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Book Reviews

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BOOK REVIEWS

ANTITRUST AND MONOPOLY, ANATOMY OF A POLICY FAILURE. By *Dominick T. Armentano*. New York: Wiley, 1982. Pp. xi, 292.

*Reviewed by Janet P. Ailstock.**

American antitrust laws have been under increasing attack throughout the 1970's and the 1980's, an attack possibly spurred by vigorous prosecution of the laws during the 1960's and the Warren Court's pro-antitrust stance.[1] The prestigious "Chicago School" of industrial organization economics has provided much of the intellectual support for this "anti-antitrust" movement.[2]

The foundation of the American antitrust system and, therefore, the lightning rod for the "anti-antitrust" argument is the Sherman Act of 1890.[3] The Sherman Act prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade,"[4] and forbids "monopoliz[ation], or attempt[s] to monopolize."[5] Congress enacted these sections for both political and economic reasons. Politically, public distrust of increasingly concentrated economic power was spreading rapidly during the 1870's and 1880's.[6] Economically, the social benefit of competition, whether described as the desirable effect of competitive conduct or the optimal condition of a competitive market structure, has long been clear to economists.[7]

Court interpretation of the Sherman Act has reflected this dual

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1 Remarks by W. Mueller, The Anti-Antitrust Movement, Address for Conference on Industrial Organization and Public Policy, Middlebury College, Middlebury, Vermont (April 16, 1981)(available in *Notre Dame Law Review* office).

2 The "Chicago School" is so known because of the prominence of University of Chicago economists in its ranks. Two of the better known authors in the Chicago School are Robert H. Bork and John S. McGee.

3 Act of July 2, 1890, ch. 647, 26 Stat. 209 (current version at 15 U.S.C. §§ 1-7 (1976)).

4 15 U.S.C. § 1 (1976).

5 15 U.S.C. § 2 (1976).

6 *See* Letwin, *Congress and the Sherman Antitrust Law: 1887-1890*, 23 U. CHI. L. REV. 221 (1956).

7 *See* C. KAYSEN & D. TURNER, ANTITRUST POLICY 11-20 (1959).

purpose. Court decisions have held purely anticompetitive conduct, such as price-fixing, illegal under the Sherman Act[8] as well as conduct which tends to lessen competition or tends to sustain a firm's intent to monopolize a market.[9] Predatory pricing, price discrimination and horizontal mergers also may, under varying circumstances, lessen competition in the free market and thereby violate the Sherman Act.[10]

In contradistinction to this classical view, many Chicago School economists contend that mergers, joint ventures, vertical distribution schemes and price discrimination have more competitive than anticompetitive effects. Therefore, they argue, diversion of conduct away from these now-illegal practices produces inefficiencies to producers and higher costs to the public. Thus, they disagree with contemporary application of antitrust policy, not its stated goal of maintaining a competitive market. They accept the basic premise that price fixing and market division, with the resultant output restrictions, are undesirable due to the tendency to cause higher prices, inefficient cost structures and misallocation of society's resources (commonly referred to as a "welfare loss"). They contend, however, that the competitive market, over time, will mitigate the harmful effects of such conspiracies.[11]

Although it is not without its critics,[12] this school of thought has been gaining support during the past decade due to its careful use of microeconomic theory. Not surprisingly, financial support for the "anti-antitrust" movement has been provided by the business community. Foundations, such as the American Enterprise Institute, the Hoover Institution, the Heritage Foundation and the Law and Economics Center at Emory University, have become established centers for conservative economic thought primarily financed by the business commmunity.[13] The Law and Economics Center, for example, invites law professors and members of the judiciary to attend an expense-paid two week seminar that exposes them to scholars who lecture on conservative economic principles and the dangers of gov-

8 United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 219-24 (1940).

9 *See* National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679 (1978); Goldfarb v. Virginia State Bar, 421 U.S. 1773 (1975).

10 Standard Oil Co. v. United States, 221 U.S. 1 (1911); United States v. American Tobacco Co., 221 U.S. 106 (1911).

11 R. BORK, THE ANTITRUST PARADOX 7-8 (1978)[hereinafter cited as BORK].

12 *See* Adams, *Antitrust and a Free Economy*, in INDUSTRIAL CONCENTRATION AND THE MARKET SYSTEM 33-44 (1979)(short review of the need for a vigorous antitrust enforcement policy).

