all) circumstances. My first purpose in this chapter is to explain the theory of monopoly in terms that should be comprehensible to readers without previous knowledge of economics yet (I hope) not wholly uninteresting to those possessed of such knowledge, and to develop the relevance of the theory to antitrust policy. My second purpose is to argue that the economic theory of monopoly provides the only suitable basis for antitrust policy and, not incidentally, an appropriate guide in interpreting our actual antitrust laws. The exposition is in places regrettably but unavoidably difficult and I hope the reader will bear with me, as this chapter is the basis for much that follows.

The Economic Theory of Monopoly and the Case for Antitrust

A monopolist is a seller (or group of sellers acting like a single seller) who can change the price at which his product will sell in the market by changing the quantity that he sells. This “power over price,” the essence of the economic concept of monopoly, derives from the fact that the price that people are willing to pay for a product tends to rise as the quantity of the product offered for sale falls. Some people will value the product more than other people do and will therefore bid more for it as the quantity available shrinks in order to make sure that they get it. The seller who controls the supply of a product can therefore raise its price by restricting the amount supplied.

The observant reader may be quick to point out that, even in a highly competitive market, with many sellers selling the identical product, each one would have some power over price; for if any seller reduced his output, the entire output of the market would fall and the market price would therefore rise. This point is formally correct, but, where a seller produces only a small fraction of the market’s total output, the change in total output brought about by a fractional reduction in his output is unlikely to be great enough to affect the market price significantly; his power over price is slight and can be ignored. Moreover, the smaller his output is in relation to that of the remaining sellers in the market, the likelier it is that any cut in his output will be promptly offset by an increase in the output of the other sellers, each of whom would need to increase his output only fractionally in order to restore the market’s total output to its level before the first seller’s reduction.

The sole seller of a product, a “monopolist,” need not worry that if he raises his price other sellers will expand their output of the product and thereby drive the price back down—by definition there are no other sellers of the product. To be sure, the higher price may give firms in other markets an incentive to enter this one; but presumably entry into the market takes time, and, assuming that the formation of the monopoly was not anticipated, the monopolist will enjoy at least a temporary power over price.

It remains to be considered why and how he will exercise that power. We may assume that every firm wants to maximize its profits—the excess of its total revenue over its total cost. Suppose that just before the market became monopolized the market price was equal to the cost of making and selling the product in question (“cost” to the economist includes a reasonable return on equity capital). In this case the market price would be the competitive price. If the monopolist reduces production below the competitive level, the market price will rise. How will his costs and revenues, and hence profits, be affected? His total cost will be lower since he will be producing less. His total revenue, i.e., price times output, will be higher or lower at the new price and output depending on whether the proportional increase in price is greater or less than the proportional reduction in output or the same. Clearly, if the price increase is proportionally greater than the reduction in units sold, the price increase will be profitable to the firm. Its total revenue will be higher, while its total cost will be lower since it will be producing less, and so the difference between its revenue and cost—profit—will be greater than at the competitive price.

Thus, the monopolist will always charge a price higher than the competitive price if demand at the competitive price is inelastic,
that is, if the proportional reduction in the quantity demanded as a result of the higher price is less than the proportional increase in price. Moreover, he will increase his price at least to the point where a further price increase would cause a proportionally larger reduction in the quantity demanded, for until that point is reached every price increase raises total revenue while reducing total cost. In other words, the monopolist will always operate in the elastic portion of his demand curve. He may raise his price beyond the point where demand turns elastic and his total revenues therefore begin to shrink, for he is interested in maximizing profits, not revenues. He will stop raising his price only at the point where any further increase would reduce total revenues by more than the reduction in total cost resulting from the smaller quantity produced. That is the point at which the monopolist’s profits are maximized. The optimum monopoly price may be much higher than the competitive price, depending on the intensity of consumer preference for the monopolized product—how much of it they continue to buy at successively higher prices—in relation to its cost.

We have established that output is smaller under monopoly than under competition but not that the reduction in output imposes a loss on society. After all, the reduction in output in the monopolized market frees up resources that can and will be put to use in other markets. There is a loss in value, however, because the increase in the price of the monopolized product above its cost induces the consumer to substitute products that must cost more to produce (or else the consumer would have substituted them before the price increase), although they are now cheaper to him (assuming that they are priced at a competitive level, i.e., at cost). Thus monopoly pricing confronts the consumer with false alternatives: the product that he chooses because it seems cheaper actually requires more of society’s scarce resources to produce. Under monopoly, consumer demands are satisfied at a higher cost than necessary.

This analysis identifies the cost of monopoly with the output which the monopolist does not produce, and which a competitive industry would. We have said nothing about the higher prices paid by those consumers who continue to purchase the product at the monopoly price. Economic analysis used to treat this transfer of wealth from consumer to producer as costless to society as a whole, since the loss to the consumer is exactly offset by the gain to the producer and both are members of society. The only cost of monopoly in that analysis was the loss in value resulting from substitution against the monopolized product, since the loss to the substituting consumers is not recouped by the monopolist (or anyone else) and is thus a net loss, rather than a mere bookkeeping entry on the social books. But the traditional analysis was shortsighted. It ignored the fact that an opportunity to obtain a lucrative transfer payment in the form of monopoly profits will attract real resources into efforts by sellers to monopolize, and by consumers to prevent being charged monopoly prices. The costs of the resources so used are costs of monopoly just as much as the costs resulting from the substitution of products that cost society more to produce than the monopolized product.

