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PRAGMATIC COMPETITION—A COALESCENCE OF LAW AND ECONOMICS

*by Jason C. Blackford**

In the vocabulary of the social control of business, no term is more praised, more condemned, more desired, and at the same time, less understood than "competition". This simple word forms the basis for our present national antitrust policy. Yet, "competition" has a different meaning for the attorney, the economist and the businessman. These real and theoretical differences stand in the way of the development of a comprehensive and coherent policy for the control of business. It is time to recognize and to coalesce these differences.

It is submitted that many judges and attorneys, both in private practice and in government, are so involved with doing legal gymnastics with the concept of competition that they ignore the basic premise underlying any legislation regulating business. In this juggling of "competition", many have interpreted "competition" as a market structure where the individual firms possess a minimum of economic power. This concept of competition forsakes economic realities and seeks a specific type of market structure rather than the ultimate social benefits of lower prices, improved product quality and increased technological innovation. The use of a market structure test has resulted in the protection of individual competitors within the market and to a degree reduced the competitive atmosphere. The purpose of Government regulation should be to create beneficial economic results rather than to design an artificial market structure.

It is the thesis of this article that it is impossible to reconcile the existing legal concepts of "competition", based primarily on market structure, with modern economic theories. New legal criteria, not based on the structure of a market, must be developed to conform with modern theory. To substantiate this hypothesis, an analysis will be undertaken of the development of present legal policy (based on market structure wherein none of the individual firms possess a substantial degree of economic power) and the concept of "competition". Specific attention will be directed toward the economic concepts which the legislative branch and the courts believe underlie the antitrust laws.

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This analysis will be confined to the statutory prohibitions against monopoly and monopolization. Restrictive trade and pricing practices which affect or are incident to economic power will be excluded. There will be an attempt to explain in layman's terms, the evolution of present economic theories of competition. It will be shown that the economic theories upon which many of the courts and the drafters of the Sherman Act relied are no longer completely accepted as valid. A kaleidoscope review will be undertaken of the last seventy years in the world in which business functions. Special attention will be directed toward government policies which have been enacted that tend to produce results directly opposite the goals of the present antitrust laws. Finally, an attempt will be made to synthesize law and economics in a pragmatic approach to the concept of "competition".

I. LEGAL PERSPECTIVE

The legal prohibitions against the economic power of individual business units are not recent developments but go back as far as the time of Roman Emperor Zeno.¹ English common law and statutes prohibited trade practices which hindered the free flow of commerce. They also outlawed monopolies, granted by the Crown, which created undesirable economic consequences, such as increased prices and the deterioration of goods.² While the United States shared England's common law heritage,³ legislative action forms the basis of our national antitrust policy.

The substantive provisions of the present antitrust laws are few and brief. They are largely contained in seven sections of three statutes—

¹ For an excellent study of the history and development of Antitrust Law see H. TOULMIN, JR., *A TREATISE ON THE ANTI-TRUST LAWS OF THE UNITED STATES* (1949) [hereinafter cited as TOULMIN].

The Emperor Zeno promulgated laws against monopolies and against any combination which sought to inflate the price of merchandise. Those violating those prohibitions were subject to forfeiture of their goods or to banishment. 1 TOULMIN *supra*, at 24.

² Hawkins, following Lord Coke's definition, 3 Coke's Inst. 181, c. 85, defined a monopoly as an "allowance by the king to a particular person or persons of the sole buying, selling, making, working or using of anything whereby the subject in general is restrained from the freedom of manufacturing or trading which he had before." Hawkins, P.C. bk. 1, c. 29, quoted in *Standard Oil Co. v. United States*, 221 U.S. 1, 51-52 (1910). See also 1 TOULMIN, *supra* note 1, at 32.

³ For a thorough analysis of the common law development see Jones, *Historical Development of the Law of Business Competition*, 35 YALE L.J. 905, 906-20 (1926); Letwin, *The English Common Law Concerning Monopolies*, 21 U. CHI. L. REV. 355 (1954); Davies, *Further Light on the Case of Monopolies*, 48 L.Q. REV. 394 (1932). The turning point in this development was the Statute of Monopolies, 21 Jac. I, c. 3 (1623-24), wherein royal monopolies were rendered illegal. See H. THORELLI, *THE FEDERAL ANTITRUST POLICY* 26 (1955).

The Sherman Act of 1890,⁴ the Clayton Act and its amendments,⁵ and the Federal Trade Commission Act of 1914.⁶ Four of these seven substantive provisions, to-wit, Section 2 of the Sherman Act, Sections 7 and 8 of the Clayton Act, and Section 5 of the Federal Trade Commission Act directly regulate business activity other than trade practices.

1. Section 2 of the Sherman Act - declares illegal (a) monopolization, (b) attempts to monopolize, and (c) combination or conspiracies to monopolize.
2. Section 7 of the Clayton Act - prohibits acquisitions, the effect of which "may be substantially to lessen competition or to tend to create a monopoly."
3. Section 8 of the Clayton Act - prohibits (a) interlocking bank directorates, (b) interlocking directorates of corporations with a net worth of more than one million dollars, and (c) interlocking directorates between railroads and their suppliers.
4. Section 5 of the Federal Trade Commission Act - declares unlawful, unfair methods of competition and unfair or deceptive practices in commerce.

The Sherman Act does not refer to competition in any manner, instead, it uses the term "monopolize". There is no statutory definition of "monopolize"—its meaning has instead been developed by the courts. Section 7 of the Clayton Act uses the word "competition" and "monopoly" but does not define either.

The initial step in the inquiry as to the legal meaning of "monopolize", "competition" and "monopoly" under the Sherman and Clayton Acts will be to review briefly their legislative history.