13 Mueller, *supra* note 1, at 10-11.

ernmental interference in the affairs of business.[14] Their position is spread in the numerous books and articles published under their auspices. For example, the Law and Economics Center recently published *The Attack on Corporate America*, containing a series of essays on the antitrust laws.[15] These essays could potentially serve as position papers for business executives, the type of tear-sheet speeches suitable for a local businessman's lunch club monthly meeting. In that fashion, they may be used to promote the philosophy that since the market will take care of anticompetitive practices, enforcement of the antitrust laws is inefficient.

The popularity of the "anti-antitrust" movement can be seen in many of the policies of the Reagan administration. Attorney General William F. Smith has said, "In the past, under the guise of promoting competition, other administrations have pursued a number of misguided and mistaken concepts that have generated anticompetitive results in the name of antitrust enforcement. . . .[S]ome argue that competition is synonymous with a large number of competitors. Economic reality, however, is more complex."[16] The Department of Justice has recently revised its merger guidelines to allow greater merger activity.[17] David Stockman, Director of the OMB, has said, "I disagree with the whole antitrust tradition."[18]

The "movement" has successfully promulgated its views to those in positions of power, if not to the general public. Professor Armentano's book properly can be evaluated only against this political backdrop.

Professor Armentano's book provides an interesting review of the basic economic theories underlying competition law and the major cases which have shaped it. However, although he agrees with the Chicago School's criticisms of the antitrust laws, he goes far beyond them. He believes, as the Chicago School adherents do, that the implementation of the Sherman Act has been misguided due to the lack of understanding of competitive, efficient business behavior. He also asserts, however, that the neoclassical model, which is the basis for defining the optimal allocation of society's resources and upon which American antitrust law is predicated, is flawed. He be-

14 Washington Post, Jan. 20, 1980, at A1, col. 3.

15 THE ATTACK ON CORPORATE AMERICA 173-302 (M.B. Johnson ed. 1978).

16 *Attorney General William French Smith's Remarks to District of Columbia Bar*, [July-Dec.] ANTITRUST & TRADE REG. REP. (BNA) No. 1021, at H-2 (July 2, 1981).

17 *Justice Department Merger Guidelines*, [Jan.-June] ANTITRUST & TRADE REG. REP. (BNA) No. 1069, at S-3 (June 17, 1982).

18 Mueller, *supra* note 1, at 12.

lieves that the real obstructions to productivity in a free market are not cartels or monopolists, which the model describes as non-optimal, but the government and its regulations which impose restraints on business through its protectionist policies such as import tariffs, regulatory schemes, quotas and licensing (p. 272).

His persistent charge against the government as a participant or co-conspirator in the perpetuation of monopoly power is an argument with which few industrial economists would disagree. But while he deplores governmentally sanctioned monopoly power on the one hand, he neglects to discuss the frequent genesis of such monopoly power. Thus, he ignores the traditional teaching that concentration of wealth and the tendency for large corporate wealth to wield its power over the government often results in the enactment of anticompetitive statutes and regulations for their respective industries.

The Sherman Act was enacted in 1890 because of public distrust of such aggregation of wealth and its attendant concentration of economic power; thus, the Act traces its origins to both political and economic foundations.[19] Therefore, even though the economic effects of the Act are certainly relevant to antitrust policy, it is myopic to discuss the Act and its consequences exclusively from that perspective.[20] Professor Armentano's analysis of the very real problem of governmental monopoly fails to adequately consider the political side of the competition problem. Evidently, he was caught on the horns of a dilemma, for a discussion of the political aspects of concentration of wealth and the ability it generates to capture the government would have diffused his arguments favoring horizontal merger activity and the resultant concentrated industries.

Armentano divides his analysis into two major sections. The first two chapters contain a review of economic price theory and a critique of the neoclassical economic model, an important component of price theory, which underlies competition policy. These chapters are the most important in the book. He believes that the model fails to support the basic premises about the nature of competitive behavior that have evolved over the past century (pp. 22-25). Thus, if competitive behavior has been misunderstood, the cases distinguishing competitive behavior are inherently wrong (p. 6). The theoretical arguments developed in these two chapters provide the bases on which Armentano critiques the adjudication of specific ille-

19 *See* notes 6-7 *supra* and accompanying text.

20 Blake & Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377 (1965).

gal business conduct under the Sherman Act. The following seven chapters discuss this conduct and the major determining cases.