Suppose, for example, that a cartel fixes prices somewhere above the competitive level (i.e., cost), and the entry of new firms or the expansion of existing firms (whether members or nonmembers of the cartel) is for some reason impeded. Each member of the cartel will have an incentive, by expending resources on making his output more valuable to consumers than the output of the other members of the cartel, to increase his sales relative to the other cartelists and thereby engross a larger share of the cartel profits. The process of increasing nonprice competition (higher quality, better service, etc.) will continue until, at the margin, the costs of the cartel members have risen to the cartel price level. The higher costs are a cost of monopoly, although there is a partially offsetting benefit since the additional nonprice

1. For example, suppose that the output of the firm at the competitive price, $5, is 1,000 units, but at $5.05 would be 999 units. Then demand at the competitive price is inelastic, because the proportional increase in price (1 percent) is greater than the proportional decrease in output demanded (1.01 of 1 percent) with the result that the higher price yields a larger total revenue—$5,044.95 compared to $5,000.

2. The determination of the optimum monopoly price is discussed at greater length in the Appendix at the end of the book. See also my Antitrust: Cases, Economic Notes, and Other Materials 5–14 (1974).

3. The sellers of the substitute product are assumed to sell at a competitive price, and thus to enjoy no profits, in the economic sense, from obtaining additional customers. This assumption is examined critically below.

competition has some value, though less than its cost, to the consumer.\textsuperscript{5} If for some reason nonprice competition were infeasible, and the expected profits of cartelizing therefore very large, the analysis would be altered, but not fundamentally. Firms would expend real resources on forming or gaining admission to cartels in order to share in the expected profits, and this process of competing to become a monopolist would presumably continue until, at the margin, the expected gains of monopoly were just equal to the costs incurred in becoming a monopolist. Of course, one way of sharing in monopoly profits is by entering a market in which a monopoly price is being charged (thereby adding to the output of the market and depressing the market price) or by expanding one's output if one is already in such a market. Unless the outsider has higher costs than the monopolist—an important qualification—these methods of "monopolizing" do not impose costs on society; quite the contrary. But they are properly analyzed as market responses that reduce the expected gains of monopoly by diminishing the monopolist's power over price rather than as market responses that transform expected monopoly gains into costs.

The tendency of monopoly profits to be converted into social costs, until recently a neglected facet of the economic analysis of monopoly, has, as will appear in subsequent chapters, a number of important implications for antitrust policy. For present purposes, the most important point is that it places the economist's hostility to monopoly on somewhat firmer ground than it would occupy if the only costs of monopoly were those that stem from the reduction in output brought about by monopoly. As shown in figure 1, if we assume that problems of cartel organization and the potential competition of new entrants into the cartelized industry constrain the price level in the typical cartelized or monopolized industry to a level only moderately higher than the competitive price level, then the social loss due to the reduction in output at the higher price—\( D \) in figure 1—will be quite small in relation to the total revenues of the industry at either the monopoly or competitive price (\( pq \) or \( p'q' \)).\textsuperscript{6} The costs of monopoly become

\begin{itemize}
\item 5. If consumers valued the additional services (or whatever) generated by this competition above its cost, presumably the services would have been produced in a price-competitive market as well.
\item 6. See the Appendix for a more elaborate presentation and an explanation of why \( D \) is an appropriate measure of the losses to those consumers induced by the monopoly price to substitute other products.
\end{itemize}

Fig. 1. The Costs of Monopoly

much more imposing if \( MP \), the transfer payment from consumers to producers of the monopolized product, is added to \( D \). To be sure, \( MP \) is at best a rough approximation of the actual costs resulting from the competition to become a monopolist—the actual costs could be greater or less—but it is at least a plausible assumption that the total social costs of monopoly will usually exceed \( D \) by a substantial amount.

Moreover, once \( MP \) is recognized as being relevant to the costs of monopoly, an objection to the economic analysis of monopoly based on the theory of the "second best" disappears. The objection, in its simplest form, is that if the substitutes for a monopolized product are not being sold at prices equal to their costs, the elimination of the monopoly may encourage rather than discourage inefficient substitutions. To illustrate, suppose that the monopolized product, widgets, is being sold at a price of \( 10\epsilon \), although it costs only \( 6\epsilon \) to produce. A substitute product, gidgets, costs

7. Greater because \( MP \) ignores expenditures by potential victims of monopoly or by law-enforcement agencies that have the effect of limiting the monopoly price increase and that are properly counted as costs of monopoly; less because expenditures on monopolizing may generate partially offsetting benefits in the form of additional nonprice competition and because some of the "costs" may represent economic rents to the owners of resources specialized to monopolizing rather than social costs.

I am of course speaking here of "bad" monopolies. If the government grants a firm a monopoly precisely in order to evoke greater expenditures by the firm than competition would—this is the economic rationale of the patent laws—the resulting transformation of expected monopoly gains into social costs does not create a net social loss.
only 5¢ to produce but it is also monopolized, and its monopoly price is 8¢. People will tend to buy gadgets, an efficient result since they are cheaper to produce than widgets. Suppose now that the monopoly of widgets is eliminated and the price of widgets therefore falls to the competitive level, 6¢. People will now substitute widgets for gadgets. But this is inefficient, since, although widgets look cheaper to the consumer, they cost society more to produce than gadgets. Nor would the problem that this example illustrates be solved if all monopolies, rather than just some, could be eliminated. Widgets might be subject to an excise tax that raised their price from 5¢ to 8¢, in which event, just as in the previous illustration, a widget monopoly would encourage efficient substitution.

But in a correct economic analysis of the monopoly problem the possible divergence between the cost and the price of substitute goods is not a decisive objection to taking action against the widget monopoly. The opportunity to obtain a monopoly profit of 4¢ per widget will attract real resources into the activity of becoming a widget monopolist, thereby transforming the 4¢ (or some portion of it) into a social cost that (1) can be eliminated by destroying the monopoly and (2) in all likelihood exceeds the losses (analogous to D) resulting from the fact that widgets are slightly more costly to produce than the substitute product.