A. *The Intent of Congress in Enactment of the Antitrust Laws.*

It is not the purpose of this article to delve extensively into the minds of the senators and congressmen who drafted the antitrust legislation and participated in the legislative debates. Exhaustive analyses of these legislative histories have been detailed elsewhere.⁷ It is sufficient to generalize that Congress, in its enactment of the Sherman Act and the Clayton Act was attempting to correct certain abuses wrought by large accumulations of capital. The recurrent themes that run throughout

⁴ 15 U.S.C. §§ 1, 2 (1964).

⁵ 15 U.S.C. §§ 13, 14, 18, 19 (1964).

⁶ 15 U.S.C. § 45 (1964).

⁷ H. THORELLI, *supra* note 3, at 225-32; A. WALKER, *HISTORY OF THE SHERMAN LAW* (1910); D. MARTIN, *MERGERS AND THE CLAYTON ACT* 43-56 (1959).

the legislative development of the Acts are a fear of the power of large accumulations of capital and a desire to avoid price increases, product deterioration and quantity restriction.⁸ No senator or congressman advocated any specific market structure which required numerous small and independent economic units. On the contrary, many recognized the need for sufficient capital to assume large risks and to market complicated products.⁹ In retrospect, commentators have asserted that the enactment of the Sherman Act was a manifestation of Social Darwinism and the Protestant Ethic of that era.¹⁰ Undoubtedly, the concept of *laissez-faire* which was widely accepted at that time and the rural composition of Congress were factors in the enactment of the Sherman Act and the original Clayton Act. But it is impossible to determine the extent of the impact of these doctrines.

The role of the economist in the formulation of the Sherman Act and the original Clayton Act was minimal. Not one economist was asked to testify before the investigating congressional committee which formulated the Sherman Act. In the speeches on the floor, those debating did not invoke the name of any economist to support their

⁸ "It can control the market, raise or lower prices, as will best promote its selfish interests, reduce prices in a particular locality and break down competition and advance prices at will where competition does not exist. Its governing motive is to increase the profits of the parties composing it." 21 CONG. REC. 2457 (1890) (remarks of Senator Sherman). Senator Pugh noted the need to prevent combinations whose purpose is "to limit production". 21 CONG. REC. 2558 (1890). Senator Morgan and Representative Culberson, the representative in charge of the bill, both warned about the power to control prices and the attendant consequences of accumulation of capital. 21 CONG. REC. 2609 (1890) (remarks of Senator Morgan); 21 CONG. REC. 4089 (1890) (remarks of Representative Culberson).

As to the Clayton Act, see D. MARTIN, *MERGERS AND THE CLAYTON ACT* 43-56 (1959). See generally S. REP. NO. 698, 63rd Cong. 2d Sess. 1 (1914). The purpose is "to arrest the creation of trusts, conspiracies and monopolies in their incipiency and before consummation." The 1950 Amendment to Section 7 was to prevent acquisition when the power existed to move prices upward. H. REP. 1191, 81st Cong. 1st Sess. 4-5 (1949); S. REP. 1775, 81 Cong. 2d Sess. 7-9 (1950).

⁹ 21 CONG. REC. 2457 (1890) (remarks of Senator Sherman). "A trust for certain purposes, which may mean simply a combination of capital, may be a valuable thing to the community and the country." 21 CONG. REC. 2471 (1890) (remarks of Senator Teller); 21 CONG. REC. 2606 (1890) (remarks of Senator Stewart).

¹⁰ The colloquy between Senator Kenna and Senator Hoar is illustrative of this concept. Senator Kenna: "Is it intended as the sections seem to indicate, that if any individual engaged in trade between states - by his own skill or energy, by the propriety of his conduct generally shall pursue his calling in such a way as to monopolize a trade, his action shall be a crime under the Act?" Senator Hoar: "Monopoly is merely a technical term which has a clear and legal signification, and it is this: It is a sole engrossing to a man's self by means which prevent others from engaging in fair competition with him." 21 CONG. REC. 3151-52 (1890).

positions, and much of the debate centered on tariff policy and the constitutionality of the bill.¹¹

It is easy for lawyers and judges to review a legislative history and find quotations to substantiate their position, regardless of what it may be. This writer believes that the draftsmen of the Sherman Act and the original Clayton Act were practical men not advocating any wild scheme of business regulation. It is submitted that Congress was attempting to solve the problem of the abuses created by certain large corporations which controlled substantial economic power in a specific area. Relying upon the common law as it then existed, most congressmen, in enacting the Sherman Act, believed they were merely codifying and to some extent expanding the common law prohibitions against unreasonable restraints of trade.¹²

The legislative history of the Sherman Act and the original Clayton Act do not indicate that a market consisting of numerous small independent entrepreneurs was favored. The statements of several of the important proponents indicated a preoccupation with the practices and with the possible adverse economic consequences which could flow from the exercise of monopoly power.¹³ After the enactment of both Acts the courts were cast adrift without any clear guidelines with respect to the application and scope of the legislation. As a result, the courts have had to develop their own tests for evaluating the legality of business activity under these sections.

B. *The Market Structure Test.*

Although the text of the pertinent antitrust law does not specify a market structure test, the courts have engrafted upon the phrases "monopolization" and "substantially lessen competition" just such a test. This market structure test takes many forms and it is primarily the adjudication of the legality of a firm's activities under Section 2 of the Sherman Act and Section 7 of the Clayton Act by a quantitative measurement of the economic power controlled by such a firm. On the

¹¹ The Congressional debates, in this author's opinion, reveal a complete lack of knowledge on the part of the participants as to any economic theory.

¹² See note 10, *supra*; 21 CONG. REC. 2456-57 (1890) (remarks of Senator Sherman); 21 CONG. REC. 2558-59 (1890) (remarks of Senator Pugh).