Professor Armentano's questioning of the neoclassical model stems from his historical explanation of market conditions in 1860-1890 and the impetus for the enactment of the Sherman Act. Citing Joseph McGuire's book *Business and Society*,[21] he notes the inconsistency of juxtaposing the increasing collusion by firms during the post-Civil War period with remarkable increases in technology and severe competition in the market (p. 14). To the practitioners of antitrust enforcement, however, these circumstances are not inconsistent but rather are entirely predictable. An empirical review of the antitrust cases prosecuted by the Justice Department indicates that collusive activities are more frequent in depressed markets.[22] In fact, firms faced with depressed prices and spare capacity naturally seek to maintain profits by cutting prices, making technological improvements to increase efficiency and cut costs, and, especially for the inefficient or unlucky (or incompetent) firms unsuccessful in so improving their operations, fixing prices. Thus, economists would *expect* to find increasing collusive conduct during the post-Civil War period, which spanned two major business recessions.

Thus, Armentano's intellectual basis for re-examining the neoclassical model is a tenuous one at best. I would suspect that the current "anti-antitrust" movement played a greater role in his desire to critique the model than any apparent historical inconsistency easily explained in the industrial organization literature. The first sentence of the Introduction, a quotation from Lester Thurow, further corroborates these suspicions: "It is now admitted that contrary to the conventional wisdom, the enforcement of the antitrust laws may have made the economy less efficient, and may have been an important contributing factor to the steady decline of business productivity in America" (p. 1). Professor Thurow, a well known M.I.T. economist, is one of the popularizers of the belief that the antitrust laws have failed to keep our economy competitive. His criticisms of the antitrust laws are often the subject of articles in newspapers and magazines.[23] However, Professor Thurow is not an industrial organization economist by training, and his arguments in favor of concentration, product differentiation and various other anticompetitive

21 J. McGuire, Business and Society (1963).

22 Hay & Kelly, *An Empirical Survey of Price Fixing Conspiracies*, 17 J. L. & Econ. 13 (1974).

23 N.Y. Times, Oct. 19, 1980, at 2F, col. 3; *Abolish the Antitrust Laws*, 117 Dun's Rev. 72 (February 1981).

practices[24] have come under severe criticism.[25]

Professor Armentano sees a basic flaw in the neoclassical model's description of an individual firm's demand curve under conditions of perfect competition. To understand Armentano's objection to the model, a brief description of the model is necessary. The model provides the basis for defining the optimal allocation of society's resources and anchors present competition policy. It suggests that a society's resources will be most efficiently employed and consumers will be better off under conditions of perfect competition. Perfect competition exists when there are many small sellers in the market. Any one seller perceives that his output decisions will not affect the market price that consumers pay for the produced goods. In other words, each firm believes that prices are determined by market supply and demand rather than by any one firm's output decision. Consequently, an individual firm has no economic incentive to reduce production in order to achieve a higher price for its goods. Firms reduce their production when the cost to produce an additional unit (the marginal cost of production) exceeds the price received for that unit. Thus, an individual firm's demand curve is said to be horizontal or flat, because the price received for the output (the height of the curve), remains constant regardless of the quantity produced (the distance from the vertical axis).[26]

Economists, both critics and supporters of the antitrust laws, generally accept that the model of pure competition may be "an extreme statement, since it may be that all sellers can affect market price somewhat, but it is conventional to ignore very small effects and to draw the individual firm's demand curve flat in fragmented markets."[27]

Professor Armentano rejects this conventional approach because he rejects the possibility that any firm can have a horizontal demand curve. This rejection is founded on the existence of a model that predicts how a firm will act under conditions of imperfect competition. This model predicts that when a market is highly concentrated or when firms are colluding a dominant firm or a group of colluding firms can increase the market price through their output decisions. Thus, one firm would have the incentive to reduce its output to an optimal quantity, which would maintain a higher market price for

24 L. THUROW, THE ZERO-SUM SOCIETY 145-50 (1980).

25 *See* Mueller, *supra* note 1, at 13-26.

26 F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 12-14 (1980)[hereinafter cited as Scherer].

27 BORK, *supra* note 11, at 92-93.

less output and result in higher overall profits. When this situation of imperfect competition exists, a firm is said to have a negative sloping demand curve, because the more it produces, the less it receives per unit of production. Consequently, the firm can restrict its output and receive a higher price per unit.[28]

Professor Armentano asserts that because a seller's output decision might have an effect on market price, all sellers have a negative sloping demand curve. Thus, to him, all sellers have an incentive to restrict their output to a point where marginal cost is just equal to marginal revenue, which is less than the market price. This results in a higher market price and a lower quantity produced. He says that it becomes "obvious then that such behavior can no longer be uniquely associated with market power, but is, instead, the natural conduct and performance of all business organizations" (p. 24).