The foregoing analysis enables one to conclude, at least tentatively, that the potential social gains from an effective antitrust policy are probably substantial (whether they are greater than the costs of such a policy is a separate question). This point has been obscured in many people’s minds by a series of studies that attempt to measure the social cost of monopoly in the American economy and find that it is very slight—perhaps no more than .1 of 1 percent of the Gross National Product.8 There are several reasons why such studies cannot be used to measure the potential gains from having antitrust laws. The first is that they measure the costs of monopoly given the existence of those laws, not the costs of monopoly that could be expected in the absence of such laws. In a sense they measure the degree to which the antitrust laws have failed. The second reason for heavily discounting these studies is that their procedure is improper—if the preceding analysis of the costs of monopoly is correct. The estimates of the monopoly price increase are based on the existence of persistently above-average rates of return in some industries, which the authors attribute to monopoly. The difference between those rates and the average rate of return for the industries in the sample is used to estimate the amount of monopoly profits in the revenues of the monopolized industries, and in turn the price increase necessary to produce those profits. This procedure yields an estimate—typically small—of the percentage by which the monopoly price level exceeds the competitive price level. But the estimate is biased downward. It ignores the tendency of competition for a monopoly position to transform expected monopoly profits into costs and thereby push down rates of return in monopolized industries toward the competitive level. A monopolized industry might be charging a price far above the competitive price yet be earning no more than a normal return. Having systematically underestimated the monopoly price increase, the studies compound their error by using the price increase to estimate only the so-called deadweight loss of monopoly (D in figure 1), ignoring the much larger costs (approximated by MP) resulting from the competition to obtain monopoly profits.

Studies such as I have just described have disturbed economists who believed in the antitrust laws; and unaware of the serious deficiencies of the studies, they have cast about for other economic grounds for concern with monopolies. Their search has led them back to the ancient idea that a lack of competition makes a firm less interested and effective in minimizing its costs, whether by careful buying of inputs and supervision of production processes or by inventing new products and processes. A moment’s reflection will show that, in some circumstances anyway, the opposite may be true: competition may reduce the incentive to minimize cost. The firm that invents a new, cost-reducing process, or a new product, may be unable to recoup its research and development expenses if the process can be promptly copied by a competing firm that has borne no such expenses. The patent laws—laws granting monopolies to inventors—recognize and counteract the tendency of competition to retard innovation; but, since the coverage of these laws is highly incomplete, the process of obtaining and enforcing a patent frequently very costly, and patents limited in scope and duration, the possession of a monopoly not depen-

dent on the patent laws may provide a greater incentive to invent than a patent—let alone competition—does.

Another weakness in the theory that monopoly leads to slack and waste is its inconsistency with the fundamental economic principle that an opportunity forgone is a cost analytically no different from a loss incurred; indeed, forgone opportunity is the economic definition of cost. For a monopolist to fail to obtain another $100 in profit by failing to exploit some new process costs him $100, and this is the same amount that is lost by a competitive firm in failing to exploit an opportunity for a $100 cost reduction or product improvement. To be sure, firms and individuals differ in their ability to minimize costs, so that in a market containing a number of firms competition will gradually weed out the less efficient ones and thereby concentrate the assets of the market in the hands of the people who are best at minimizing costs. This process of “natural selection” is attenuated—although not eliminated—in a market that is effectively monopolized in the sense that not only is there only one firm but the entry of new firms is blocked. However, the monopolistic firm has an incentive to simulate the competitive struggle for survival in order to minimize its costs and hence maximize its profits, and it can do this readily by establishing competing profit centers within the firm which vie with one another to minimize costs. The wise monopolist eliminates competition only at the level where competition is harmful to the firm—in the pricing of its product. Competition is retained in those areas where it increases profits. The only danger that remains is the lack of a market mechanism other than the takeover bid for displacing unwise or ineffectual management of a monopoly. The empirical significance of this danger is unknown; perhaps the takeover bid is a generally adequate mechanism for this purpose.

The analysis is basically similar if, instead of being only one firm, the market is effectively cartelized and new entry is blocked. Then each member of the cartel is formally in the same position as the single-firm monopolist in our example, but there are important practical differences. The cartel member has to consider the possibilities (1) that the cartel will break down, (2) that the members of the cartel having the lowest costs will press for a reduction in the cartel price, since the lower a firm’s marginal costs, other things being equal, the lower the price that will maximize its profits.

I have thus far assumed that new entry into the monopolist’s or cartel’s market is blocked. This assumption is in general unrealistic, and where entry is possible the monopolist or the members of the cartel will have a strong incentive to minimize costs in order to avoid being displaced by a more efficient new entrant.

Another important reason for doubting that monopolists are in general less vigorous innovators than competitive firms derives from our earlier analysis of the tendency of expected monopoly profits to be transformed into actual resource costs. (This reason is applicable only where there is more than one seller, and where they are colluding, but that is empirically a much more important type of monopoly than the single-firm monopoly.) Members of a cartel rarely find it practicable to agree not to compete in every dimension of possible rivalry. Usually it is just price and other terms of sale that are fixed, and the firms remain free to compete in other respects. As we have seen, the effect of collusive pricing when nonprice competition is not restricted is to channel the profits generated by such pricing into expenditures on nonprice competition, which comprise all sorts of product and service improvements. If anything, therefore, we would expect cartelization to increase the incentive to invent compared to what it would be in a price-competitive market—and even to carry invention beyond the optimal point.

In summary, I do not think that in the present state of our knowledge cartelizeation or even single-firm monopolization can be condemned on the ground that a lack of price competition retards invention or generates slackness about costs. There is simply no satisfactory theoretical or empirical basis for such concerns. But

9. A firm that fails to exploit its opportunities is always in danger of being taken over by another firm, which can offer the shareholders a price for their shares in excess of the market price since the assets of the firm will be worth more in the hands of its new management.

10. See Appendix, infra p. 248.

11. This is true even in countries that have no antitrust laws. Presumably diseconomies of large-scale operation make it more economical to have more than one firm in substantial markets, even if some or all monopoly profits are forgone as a result. There will be more than one firm in the market so long as the higher costs that would result from eliminating the last competitor would exceed the resulting loss of monopoly profits.
we need not be troubled by this, since, as we saw earlier, there are other, and powerful, grounds for believing that monopoly, when it is not simply a by-product of superior efficiency, as in the patent example, is a source of substantial social costs.