¹³ Disturbing the social order, inequality of condition, higher prices, price fixing. 21 CONG. REC. 2460 (1890) (remarks of Senator Sherman); TOULMIN, *supra* note 1, at 23. As to the original Clayton Act, Section 7, see D. MARTIN *supra* note 7, at 46, and remarks of Senator Cummins regarding resort to government controls to fix prices. 51 CONG. REC. 14256 (1914). See generally 1950 Amendment to Section 7 of the Clayton Act.

horizontal level, the market structure test scrutinizes the percentage of the relevant sales market controlled by the defendant and the relative strength of the defendant's competitors. In appraising the legality of vertically integrated power, the quantitative amount of the foreclosure of the defendant's rivals from a market is the primary test. Conglomerate or diversified economic power is found to violate the anti-trust laws if the size of the organization can potentially be detrimental to the competitors in a particular field.

The evolution of the market structure test is demonstrated by a review of the application of Section 2 of the Sherman Act to monopolization. Section 7 of the Clayton Act, as amended, did not undergo such an evolution but incorporated the market structure approach as it had been developed by the courts under Section 2 of the Sherman Act.

C. *Development of the Market Structure Test Under Section 2 of the Sherman Act.*

As indicated, Section 2 of the Sherman Act did not incorporate a market structure test but rather introduced a new term to the vocabulary of public control of business "monopolization". It was not until the Supreme Court decision in *Standard Oil Co. v. United States*¹⁴ that meaning was given to the term "monopolization". At this initial stage, the Court did not define the term by means of a market structure approach. Rather, Justice White, unable to find a meaning for the word at common law, resorted to analogizing "monopolization" to the concept of monopoly at common law.¹⁵ The common law concept of monopoly was conceived by Justice White to be those market situations wherein the defendants possessed a degree of economic power *and* engaged in predatory practices which produced non-beneficial economic results such as: 1) increased prices, 2) restriction of production, 3) deterioration of quality, and 4) the elimination of competitors.¹⁶ In other words, monopoly or "monopolization" was not conceived to be a specific type of market but was interpreted as the existence and exercise of economic power which generated non-beneficial economic consequences. There was no condemnation of mo-

¹⁴ 221 U.S. 1 (1911).

¹⁵ *Id.* at 51-52.

¹⁶ *Id.* at 52. Mr. Justice White was able to do this by observing that there was no common law prohibition against the creation of a monopoly by an individual and that the statute omitted "any direct prohibition against monopoly in the concrete". *Id.* at 52.

nopoly power standing alone. The existence of abusive practices causing non-beneficial economic consequences inferred the requisite of intent.¹⁷ The Supreme Court in subsequent cases¹⁸ continued to apply this analysis which can best be labeled as an abuse test. The discussions of economic power in these cases centered on the amount of capital accumulated by the defendants rather than the percentage of a market controlled by the defendants.¹⁹

To summarize, the Supreme Court decisions in *Standard Oil*,²⁰ *American Tobacco Co. v. United States*,²¹ *Union Pacific Railroad Co. v. United States*²² and others, was primarily an "abuse" test emphasizing the element of intent. Upon non-beneficial economic consequences and predatory practices the court would infer that the defendant had an intent to monopolize. When this intent was combined with substantial economic power, Section 2 of the Sherman Act had been violated.

The abuse test continued as the primary method of determining the legality of a firm's action under Section 2 until the decision of Learned Hand in *United States v. Aluminum Co. of America*.²³ This landmark decision shifted the emphasis from an abuse test to a market structure test by manipulation of the concept of intent. Judge Hand in *Alcoa* found that there was monopoly power by defining the total market and then ascertaining the percentage of that market controlled by the defendant.²⁴ Judge Hand then stated that the defendant was guilty of monopolization if its monopoly power was achieved by

¹⁷ *Id.* at 75.

¹⁸ *United States v. American Tobacco Co.*, 221 U.S. 106 (1911); *United States v. United States Steel Corp.*, 251 U.S. 417 (1917); *United States v. Union Pac. R.R. Co.*, 226 U.S. 61 (1912).

¹⁹ For example, in *Standard Oil*, the opinion of Mr. Justice White merely enumerated the companies controlled by Standard Oil and its share ownership of each. No total asset figure was used. 221 U.S. 1, 71 n.1 (1911). A generalized statement was made that "aggregating a so vast capital, gives rise, in and of itself, in the absence of counter-vailing circumstances, to say the least, to the prima facie presumption of intent and purpose to maintain dominance over the oil industry . . ." *Id.* at 25. In *American Tobacco* the total output of the corporation in 1891 was stated. 221 U.S. 106, 159 n.1 (1911). The gradual accumulation of companies is detailed but an asset analysis or market study is not undertaken.

²⁰ 221 U.S. 1 (1911).

²¹ 221 U.S. 106 (1911).

²² 226 U.S. 61 (1912).

²³ 148 F.2d 416 (2d Cir. 1945).

²⁴ Although the market was limited to virgin aluminum ingots, the effect of the "secondary" aluminum was considered. *Id.* at 424-25. The court concluded that Alcoa's control over the ingot market was reckoned to be over 90%. *Id.* at 425.

maneuvers which, though "honestly industrial", were not economically inevitable but were the results of conscious business choice.²⁵ Intent was derived from the mere existence of size,²⁶ in the absence of proof that the defendant had the power "thrust" upon him. The requirement of predatory practices or non-beneficial economic consequences was eliminated. Evidence of reasonable profits or other beneficial economic consequences was rejected by the court on the assumption that "unchallenged economic power deadens initiative, discourages thrift and depresses energy."²⁷ To substantiate the condemnation of size Judge Hand cited statements by Senator Sherman.²⁸ A review of these statements indicates that they were taken out of context and did not reflect the position of Senator Sherman as there were indications that the Senator conceived a monopoly not only in terms of size, but also in terms of economic consequences.²⁹ The only other authority which was cited to support this analysis was Judge Hand's opinion in *United States v. Corn Products Refining Co.*³⁰

The opinion by Judge Hand chanted the ritualistic liturgy that "mere size" is not an offense against the Sherman Act but then proceeded to "disregard any question of intent."³¹ The only intent necessary is a general intent to maintain the economic power. In other words, any conscious activity which does not decrease the market percentage controlled infers general intent. By the elimination of a specific intent to monopolize, there is no other requirement except a high degree of market penetration which in itself a court construes as evidence of general intent. In spite of the homage to the abuse test, a strict market structure test was created.