Professor Armentano is correct that the "natural conduct" for a firm is to attempt to achieve a higher price for its product, thereby maximizing its profits. In fact, recognition of man's tendency towards achieving a higher price was expressed long ago by Adam Smith: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."[29] However, competition policy does not strive to prohibit the "natural conduct" of a firm's desire to achieve a higher price for its goods.

Unfortunately, Professor Armentano's discussion of "natural conduct" emanating from the imperfect competition model ignores the effects of the countervailing tensions of competition in the market place working against a firm's objective of profit maximization. Price theory predicts that competition will only allow a firm to receive the market price for its product, because "any manufacturer who quoted a price above the prevailing market price would make zero sales, since every purchaser would turn to another supplier."[30] Thus, it is not obvious why a firm operating in a competitive market, and acting unilaterally, would "naturally" act like a monopoly, restricting its output to a level of production above the competitive market price, thereby losing all of its sales. Professor Armentano's failure to consider the impact of competition, which would reverse any "natural conduct" of the tendency to restrict output in order to achieve a higher price, is entirely inconsistent with the views ex-

28 R. BLAIR, MICROECONOMICS FOR MANAGERIAL DECISION MAKING 330-33 (1982).

29 A. SMITH, THE WEALTH OF NATIONS, bk. I, ch. X (1776).

30 BORK, *supra* note 11, at 92-93.

pressed in Chapter Five. There he states that the competitive market is vigorous enough to ameliorate the harmful effects of the most egregious price-fixing agreements (p. 137). Thus, he believes that competition is a pervasive, vigorous force in the market place. However, his "natural conduct" argument chooses to incorporate these effects only selectively.

Professor Armentano further objects to the model because it is static rather than dynamic. This static nature is generally accepted by economists, but they still find the model useful because it "represents the ultimate situation toward which economic forces tend to drive the firm."[31]

Professor Armentano, having rejected the competitive model, suggests an alternative approach to achieve the desired goal of maximizing society's welfare. In this discussion he assumes that "individual human action is purposeful and aims at accomplishing selected ends by adopting patterns of resource use (plans) consistent with those ends. If the means employed in the pursuit of selected ends are consistent with those ends, thus the means or plans are said to be efficiently employed" (p. 29). Having adopted that assumption, he believes that any business conduct, such as price fixing, market division or production restrictions can be efficient. One must have a Rousseauan faith about man's business conduct to accept Armentano's assumption without empirical or theoretical proof. The remainder of the book does not offer such proof.

The second section of the book reviews the major cases in antitrust law in light of the theoretical discussion in the first part. Chapter Three (pp. 49-84) contains a review of *Standard Oil of New Jersey*,[32] a classic antitrust case. A study of the structure of the petroleum industry in this country from 1846 to the present provides the facts on which Armentano bases his hypothesis that monopoly is the result of government intervention rather than the free market (p. 55). He is convincing in his argument that the government has helped the petroleum industry achieve monopoly profits since 1911 through state pro-rationing schemes designed to balance crude oil supply and demand, import tariffs designed to keep inexpensive Middle Eastern crude oil out of U.S. markets during the 1960's, the favorable taxation schemes on oil provided through the depletion allowance and foreign tax credit provisions during the 1960's and the price regulations and allocation controls in the 1970's (in which the U.S. Depart-

31 *Id.* at 95.

32 Standard Oil Co. v. United States, 221 U.S. 1 (1911).

ment of Energy performed the difficult and costly function of an administrator of customer allocation schemes, initially drafted by the industry and later adopted by the federal government). Implicit in a customer allocation agreement is the objective that suppliers will not compete for existing customers. Obviously, the absence of competition to supply customers results in a higher price structure than if competition for supplies were present.

Professor Armentano's belief that because competition was rampant in the oil industry prior to World War I, there was no need to divest the Standard Oil Trust of its monopoly power is more controversial. Even though the Standard Oil Trust controlled 90% of the rapidly growing petroleum industry in 1890,[33] Armentano attributes Standard Oil's market power to its intense competitive nature and its competitive conduct. Indices of competitive behavior in the petroleum industry were secret rebates to railroads, predatory pricing practices (the objective of which was to drive competitors out of the market) and the buying up of competitors in order to achieve greater market power (pp. 60-63). According to Armentano, "there was no restriction of supply and monopoly prices were never realized, even during periods of relatively high market share" (p. 66). Unfortunately, on reading this example of supposedly misdirected antitrust enforcement, one is not convinced that the Standard companies were not engaging in conduct that contributed to a lessening of competition. Predatory pricing may be competitive in nature, but when employed by a firm with 90% market power its effect could be less than socially optimal if it prohibited the entry of new, efficient competitors. Such conduct on the part of a monopolist would tend to artificially stimulate demand while the prices were below cost, generating hidden social costs, and then extract monopoly profits after the competitors were forced out of the market.