**Sociopolitical Objections to Monopoly**

Having considered the economic objections to monopoly, I want to discuss now three broadly political arguments against it. The first is that monopoly transfers wealth from consumers to the stockholders of monopolistic firms, a redistribution that goes from the less to the more wealthy. This appealing argument is undermined by the point made earlier that competition to become a monopolist will tend to transform the expected gains from monopoly into social costs. To the extent that this occurs, consumers' wealth will not be transferred to the shareholders of monopoly firms but will instead be dissipated in the purchase of inputs into the activity of becoming a monopolist.

A second argument is that monopoly, or more broadly any condition (such as concentration) that fosters cooperation among competing firms, will facilitate an industry's manipulation of the political process to obtain protective legislation aimed at increasing the industry's profits. Often such protection takes the form of controls over entry and price competition, coupled with exemption from the antitrust laws, that result in cartelizing the industry much more effectively than could be done by private agreement. This is not the place to pursue the intricacies of the nascent economic analysis of the determinants of political power. It is enough to note that, while concentration may reduce the costs of organizing effectively to manipulate the political process, it may also reduce the demand for public assistance in suppressing competition, since, as we shall see in chapter 4, a concentrated industry, other things being equal, is in a better position to suppress competition through private agreement, express or tacit, than an unconcentrated industry. It is therefore unclear whether on balance concentrated, or monopolistic, industries will obtain greater help from the political process than unconcentrated, or competitive, industries. This theoretical indeterminacy is mirrored in the empirical world, where we observe many unconcentrated industries—agriculture, trucking, local broadcasting, banking, medicine, to name a few—enjoying governmental protection against competition.

In any event, however, this political objection to monopoly and concentration is not sharply different from the economic objection. The legislation sought by an industry—a tariff, a tax on a substitute product, control of entry—will usually have economic effects similar or even identical to those of a private cartel agreement. The political argument—which is simply that concentration facilitates monopoly pricing indirectly through the legislative process, as well as directly through cartelization—thus implies no change in the character of an antitrust policy deduced from economic considerations. (This is also true, incidentally, of the wealth-redistribution argument: the implications for public policy are not sharply different whether one objects to monopoly pricing because it wastes resources or because it brings about undesirable changes in the redistribution of wealth.)

The last political argument that I shall discuss has, in contrast, implications for antitrust policy that diverge sharply from those of economic analysis. The popular (or Populist) alternative to an antitrust policy designed to promote economic efficiency by limiting monopoly is a policy of restricting the freedom of action of large business firms in order to promote small business. (It may be possible to conceive of a different alternative to an efficiency-based antitrust policy, but this is the only one suggested with any frequency.) The idea that there is some special virtue in small business compared to large is a persistent one. I am not prepared to argue that it has no merit whatever. I am, however, confident that antitrust enforcement is an inappropriate method of trying to promote the interests of small business as a whole. The best overall antitrust policy from the standpoint of small business is no antitrust policy, since monopoly, by driving a wedge between the prices and the costs of the larger firms in the market (it is presumably they who take the lead in forming cartels), enables the smaller firms in the market to survive even if their costs are higher than those of the large firms. The only kind of antitrust policy that would benefit small business would be one whose principal objective was to limit the attempts of large firms to underprice less efficient small firms by sharing their lower costs with consumers in the form of lower prices. Apart from raising in acute form the question of whether it is socially desirable to promote small business at the expense of the consumer, such a policy would be unworkable because it would require comprehensive and
continuing supervision of the prices of large firms. There are no effective shortcuts. For example, if mergers between large firms are forbidden because of concern that they will enable the firms to take advantage of economies of scale and thereby underprice smaller firms operating at less efficient scale, one (or more) of the larger firms will simply expand until it has achieved the most efficient scale of operation. If franchise termination is made difficult in order to protect small dealers, the costs of franchising will be higher, and there will be less franchising, which will hurt the very class of small businessmen intended to be benefitted. The tools of antitrust enforcement are poorly designed for effective discrimination in favor of small firms, compared, for example, to the effectiveness of taxing larger firms at higher rates. We shall have frequent occasion in this book to remark how difficult it is to press the antitrust laws into the service of small business. The realistic choice is between shaping antitrust policy in accordance with the economic (and congruent political) objections to monopoly and—if we think that limiting big business and promoting small is more important than efficiency—abandoning it.

This conclusion would have little relevance to judicial interpretation, as distinct from legislative reform, of antitrust if in fact social or political objectives that are inconsistent with the economic approach to monopoly had been embraced by the framers of the antitrust statutes. However, although noneconomic objectives are frequently mentioned in the legislative histories, it seems that the dominant legislative intent has been to promote some approximation to the economist’s idea of competition, viewed as a means toward the end of maximizing efficiency. Accordingly, the economic approach outlined in this chapter constitutes a generally reliable guide to the interpretation as well as revision of the antitrust statutes.