Many experts believe that *Alcoa* has been approved by the United

²⁵ "It was not inevitable that it should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel." *Id.* at 431.

²⁶ *Id.* at 430-31.

²⁷ *Id.* at 427. The lower court had found that *Alcoa's* profit upon capital invested after the payment of income taxes had been only about 10%. Even Judge Hand stated that *Alcoa* had not made exorbitant profits on ingot aluminum. *Id.* at 427-28.

²⁸ *Id.* at 428-29 n.1, citing 21 CONG. REC. 2457 (1890), 21 CONG. REC. 2460 (1890), 21 CONG. REC. 2598 (1890).

²⁹ L.S. LEVY & R. J. SAMPSON, *AMERICAN ECONOMIC DEVELOPMENT* 494 (1962).

³⁰ 234 F. 964 (S.D.N.Y. 1916).

³¹ *United States v. Aluminum Co. of America*, 148 F.2d 416, 431 (2d Cir. 1945).

States Supreme Court.³² This concept of approval originated with Judge Wyzanski's opinion in *United States v. United Shoe Machinery Corp.*³³ In that opinion, three different but cognate approaches are recognized in determining whether a defendant has violated the monopolization provisions of Section 2 of the Sherman Act.³⁴ First, the "abuse" test is recognized. A second more inclusive approach is identified with Justice Douglas's opinion in *United States v. Griffith*.³⁵ Judge Wyzanski interpreted that opinion as not requiring a showing of a violation of Section 1 of the Sherman Act to prove a violation of Section 2. If an enterprise has the power to exclude competition and has exercised such power or intends to exercise this power, then Section 2 is violated. Judge Wyzanski differentiates this approach from the abuse test by stating that it is not necessary to have a technical restraint of trade but merely to have effective control of a market to use or plan an exclusionary practice. Judge Wyzanski construes *Griffith* as an endorsement of *Alcoa*. The basis for this assumption rests in the use by Justice Douglas of the terms "monopoly power" and "effective market control".³⁶

Griffith states that the existence of power to exclude competition is a violation of Section 2, "provided it is coupled with the purpose or intent to exercise that power".³⁷ Judge Wyzanski claims not to rely on any distinction between the approach taken by Justice Douglas in *Griffith* and the approach taken by Judge Hand in *Alcoa* since he finds that the defendant had the requisite market strength and that this strength excluded potential and limited actual competition.³⁸ This departs from the test outlined in *Griffith* and is instead a whole-hearted acceptance of the concepts advanced in *Alcoa*.

Regardless of the manner in which the market structure test became the law of the land, recent Supreme Court decisions clearly indicate that size is the only element necessary for a violation of the monopolization provision of Section 2 of the Sherman Act. *United*

³² ABA ANTITRUST LAW SECTION, ANTITRUST DEVELOPMENTS 1955-1968 at 35-36 (1968).

³³ 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

³⁴ *Id.* at 342.

³⁵ 334 U.S. 100, 106-07 (1948).

³⁶ *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295, 342 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954), *citing* *United States v. Griffith*, 334 U.S. 100, 107 (1948).

³⁷ *Id.*

³⁸ 110 F. Supp. 295, 343 (D. Mass. 1953).

*States v. Grinnell Corp.*³⁹ is clearly indicative of the Court's thinking. There, the existence of the necessary economic power was inferred solely from the predominant share of the market.⁴⁰ Although the Supreme Court seemed to require proof that economic power was attained or acquired by means other than a superior product, business acumen or historical accident, the majority opinion inferred monopolistic intent from the conscious acquisition of the market share held by the defendants.⁴¹ The Court stated that this presented no problem "as what was done in building the empire was done plainly and explicitly for a single purpose."⁴² There is no indication what that purpose was but the majority opinion had outlined in simplified form the growth of the four affiliated defendants. The only questionable activity engaged in by the defendant involved certain territorial restrictions. Although these activities were viewed as *per se* violations of Section 1, that issue was not before the Court. Furthermore, there was no causal relationship between the market controlled and the restrictive agreements. The only conclusion that can be derived from this case is that the market structure test is firmly engraved on the antitrust law.

The market structure theory of monopoly may initially seem more attractive than the abuse theory since it strikes at the heart of monopoly power rather than at its manifestations. It is a beguiling simplicity that overlooks certain difficulties of the gravest consequences. Since the market structure test incorporates only a requirement of a general intent, the approach becomes dependent only upon the percentage of the market controlled. The problem of market definition becomes all important. The degree of judicial discretion which is permitted in the delineation of the market gives rise to the possibility that it may be exercised in a partisan manner. A brief digression may serve to illustrate this observation.

The decision of Judge Hand in *Alcoa* is of interest in examining the manner in which he defined the market. The principal question discussed in that opinion was whether virgin aluminum and scrap aluminum should be considered a single market. The court did not take into consideration the competition afforded by other metals. By utilizing this

³⁹ 384 U.S. 563 (1966).

⁴⁰ 87% of the accredited central station service business. *Id.* at 571. The dissent of Justice Fortas, with whom Justice Stewart joined, questioned the definition as being tailored to the dimensions of the defendants. The relevant market was characterized as a "strange, red-haired bearded, one-eyed man-with-a-limp classification". *Id.* at 591.

⁴¹ *Id.* at 576.