Chapter Five contains a review of price-fixing theory and several cases (pp. 133-166). Although Armentano is not convinced that successful price-fixing conspiracies necessarily work against the public interest, due to the socially beneficial results from "natural conduct" (p. 133), he doubts that conditions would ever permit the success of such a price-fixing agreement. Armentano thus follows the belief of his "Chicago School" colleagues that cartel prices lead to excess profits which attract entry of new firms. If this entry process is instantaneous the price-fixing ring would be unsuccessful because greater

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33 B. BRINGHURST, ANTITRUST AND THE OIL MONOPOLY 1 (1979).

supply generated by these new firms would drive prices down.[34] However, even Bork recognizes that "[a]ntitrust is valuable because in some cases we need not suffer losses while waiting for the market to erode cartels and monopolistic mergers."[35]

In the real world, markets do exist which, over a substantial period of time, meet the following conditions: inelasticity of demand, concentrated industry, and barriers to entry while demand is increasing. In these difficult-to-enter industries, the social costs of allowing cartels or concentration is great. Classic examples, omitted by Professor Armentano but presently on the minds of the American public are the American steel and auto industries and their failure to compete on a price basis with foreign competition during the 1970's. Entry barriers such as economies of scale, product differentiation and import tariffs insulated them from the effects of domestic and foreign competition for years, and now they find themselves non-competitive compared to their more efficient foreign rivals. We are presently experiencing the pernicious effects in unemployment and higher prices from a lack of maintaining domestic competition within these two very important industries. Although there may be few concentrated markets where entry barriers are high, the need for a vigorous antitrust policy to ensure competition in these markets through market structure guidelines or through acceptable conduct rules is a point Armentano neglects to underscore.

Instead, ignoring the misallocation of resources problem, he reverts back to his earlier premise that all agreements are the result of "natural conduct" and "are explicit evidence of an attempt to increase efficiency and ought to be allowed" (p. 137). He believes the loss to society is not subject to rigorous measurement, and so these losses are subjective in nature (p. 138). Because he believes the benefits of price fixing could outweigh the costs of prohibiting price fixing, he recommends abolishing even this prohibition in the antitrust laws.

The most serious danger to him in prohibiting price fixing is the possible misinterpretation that "tacit agreement" or interdependence among oligopolists may be misperceived as collusion by the authorities (p. 138). There is much debate concerning theories of tacit collusion in oligopoly,[36] and this important legal question remains unanswered by antitrust scholars and practitioners. Bork believes that "[o]ligopoly theory is really a first cousin of the theory of overt

34 *See* BORK, *supra* note 11, at 311.

35 *Id.*

36 *See* SCHERER, *supra* note 26, at 149-182.

collusion."[37] However, since the penalty for price fixing is a felony conviction, price fixing is a clandestine act. Consequently, it is very difficult for prosecutors to obtain evidence of an agreement and the empirical evidence for establishing the existence of agreement is difficult to discover. Armentano's treatment of the oligopoly problem is a superficial one at best.

Armentano reviews three price-fixing cases in which he concludes that the conspiracies were ineffectual in sustaining high prices (pp. 138-163). The Department of Justice brought these cases, so it is not surprising that empirical evidence concerning the amount of the overcharge attributable to the conspiracy did not exist. The Department of Justice prosecutes for relief, not proprietary injury. Overcharges to the consumers, which are only one measure of damages to society, would be more accurately measured by reviewing private antitrust cases.

In summary, Armentano's acceptance of the conclusions that the competitive model is inaccurate, that a firm's "natural conduct" is output-restricting behavior, and that any business behavior is efficient and thus socially optimal, are the bases for his proposal to abolish the antitrust laws. According to Armentano, concentrated industries or monopolies are socially optimal due to the arbitrariness of the model (p. 39); price fixing is efficient because business behavior is always efficient; price discrimination is competitive behavior because his perceived flaw in the model prevents reaching the goal of perfect competition (p. 168); and tying agreements should be allowed because one has difficulty measuring their costs or benefits (p. 225). That his analysis requires three hundred pages is not evidence of rigorous proof of these theories, but rather his proselytizing approach to the subject.

37 *See* BORK, *supra* note 11, at 185.