This is not to say that there are no statutory pockets of anticompetitive protectionism which the courts are bound to respect until Congress decides to change the law. An example of such a pocket is the failing-company doctrine, an implicit provision of section 7 of the Clayton Act (the antimerger law). The doctrine permits a merger that would otherwise be condemned because of its anticompetitive effects to be spared if it is shown that, but for the acquisition, the acquired firm would have gone bankrupt. If the sole concern of the Clayton Act were with competition and efficiency, there would be no need for a failing-company defense as such. To be sure, in some cases the imminent failure of the acquired firm would be relevant in appraising the competitive effect of the acquisition. It might indicate that the acquisition had changed nothing in the market: the competitor eliminated by it was on his way out anyway. But one can imagine cases where competition would be promoted by letting the acquired firm go under. As an extreme but illustrative example, suppose the failing firm is a monopolist. If it is acquired, its monopoly will be preserved. If instead it is forced to declare bankruptcy and to liquidate, its assets and sales may be divided up among a number of firms and competition thereby restored (assuming the market is not a natural monopoly). Yet the legislative history of section 7 makes clear that even a merger which preserved a monopoly would not violate the statute if the alternative to acquisition was bankruptcy, because the intention of Congress was to protect the creditors, employees, and shareholders of failing companies, if necessary at the cost of permitting monopoly pricing. Nor can this result be justified, on economic grounds, by reference to the

14. See, e.g., S. Rep. No. 1775, 81st Cong., 2d Sess. 7 (1950); Derek C. Bек, “Section 7 of the Clayton Act and the Merging of Law and Economics,” 74 Harv. L. Rev. 226, 340 (1962); International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930). One court of appeals has held recently that the failing-company defense requires proof that the acquired firm could not have been successfully reorganized in bankruptcy proceedings. United States Steel Corp. v. FTC, 426 F.2d 592 (6th Cir. 1970). This holding, which is based on a dictum in Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969), is wrong. The legislative history of section 7 makes clear beyond possibility of doubt that the purpose of the failing-company defense is precisely to avert bankruptcy because of the losses that a bankruptcy proceeding is likely to impose on creditors and shareholders of the bankrupt. Indeed, the position adopted in the Steel decision had been expressly rejected by the Supreme Court in the International Shoe decision, supra (compare 280 U.S. at 301–02 with the Federal Trade Commission’s brief at 15, 23–24), which the framers of the amended section 7 expressly approved as the authoritative statement of the failing-company defense. The Citizen dictum is probably just an example of Justice Douglas’s careless opinion writing and has been abandoned in subsequent Supreme Court statements of the failing-company defense. See United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555 (1971); United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974). These decisions, which postdate Steel, greatly undermine the authority of that decision. See United States v. M.P.M., Inc., 1973 Trade Cases ¶ 60,312 (D. Colo.).
social costs of business failure. Business failures constitute an essential means of imparting incentives for efficient business behavior, by placing the costs of mistakes on the firms that make them. Condoning monopoly in order to avert business failure protects not only monopoly, but, what is worse, inefficient monopoly.

Examples of anticompetitive doctrines that, like the failing-company defense, are part of the statutory fabric itself are rare. As we shall see in subsequent chapters, there are a great many judicially fashioned antitrust doctrines that are perverse from an efficiency standpoint, but what is at once striking and heartening is how few of these doctrines can be justified by reference to a legislative determination to subordinate efficiency to other values. The scope for judicial reform of antitrust doctrine is enormous.

Efficient Monopolies

Assuming that antitrust policy is to be shaped by economic analysis of the monopoly problem, what is the proper treatment of those practices that, while monopolistic, may on balance be efficient? The costs resulting from monopoly pricing will sometimes be lower than the cost savings generated by such pricing. Imagine the creation of a monopoly in a market so small in relation to the efficient scale of production that a single firm will have much lower costs than more than one firm—so much lower, indeed, that the profit-maximizing monopoly price is actually below the competitive price. Plainly, society’s economic welfare would be greater if the monopoly were permitted than if it were forbidden, and since, in an economic analysis, we value competition because it promotes efficiency—i.e., as a means rather than as an end—it would seem that whenever monopoly would increase efficiency it should be tolerated, indeed encouraged. The problem, as we shall see, is that it is very difficult to measure the efficiency consequences of a challenged practice; and thus throughout this book we shall be continually endeavoring to find ways of avoiding the prohibition of efficient, albeit anticompetitive, practices without having to compare directly the gains and losses from a challenged practice. Fortunately, since few economists believe that collusive pricing generates significant economic gains, when a practice has been correctly identified as a form of collusion we can generally suppress it without misgivings. As it happens, collusion has been—and will and should remain—the principal focus of antitrust policy, and it is the principal focus of this book as well.

3 An Overview of the Antitrust Laws

In the previous chapter, I offered my view of the proper objectives of antitrust policy. Subsequent chapters will examine the extent to which these objectives have in fact informed the interpretation and application of the antitrust laws, while the purpose of the present chapter is to orient that discussion by describing very briefly the evolution and principal features of contemporary antitrust policy.

Antitrust Doctrine

The basic federal antitrust law, the Sherman Act, was passed in 1890 against a background of rampant cartelization and monopolization of the American economy. Section 1 of the Act prohibited contracts, combinations, and conspiracies in restraint of trade; section 2, monopolization and conspiracies and attempts to monopolize. Since “monopoly” and “restraint of trade” were terms that had a common-law history in both England and America, it would be natural to view the act as the culmination of a tradition of legal concern with the monopoly problem; but it would be incorrect to do so. The framers of the Sherman Act appear to have been concerned mainly with the price and output consequences of monopolies and cartels,¹ whereas the common law of monopolies and restraints of trade had a miscellany of objectives mostly unrelated and sometimes antipathetic to competition and efficiency: such as to assert the supremacy of Parliament over the Crown, to prevent people from making improvident contracts, to thwart unionization, and to limit competition in the distribution of goods.² Sometimes, to be sure, contracts monopolistic in the economic sense were refused enforcement on grounds

of public policy, but no consistent antimonopoly policy is discernible. The discontinuity between the common law of trade regulation and the Sherman Act is important to remember whenever one sees a lawyer or judge attempting to buttress his antitrust theories by reference to some common-law doctrine that he contends was incorporated into the antitrust laws by the Sherman Act. Such an argument is almost always unhistorical. The Sherman Act did not enact the common law of restraint of trade. A better guide to interpreting the Sherman Act is the economic analysis of monopoly.