⁴² *Id.* at 571.

very limited market, the court was able to find that the defendant controlled over 90% of the virgin ingot production within a given geographical area.⁴³ A more recent example of a distorted market analysis is found in *Grinnell*. The government brought civil action claiming monopolization of the accredited central stations service protection industry by four affiliated firms controlling 87% of that market. The lower court rejected all the defendant's attempts to expand the market by the use of economic data to present the effect of competition from other forms of fire and burglary protection. The majority opinion did not undertake any economic examination to substantiate the market definition which "fits neatly" the defendant's operations. Justice Fortas, dissenting, accurately noted that it is simple to find the requisite market power when the trial court has "tailored the market" to fit the defendants. Further, Justice Fortas felt the market definition accepted by the majority was very strange indeed.

Such absurd market definitions are possible because the statute does not incorporate any specific test of market delineation. The economically sound test advanced in *United States v. E. I. DuPont de Nemours & Co. (Cellophane)*,⁴⁴ which evaluated the cross-elasticity of the products with substitutes, has not been followed in subsequent decisions by the Supreme Court. Without a valid economic delineation of the relevant market by accepted economic methods, the market structure test becomes an absurdity.⁴⁵

D. *Market Structure Test Under Clayton Act, Section 7.*

Section 7, as amended by the Celler-Kefauver Bill of 1950,⁴⁶ provides:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.⁴⁷

To summarize the statute, it prohibits any acquisition or merger which substantially lessens competition or tends to create a monopoly

⁴³ *United States v. Aluminum Co. of America*, 148 F.2d 416, 425 (2d Cir. 1945).

⁴⁴ 351 U.S. 377 (1956).

⁴⁵ See generally Note, *The Market: A Concept In Anti-Trust*, 54 COLUM. L. REV. 580 (1954).

⁴⁶ Clayton Act § 7, 15 U.S.C. § 18 (1964).

⁴⁷ *Id.*

in any line of commerce. It is clear that Section 7 is not directed at economic power accumulated by internal growth.⁴⁸ Whatever the legislative intent of the draftsmen, the statute has gained its meaning from judicial decisions. It became quickly apparent that Section 7 embodied a completely different set of standards than Section 2 of the Sherman Act.

First, the standard by which the legality of acquisitions is to be evaluated is whether the effect is to "substantially to lessen competition, or to tend to create a monopoly". This standard implies that the statute is designed to arrest acts and practices in their incipiency before they could rise to the level of a violation of the Sherman Act.⁴⁹ The first authoritative decision under the amended Section 7 was *Brown Shoe Co. v. United States*,⁵⁰ wherein the government claimed that the merger of the nation's eighth largest shoe manufacturer with the third largest shoe manufacturer violated Section 7 of the Clayton Act. The Justice Department's attack was on both the horizontal and the vertical aspects of the merger. In declaring the challenged merger to violate Section 7, Chief Justice Warren provided a comprehensive exposition of the statute, ruling that each acquisition is unique and must be evaluated in the context of the relevant market.⁵¹ Emphasis was placed on the degree of concentration within the relevant market and the recent trends within that market. The Court in *Brown Shoe* rejected consideration of the economic consequences of the merger, and focused instead on the market structure for the determination of the

⁴⁸ It is of historical interest to note that the study which gave rise to the 1950 amendment indicated that in the highly concentrated industries, few acquisitions were undertaken. FTC, *The Present Trend of Corporate Mergers and Acquisitions*, S. Doc. No. 17, 80th Cong., 1st Sess. 6-7 (1947).

⁴⁹ *United States v. E.I. DuPont de Nemours & Co.*, 353 U.S. 586, 597 (1957). This is clearly established by the legislative history. S. REP. NO. 698, 63rd Cong. 2d Sess. 1 (1914) comments on the original Clayton Act:

Broadly stated, the bill, in its treatment of unlawful restraints and monopolies, seeks to prohibit and make unlawful certain trade practices which, as a rule, singly and in themselves, are not covered by the Act of July 2, 1890, [the Sherman Act], or other existing antitrust acts, and thus, by making practices illegal, to arrest the creation of trusts, conspiracies and monopolies in their incipiency and before consummation.

For an excellent summary of the legislative history of Section 7, see D. MARTIN, *MERGERS AND THE CLAYTON ACT* 221-53 (1959).

⁵⁰ 370 U.S. 294 (1962).

At the time of trial, *Brown Shoe Co.* operated thirty shoe factories and controlled 1230 retail outlets. It produced approximately 5% of all domestic shoes. The other parties in the acquisition produced one-half of 1% of all shoes in the United States. Kinney's over 400 retail outlets accounted for 1.2% of all shoe sales in the country in dollar volume.

⁵¹ *Id.*

legality.⁵² The amount of prohibited economic concentration is deemed to be more than *de minimus* yet less than required to violate the Sherman Act.⁵³ Intent to lessen competition was not held to be a pertinent consideration.⁵⁴

The flexible interpretation of market structure propounded in the *Brown Shoe* case, was abruptly and significantly altered in *United States v. Philadelphia National Bank*.⁵⁵ Mr. Justice Brennan writing for the majority promulgated a rule of presumptive illegality when a merger or acquisition "produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market. . . ."⁵⁶ As a result of this merger, the surviving entity would have approximately thirty per cent of commercial banking business in the four county Philadelphia metropolitan area. The Supreme Court refused to specify the smallest market share that would be deemed to threaten competition.⁵⁷

The rationale of the *Philadelphia National Bank* case was followed in *United States v. Aluminum Co. of America (Alcoa-Rome Cable)*⁵⁸ and *United States v. Continental Can Co.*⁵⁹ In both, slight increases in concentration in already concentrated industries was held to be unlawful without extended analysis.⁶⁰ These mergers would have resulted in combined market shares of 29 percent and 25 percent. Both of these industries were characterized by increasing concentration.

The coup' de grace to the market structure test under Section 7 was delivered by the Supreme Court in *United States v. Von's Grocery*

⁵² No detailed analysis will be attempted of the vertical aspects of *Brown Shoe*, and Section 7 of the Clayton Act. There is a difference between horizontal and vertical power. The horizontal control is primarily a power over price, whereas vertical power is evaluated in terms of foreclosure. See Blackford, *Vertical Acquisitions and Section 7 of the Clayton Act*, W. RES. L. REV. 102 (1965).