As shown in table 1, few cases were brought during the early years of the act. Yet by 1898 the Supreme Court had firmly established the principle, immensely important to the development of a sound antitrust policy, that cartels and other price-fixing agreements were illegal regardless of the "reasonableness" of the price fixed. Consistent with the economic analysis of the monopoly problem, the Court decided that collusive pricing was inefficient and should be forbidden; the reasonable price was the competitive price.

This was a good rule, but in the course of successive statements its original purpose was largely forgotten and it degenerated into a shibboleth. The rule had been designed to preserve competitive pricing. Accordingly, the early formulations stressed the effect of the challenged conduct on the market price. This did not mean that evidence of actual effect on price was required—evidence that would have eluded, and still would often elude, the best efforts of economic science. It meant only that the circumstances in which the behavior complained of occurred, and in particular the degree to which the colluding sellers controlled the market in question, had to support an inference that the defendants were likely to succeed in raising the market price above the competitive level. Yet by 1940, when the Supreme Court uttered its definitive statement of the rule against price fixing in the Madison Oil case, the requirement of demonstrating a probable impact on the market price had disappeared. The offense was no longer the charging of a monopoly price—it was the attempt to charge a monopoly price; and no evidence that the defendants were likely to succeed in their attempt was required. The rule against price fixing had become a part of the law of conspiracy instead of a part of the law of monopoly.

This transformation of the rule had two effects, which are discussed in detail in the next chapter. It made it possible for the government to try a price-fixing case on the basis solely of the kind of evidence (secret hotel meetings and the like) that it uses in ordinary conspiracy cases, and to thus ignore the economics of price fixing; and because the government soon became accus-

5. See note 1 supra.
6. Table 1 is limited to cases brought by the Department of Justice; however, few private cases were brought during the early years of the act, although reliable statistics are lacking. The Federal Trade Commission, which shares responsibility for federal antitrust enforcement with the Justice Department, was not created until 1915. Serious state antitrust enforcement activity is a quite recent phenomenon.
7. See United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897); United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898).
tomed to place its entire reliance in enforcing the rule against price fixing on this kind of evidence, it obscured the problem of forms of collusive pricing that do not generate such evidence.

An intelligently designed antitrust policy cannot stop with collusive pricing among independent firms and ignore monopoly pricing by a single firm. Such an approach—which would provide competing firms with a strong incentive to merge into a single firm so as to be able to practice monopoly pricing without inviting punishment—was accordingly rejected by the Supreme Court, in 1904, in the Northern Securities decision. The Court in that case held that placing the stock of two competing railroads in the hands of a holding company was a combination in restraint of trade. The case was correctly decided on its facts, but in the course of its decision the Court committed an analytical error of major proportions. It reasoned that the union of control over the railroads achieved through the holding-company device was illegal because it had the same effect as a cartel agreement between the railroads—the elimination of competition between them. The idea that transactions which have the same effect on competition between the parties to them should therefore be treated by the law in the same way is a recurring one in antitrust analysis, but is thoroughly unsound. It ignores the possibility that, while the two transactions have the same effect on competition between the parties, they differ in other respects that are crucial in an evaluation of their total economic effect. Suppose that two competing firms, each very small relative to the other firms with which they compete, merge in order to take advantage of economies of large-scale production or to increase the efficiency with which the assets of one of the firms is managed. The merger would eliminate competition between the firms even more effectively than a price-fixing agreement between them, yet it would be absurd to treat the merger as if it were a cartel—the approach suggested by the Court in Northern Securities. The merger would not confer on the parties any power to increase price and might actually lead to a reduction in the market price, due to the cost reductions it made possible. This is very different from the effect of a cartel.

It was accordingly a relief when, in 1911, in deciding the government’s suit against John D. Rockefeller’s Standard Oil Trust, the Supreme Court held that the legality of eliminating competition by fusion as distinct from contract between competing firms was to be determined by applying a “Rule of Reason,” which would allow a fuller and more flexible inquiry into the economic consequences of a challenged agreement than was permitted or would have been appropriate in a cartel case. Unfortunately, the Court’s opinion was murky. In particular it left unclear the extent to which the illegality of the Oil Trust under the Sherman Act depended on various improper practices—such as exacting secret rebates from railroads, selling below cost to destroy or intimidate local competitors, and evading state regulatory authority—that the trust had been found to have engaged in but that might not have been essential to its achieving and exercising power over price. This ambiguity has never been explicitly resolved. The great merger movement that produced the Oil Trust, the Powder Trust, the Tobacco Trust, the Steel Trust, and a number of other single-firm monopolies ended in about 1905, and by 1911 most of the antitrust cases attacking the classic trusts had run their course. Moreover, only one of these trusts, the Steel Trust (created by the formation of the United States Steel Corporation in 1901), had a record clear of improper practices other than the initial consolidation that gave the trust a commanding market share. And in 1920 the Supreme Court held that U.S. Steel had not violated the Sherman Act, although there was some language in the Court’s opinion which suggested that the case might have been decided differently had the government brought suit promptly after the formation of U.S. Steel, rather than waiting ten years. Since there has never been a recurrence of the merger-to-monopoly movement that swept the country in the period preceding 1905,

10. Northern Securities Co. v. United States, 193 U.S. 197 (1904). Justice Holmes in dissent urged vigorously that the Sherman Act permitted any merger or other form of corporate amalgamation to which the only objection was the elimination of competition among the parties to the transaction.

11. In fairness to the Court, it should be pointed out that the parties were relatively very large firms (two of the four major transcontinental railroads) and the form of the transaction—control of the firms by means of a holding company—did not involve an actual consolidation of the firm’s operations that might have created substantial opportunities for efficiency gains.