⁵³ *Brown Shoe Co. v. United States*, 370 U.S. 294, 328-29 (1962).

⁵⁴ The only "psychoanalysis" of the parties was as to their business purposes motivating the merger. Evidently, this was done to permit acquisitions of firms in financial difficulty. *Id.* at 331.

⁵⁵ 374 U.S. 321 (1963).

⁵⁶ *Id.* at 363.

⁵⁷ *Id.* at 364.

⁵⁸ 377 U.S. 271 (1964).

⁵⁹ 378 U.S. 441 (1964).

⁶⁰ In *United States v. Aluminum Co. of America (Alcoa-Rome Cable)*, 377 U.S. 271 (1964), Alcoa had 27.8% of the relevant market and Rome Cable accounted for only 1.3% of the same market. Although Rome Cable was small percentagewise, it ranked ninth among all companies and fourth among independents in the aluminum conductor market. *Id.* at 280-81. Similarly, in *United States v. Continental Can Co.*, 378 U.S. 441 (1964), Continental Can had 21.9% of relevant market, ranking second in the industry, and Hazel-Atlas ranked sixth in the market with 3.1%. *Id.* at 461.

Co.⁶¹ Von's, the third largest food chain in the Los Angeles area, acquired the sixth largest chain in the same market. When combined, the sales of the new firm would be the second largest in the area. In the thirteen years prior to the Court's decision, the number of single store operators had decreased by over 40 percent while the number of chains had increased substantially.⁶² These facts furnished sufficient basis for the conclusion that the merger violated Section 7.⁶³

The reasoning that runs through the Supreme Court decisions from *Philadelphia National Bank* to *Von's Grocery* is that Section 7 was designed to prevent economic concentration by keeping a large number of small competitors in business.⁶⁴ The majority in *Philadelphia National Bank* asserted that such a view was fully consonant with economic theory, stating, "competition is likely to be greatest when there are many sellers, none of which has any significant market share. . . ."⁶⁵ If this test were to be accepted *in toto*, then any merger or acquisition on the horizontal level would be illegal in that it reduces the number of competitors.⁶⁶ There has been an evolution from a preservation of competition to a prohibition against economic concentration within a line of commerce.

E. Guidelines of the Enforcement Agencies.

The market structure test has become the keystone of the efforts of the Department of Justice and the Federal Trade Commission in their enforcement procedures. On May 30, 1968, the Antitrust Division of the Department of Justice outlined its standards for determining whether to oppose corporate acquisition under Section 7 of the Clayton Act.⁶⁷ Though these guidelines are not binding on the Department of Justice, the purpose was to inform the public of the enforcement procedures. The guidelines separate the types of acquisitions

⁶¹ 384 U.S. 270 (1966).

⁶² *Id.* at 272-73.

⁶³ *Id.* at 274.

⁶⁴ *Id.* at 275; *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362-63 (1963).

⁶⁵ 374 U.S. at 363-65 quoting Comment, "Substantially to Lessen Competition . . .": *Current Problems of Horizontal Mergers*, 68 YALE L.J. 1627, 1638-39 (1959).

⁶⁶ This possibility has been noted by more than one writer. See Handler, *Some Misadventures in Antitrust Policymaking—Nineteenth Annual Review*, 76 YALE L.J. 92, 103 (1966); Solomon, *Why Uncle Sam Can't Lose a Case Under Section 7 of the Clayton Act*, 53 A.B.A.J. 137 (1967); Speech by ROBERT A. BICKS, *Acquisition and Mergers*, before the First Annual Antitrust Institute, Pittsburgh, Pennsylvania, Nov. 5, 1965.

⁶⁷ Department of Justice, Merger Guidelines, 1 TRADE REG. REP. ¶ 4430 (1968).

into three categories—horizontal, vertical and conglomerate. In the horizontal acquisition, there are sub-categories of highly⁶⁸ and less highly concentrated markets,⁶⁹ and markets with a trend toward concentration. The percentage share of each participant in the acquisition is the sole criterion of the Department of Justice policy.⁷⁰ It is merely enough that a given market share exists.⁷¹ There is no inquiry as to the intent of the parties, nor any analysis of the industry, nor any evaluation as to the economic consequences of the combination.

The Federal Trade Commission has been issuing guidelines in specific industries, e.g., vertical acquisitions in the ready mix concrete and cement industries,⁷² food distribution industries,⁷³ product extension mergers in grocery products manufacturing,⁷⁴ and textile mill products industries.⁷⁵ All of these guidelines have as their basis a market percentage or a fixed dollar amount in size. Although the Federal Trade Commission guidelines recognize the characteristics of an industry, the market structure test still predominates. In addition, to the industry guidelines, the Federal Trade Commission uses its investigative powers to monitor acquisition activity.

On April 8, 1969, the Federal Trade Commission issued a resolu-

⁶⁸ Where the shares of the four largest firms amount to 75% or more of the market, the following acquisitions will be challenged:

Acquiring Firm	Acquired Firm
4%	4% or more
10%	2% or more
15% or more	1% or more

Id. at 6683.

⁶⁹ Where the shares of the four largest firms amount to less than 75% of the market, the following acquisitions will be challenged:

Acquiring Firm	Acquired Firm
5%	5% or more
10%	4% or more
15%	3% or more
20%	2% or more
25% or more	1% or more

Id. at 6684.

⁷⁰ There is some recognition of the failing firm doctrine and the possible advantages of economics of scale. *Id.* at 6684-85.

⁷¹ In vertical situations, if a supplying firm has 10% or more of the market and one or more of the purchasing firms, accounting *in toto* for approximately 6% of the total purchases, an acquisition will be challenged unless there are no barriers to entry. Conglomerate acquisitions involving potential entrants or where there exists the danger of reciprocal buying are again evaluated in percentages. *Id.* at 6686-89.

⁷² CEMENT INDUSTRY—VERTICAL MERGERS, *Id.* ¶ 4510, at 6801-04.

⁷³ FOOD DISTRIBUTION INDUSTRIES, *Id.* ¶ 4520, at 6804-08.

⁷⁴ GROCERY PRODUCTS MANUFACTURING—PRODUCT EXTENSION MERGERS, *Id.* ¶ 4530, at 6808-13.

⁷⁵ TEXTILE MILL PRODUCTS INDUSTRIES, *Id.* ¶ 4540, at 6814-28.

tion suggesting that firms undertaking large corporate mergers or acquisitions be required to notify the Commission and furnish special reports⁷⁶ within ten days after any agreement in principle is reached and no less than sixty days⁷⁷ prior to the consummation of the transaction.⁷⁸ This notification program applies to those firms subject to the FTC jurisdiction, and having assets of 10 million dollars or more, plus combined assets of 250 million dollars. The reports filed with the FTC are public information and are shared with the Department of Justice.

II. ANTITRUST CONCEPTS

The preceding legal analysis is not, nor was it intended to be, definitive. The purpose of the foregoing was to reduce to a relatively elementary level the substantive provisions of the antitrust laws. It is hoped that this simplification will expose the paradoxes and misconceptions that abound in this legal morass. It is imperative to look at the present state of the antitrust laws without any preconceived conclusions and at a distance from the factual circumstances of the cases. The following are the emerging trends and problems which are evident from the foregoing analysis.

First, without an accurate finding as to the relevant market, there can be no way of determining whether the defendants have the requisite degree of market power. A "tailor made" delineation of the market, such as in the *Grinnell* case, can be utilized to hold any substantial firm guilty of monopolization or to prevent any external growth of such firm. As a practical matter, any distortion in the market definition creates a concurrent distortion in the analysis of market power. The reason for this restrictive market interpretation has been the failure of the courts to heed their own pronouncements that the boundaries of the relevant market be determined in accordance with economic concepts. To obtain an accurate picture, the impact of actual and potential substitute products must be considered. In addition, rational geographic limits must be outlined.

It should be noted that different markets are specified in the two antitrust statutes. The "line of commerce" phrase of the Clayton Act is a

⁷⁶ F.T.C. MERGER NOTIFICATION PROGRAM, *Id.* ¶ 4455, at 6702-06.

⁷⁷ MERGER NOTIFICATION REPORT FORM, *Id.* ¶ 4455.10, at 6705-07.

⁷⁸ ". . . as promptly as possible." Letter from FTC Chmn. Dixon in answer to letter on behalf of Trade Reg. Comm., N.Y.C.B.A., released July 16, 1969, in Trade Reg. Rep. ¶ 4455.20, at 6706 (1969).

narrower market definition than specified market under the Sherman Act. In practice, both are manipulated to achieve the desired results but in theory they are different. Why should there be any difference? Perhaps it is time to reconsider these circumscribed market definitions in favor of one more in accord with economic realities.

Second, at the present time, there is no statutory prohibition against being a monopoly. Judicial decisions have engrafted their own prohibitions against economic power which are tantamount to declaring monopoly *per se* illegal. Perhaps, it is time to reconsider the origin of monopolization. The early cases clearly indicated that it was not the power of the firm that was tainted but the *results* from the use of that power. In *Standard Oil* and *American Tobacco*, competitors were excluded and prices were increased—all results of the exercise of economic power. Gradually, a shift in reasoning occurred. No longer was an evaluation made of the results, but attention was focused on the power of a firm within a specific market and the intent of the possessor of such power. Similarly, under Section 7 of the Clayton Act, recent cases indicate a prohibition against the rise of any economic power at its incipency. Under all three of the statutory provisions previously discussed, the present basis of the illegal taint is quantitative control, not the effects or the results of such dominion. Regardless of judicial protestations to the contrary, *size* is now the determinative element of legality under our antitrust laws.

Third, some legislators and judges have not been cognizant of the basic distinctions among the different forms in which economic power may exist. On the same level of industrial organization (horizontal), the effects of such power are apparent on that level by increased prices, product deterioration or by exclusion of competitors. The competitive effects of vertical power (several integrated tiers of industrial organization) are not so readily discernible. The legality of vertical power or vertical integration is normally evaluated in terms of foreclosure. In other words, competition on all levels is limited if the competitors on each level are foreclosed from a segment of the market which would otherwise be open to them. Unless size is utilized as the sole criterion of legality in vertical situations, there would be extreme difficulty in calculating the effects of vertical power. Similarly, can the tests of legality applied to horizontal and vertical situations be used to adjudicate conglomerate economic power? Not only is it time to examine the concepts of size and foreclosure as the basis for le-

gality but also to apply the right test to the appropriate economic power.

Fourth, the key to many of the problems that plague government control of business is preconceived concepts of economic competition held by policymakers. For example, it is abundantly clear that many legislators view economic competition as requiring a market consisting of many sellers each of whom possess little power. Recent judicial opinions indicate that such a market represents the ideal to be copied. It is assumed that in such an environment, the competitive pressures will lower prices, improve the product quality and accelerate technological innovations. It is time to re-examine not only the goals of antitrust policy but also the institutional economic structure that can best achieve desired results. The following review of the development of economic theory sheds some light on this problem.

III. ECONOMIC PERSPECTIVE

Compared to the study of law, economics is a relatively new discipline. The early economic writings of Adam Smith, Ricardo and Matthews were devoted to observations of the existing market place. It was not until the late nineteenth century that attempts were made to develop a systematic body of economic thought. The most highly developed of these schools of thought was the neo-classical micro-economic theory. It is this early economic theory that furnishes the justification for the market structure test applied by the courts.