13. The disappointing results of this legal campaign are discussed in chapter 5 infra.

the precise legal standard governing such mergers is a somewhat academic question. It has been doubly academic since 1950, when Congress passed a stringent antimerger law that clearly forbade monopolistic mergers—and much else besides.\(^{15}\)

The reference in the *Standard Oil* opinion to the bad practices of the Rockefeller trust, such as predatory price cutting, proved to be exceedingly important for the subsequent development of antitrust law. Price fixing and mergers to monopoly are methods by which cooperating sellers voluntarily eliminate competition among themselves. They are not forms of aggression against noncooperating competitors. On the contrary, the formation of a cartel, or the merger of competing firms to create a single-firm monopoly, increases the profit-making opportunities both of other sellers in the market and of potential new entrants by raising the market price above the competitive level. Collusion would be more profitable if entry or expansion by nonparticipants in the cartel or monopoly could somehow be discouraged. Predatory price cutting is one of a number of practices by which a seller or group of sellers might be able—or might be thought able—to obtain or maintain monopoly power by eliminating or intimidating competing sellers or potential competitors.

The difference between “collusive practices,” the general term that I shall use to denote cooperative anticompetitive arrangements, and “exclusionary practices,” the coercion of sellers outside of the collusive group, is fundamental to an understanding of the antitrust laws. The pure collusive practice involves cooperation between competing sellers (in the form of an agreement, express or tacit, limiting competition, or a merger or other method of fusion) to raise the market price above the competitive level. The agreement generates monopoly profits, but it also induces other firms to expand their output of the product sold by the colluding sellers (or to begin making the product if they have not done so previously) in order to capture a share of the monopoly profits. The pure collusive practice thus carries the seeds of its own destruction. An exclusionary practice is generally a method by which a firm (or firms) having or wanting a monopoly position trades a part of its monopoly profits, at least temporarily, for a larger market share, by making it unprofitable for other sellers to compete with it.

\(^{15}\) The Celler-Kefauver Antimerger Act, amending section 7 of the Clayton Act; see chapter 5 infra.

The difference is nicely illustrated by the formation and subsequent experience of the United States Steel Corporation, to which reference has already been made. U.S. Steel apparently had such a large fraction of the productive capacity of the steel industry that it could obtain monopoly profits by limiting its output. Had the remaining firms in the industry been able to expand their output rapidly without incurring higher production costs, or had new firms been able to enter the industry rapidly and operate at a cost level no higher than that of the existing firms, U.S. Steel’s limitation of output would not have resulted in any significant reduction in the over-all output of the steel industry, and the market price would therefore have remained at the competitive level. Even if these conditions were not fulfilled, so long as U.S. Steel took no steps to prevent its competitors from gradually increasing their output or new firms from gradually entering the industry, its monopoly position would inevitably diminish over time. The company did make some efforts to collude with competitors, but it made no attempt to exclude them and as a result its market share declined steadily (from about 60 percent when the company was formed in 1901 to about 20 percent today). The history of U.S. Steel illustrates the policy and the eventual position of a monopolistic firm that does not engage in exclusionary practices.\(^{16}\)

Many practices besides predatory price cutting have at one time or another been thought to belong in the exclusionary-practices category, such as tie-in agreements, vertical integration, reciprocal buying, exclusive dealing, price discrimination, and group boycotts. Of course, the most effective method of excluding a competitor is to have lower costs that make it possible to underprice him without selling at a loss; happily, this method of exclusion has only occasionally been considered actionable under the antitrust laws. As we shall see, some of the practices deemed exclusionary, mainly price discrimination in its various guises (including tie-in agreements), are monopolistic but not exclusionary—and not collusive either. These are the practices that, for want of a better term, I shall call “unilateral noncoercive monopolization,” and they will be discussed in chapter 8.

Exclusionary practices, perhaps because they inflict concentrated losses on business competitors rather than diffuse losses on consumers and suppliers, have been magnified into a much greater social problem than the available evidence indicates them to be. For reasons that will become clear when we discuss those practices in detail, it seems unlikely that they have ever played a major role in the growth or persistence of monopoly conditions. Yet they have been the cutting edge of antitrust doctrine since the Standard Oil decision in 1911. Three years later Congress enacted the Clayton and Federal Trade Commission Acts. Section 5 of the Federal Trade Commission Act, the principal substantive provision of that act, forbade "unfair methods of competition," and it seems that this prohibition was directed primarily against exclusionary practices, although it was later held to forbid virtually anything forbidden by any other antitrust provision, and then some. Section 2 of the Clayton Act forbade price discrimination, and section 3 tying and exclusive dealing, in circumstances where the effect might be substantially to lessen competition or tend to create a monopoly. Sections 7 and 8 of the Clayton Act limited stock acquisitions and interlocking directorates, which are not readily conceived of as exclusionary practices (although the framers of the Clayton Act may have thought of them in those terms), but neither provision turned out to have any practical importance. Section 7 was easily avoided by substituting a merger or consolidation (that is, an asset acquisition) for the stock acquisition forbidden by the statute, and interlocking directorates never have been an effective method of collusion or monopolization. Moreover, when section 7 was amended many years later to bring mergers and other asset acquisitions within its scope, it provided a legal basis, as we shall see in chapter 6, for condemning a large number of mergers—including mergers between competing firms—as exclusionary practices.

The Sherman Act has been on the statute books (at this writing) for eighty-five years, and even the most recent substantive amendment of the antitrust laws, the Celler-Kefauver Antimerger Act, has been operative for twenty-five years—time enough, one would have thought, for the major substantive issues of antitrust policy to be resolved in a reasonably satisfactory manner. Yet the body of substantive antitrust doctrine is today in a profoundly unsatisfactory state. The major problem areas—and the central topics of chapters 4-9—are the following:

1. The Sherman Act has proved to be ineffectual in dealing with forms of collusive pricing that do not generate detectable acts of agreement or communication among the colluding sellers.

2. The courts have swept within the rule forbidding price fixing many practices, such as the exchange of price information among competitors and the fixing of maximum or minimum resale prices by a seller, which are often procompetitive rather than anticompetitive.

3. The courts have been unable to formulate consistent, sensible, and workable standards of illegality for mergers either between competitors or between potential competitors.

4. The category of exclusionary practices has been permitted uncritically to expand, embracing many practices that actually reduce the social costs of monopoly.

The errors of legal policy have been errors of both commission and omission. Practices are forbidden that should not be, and other practices that in fact contravene the policy of the antitrust laws are left alone.

Antitrust Enforcement

Besides the confusion of substantive doctrine, the antitrust area has been plagued by problems of remedy and enforcement. The Sherman Act as originally enacted provided that violations of the act were misdemeanors punishable by a maximum fine of $5,000 and/or imprisonment for up to one year. In addition, either the Department of Justice or a private individual or firm injured by a violation of the act could seek injunctive relief. The private plaintiff could also bring a damage suit, and if he won the court would award him an amount triple his actual damages plus a reasonable attorney's fee. The pattern of remedies set in the original act has
survived essentially intact to this day. The maximum fine was raised in 1955 to $50,000 and in 1974 to $100,000 for an individual defendant and $1 million for a corporate defendant. The 1974 amendments also increased the maximum prison sentence to three years. The Clayton Act carries no criminal penalties; otherwise it is enforced just like the Sherman Act. The Federal Trade Commission Act is enforced exclusively by the Federal Trade Commission, whose only remedy is a type of injunction called a “cease-and-desist order.”

The criminal penalties actually meted out under the Sherman Act have been exceedingly mild. Table 2 shows the average fine per case imposed under the Sherman Act, both in dollars and as a percentage of the estimated sales involved in the illegal activity in the average case. Table 3 indicates the infrequency with which imprisonment has been used as a sanction, though some increase in frequency is evident in the most recent period. The 1974 amendments may of course bring about a quantum jump in the severity of the sanctions meted out to convicted Sherman Act violators, though one doubts it. My own opinion, which is developed in

### Table 2 Fines in Price-fixing Cases, 1890–1969

<table>
<thead>
<tr>
<th>Period in Which Case Was Instituted</th>
<th>Average Fine Per Case</th>
<th>Average Fine as Percentage of Sales Involved on Conspiracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1890–1899</td>
<td>$0 (0)</td>
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</tr>
<tr>
<td>1900–1909</td>
<td>20,000 (11)</td>
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<td>1910–1919</td>
<td>20,000 (24)</td>
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<td>1920–1929</td>
<td>98,000 (15)</td>
<td>. . . .</td>
</tr>
<tr>
<td>1930–1939</td>
<td>61,000 (18)</td>
<td>. . . .</td>
</tr>
<tr>
<td>1940–1949</td>
<td>52,000 (149)</td>
<td>. . . .</td>
</tr>
<tr>
<td>1950–1959</td>
<td>40,000 (121)</td>
<td>0.08%</td>
</tr>
<tr>
<td>1960–1969</td>
<td>131,000 (103)</td>
<td>0.21%</td>
</tr>
</tbody>
</table>


*Rounded to nearest thousand.

**Number in parenthesis is number of convictions during the period.

23. For the sake of comparability, the figures in table 2 are limited to price-fixing cases; however, these constitute 70 percent of all criminal proceedings under the Sherman Act.

24. A glance at table 2 will show that the average fine in 1960–69, when the maximum fine was $50,000, was a good deal less than ten times the average fine in 1940–49, when the maximum fine was only $5,000.

### An Overview of the Antitrust Laws

#### Table 3 Prison Sentences in Federal Antitrust Cases

<table>
<thead>
<tr>
<th>Period in Which Case Was Instituted</th>
<th>Number of Cases in Which Prison Sentence Was Imposed</th>
<th>Length of Sentence</th>
<th>Characteristics of Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>1890–1894</td>
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<tr>
<td>1910–1914</td>
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<tr>
<td>1915–1919</td>
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<td>labor-sabotage</td>
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<tr>
<td>1920–1924</td>
<td>5</td>
<td>10 days</td>
<td>price fixing-labor</td>
</tr>
<tr>
<td>1925–1929</td>
<td>3</td>
<td>6 months</td>
<td>price fixing-labor</td>
</tr>
<tr>
<td>1930–1934</td>
<td>6</td>
<td>3 months</td>
<td>monopolization-violence</td>
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<tr>
<td>1935–1939</td>
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<td>labor-violence</td>
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<td>1945–1949</td>
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<tr>
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<td>90 days</td>
<td>price fixing-labor</td>
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<td>price fixing</td>
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<tr>
<td>1965–1969</td>
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<td>24 hrs–60 days</td>
<td>price fixing-labor</td>
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<td>1970–1974</td>
<td>6</td>
<td>3 months</td>
<td>price fixing-threats</td>
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*Suspended sentences and probation omitted.*
chapter 10, is that the use of the criminal laws to punish antitrust violations is fundamentally misconceived.

Although data on private actions to enforce the antitrust laws are unavailable for years prior to 1937, such actions were apparently rare during that period. Since then, they have grown explosively, as shown in table 4. Private actions for price fixing were probably rare until the private damage suits arising out of the great electrical conspiracy of the early 1960s demonstrated the opportunities for large awards in such cases (some $400 million was awarded in the electrical cases). In recent years the opportunities for substantial damages in price-fixing cases have become even greater as a result of the development of the consumer class action.

The burgeoning of the private antitrust action has induced enormous, and I think justified, concern about the overexpansion of the antitrust laws and their increasing use to retard rather than promote competition. If there were less substantive confusion in antitrust policy, the creation of effective remedies would not be a source of concern—quite the contrary. But to the extent that such confusion seems likely to remain a permanent feature of antitrust policy, we may be forced to the unappetizing choice between failing to provide effective remedies for those violations of the antitrust laws that really harm competition and efficiency, and providing remedies that can be used by private plaintiffs to block takeover attempts by more efficient firms, to harass competitors that have lower costs, and otherwise to frustrate the fundamental goals of antitrust policy. Chapter 10 attempts to resolve this dilemma.