A. *Neo-Classical Economics.*

Neo-classical economics is the school of economic thought which distilled a mixture of the ideas of Adam Smith, Ricardo and Mill into a comprehensive system of price and quantity determination. Neo-classical economics was the forerunner of the present day mathematical economics (econometrics) which attempts to reduce the business world to a mathematical model. This school of thought had many spokesmen, such as W. S. Jevons⁷⁹, Philip Wickstead, Karl Menger, Frederick von Wieser, J. B. Clark and Leon Walras, but the outstanding authority was considered to be Alfred Marshall.⁸⁰ The neo-classical economists sought to create a series of models which could produce pre-

⁷⁹ W. JEVONS, *THE THEORY OF POLITICAL ECONOMY* (4th ed. 1911).

⁸⁰ A. MARSHALL, *PRINCIPLES OF ECONOMICS* (8th ed. 1922).

dictable mathematical results.⁸¹ This mathematical approach was tempered by the inclusion of subjective psychological variables. By combining certain of the fundamental assumptions of economics and psychology, the neo-classical economists sought to fuse supply and demand into a mechanism for determining a price equilibrium. To show the interaction of supply and demand in different situations, models were devised. These models reflect different market structures and form the basis upon which policymakers and the courts rationalize the so-called market structure test. The following paragraphs attempt to show the theoretical basis of individual market structures.

Pure Competition. The essence of pure competition is that no single buyer or seller has enough power within the market to have any appreciable influence over price. The model is characterized by numerous sellers, each acting independently, with complete freedom of market entry. The pure competition model is based on several assumptions: 1) perfect knowledge of all firms in the market as to supply, demand and relevant prices; 2) each individual within the market acts rationally; and 3) the goods produced by each firm are identical. In such a situation, the demand curve for the product of each individual firm is infinitely elastic.⁸² Total revenue for each firm will increase with each additional product sold. The firm will operate at that point where it maximizes its profit. This optimum point is related directly to the cost structure of the firm. Since the individual firm has no control over the price, the price will be determined by the entire demand for the product. The price of the product in a perfect competition is the result of the meeting of the total demand curve for the entire industry and the available supply.

In a purely competitive market, certain economic results are supposed to flow naturally. First, in the long run, the optimum allocation of resources is achieved. The inefficient firms having a high cost structure are eliminated. Assuming that the entire economy is purely competitive, the industry will be judged by the public demand. Second, the price for the product is the lowest possible, as a firm will produce up to its break-even point. This is due to the close relation of costs to

⁸¹ FERGUSON, LANDMARKS OF ECONOMIC THOUGHT 175-91 (1950); O. TAYLOR, A HISTORY OF ECONOMIC THOUGHT 310-36 (1960).

⁸² The elasticity of a demand curve is the degree to which an increase in the quantity sold affects the price. If the total revenue of a firm goes up when price is reduced, then the demand is deemed elastic. On the other hand, if total revenue goes down when the price is decreased, the demand is inelastic.

prices. If the individual firm raises its price, its sales would drop to zero as business goes elsewhere. Third, this competitive process is presumed to furnish the proper climate for optimum technological progress.⁸³

Monopoly. As opposed to pure competition, monopoly is the ability of a firm to control price and to control entry into the field.⁸⁴ The general conditions for a theoretical monopoly include: 1) an absence of close substitutes; 2) a means of excluding actual and potential entrants (such as a patent, control of supply, etc.);⁸⁵ and 3) locational advantages. There are few long run monopolies in the United States except those that are granted by the government, such as public utilities. Normally, a short run monopoly can be attained by a technological advance or entry into a market that can support only one firm. These short run monopolies are eroded by obsolescence or by increased demand. The neo-classical marginal analysis of the firm can be very helpful in evaluating the theoretical reasons why so many have condemned a monopolistic market structure.

The demand curve facing for a monopoly is the same as it is for the entire industry under pure competition. In a monopoly situation, the demand curve also represents the average price received for the product. The price that the monopolists will charge is that which maximizes total profit. The point at which the monopolist will operate (i.e., where his total profit will be the greatest) will be where marginal revenue is equal to marginal cost. Marginal revenue is the addition to total revenue derived from the sale of one additional unit. The marginal revenue curve is downward, because as a monopolist increases his sales, a lower price must be accepted, thus lowering the price on all previous units. Marginal cost is the increase in total cost consequent to the production of one additional unit. It is a "U" shaped curve for the same reasons as the average total cost curve.

Unfortunately, for the real monopolist, the theoretical model is based upon an assumption of perfect knowledge as to demand and costs. It must also be remembered that the neo-classical concept is a

⁸³ See generally, J. BAIN, *PRICING, DISTRIBUTION AND EMPLOYMENT* 130-51 (1953); M. BOBER, *INTERMEDIATE PRICE AND INCOME THEORY* 203-35 (1962); F. MACHLUP, *THE ECONOMICS OF SELLER'S COMPETITION* (1952); P. SAMUELSON, *ECONOMICS* 441-50 (3rd ed. 1955).

⁸⁴ A. MARSHALL, *supra* note 80, at 477-95; G. BACH, *ECONOMICS: AN INTRODUCTION TO ANALYSIS AND POLICY* 453-62 (5th ed. 1966); A. BURNS, AND OTHERS, *MODERN ECONOMICS* 346-50 (1948).

⁸⁵ M. BOBER, *supra* note 83, at 237-38.

long term model and assumes immunity from technology, obsolescence and competitors attracted by high profits.

The results of this theoretical monopoly should be noted. First, there is no question that, in a theoretical sense, prices will be higher in a monopoly situation than in pure competition. Second, some assert that the profit element extorted by the monopoly misallocates the resources of the entire economy. If all other sectors of the economy were theoretical monopolies, then perfect competition would prevail among these sectors.

The mechanism of the neo-classical model for monopoly contains no inherent requirement that the product quality deteriorate in monopoly situations. Similarly, there is no theoretical reason why technological innovation will progress faster in pure competition than in a monopoly. It is only an assumption that the competitive process stimulates innovation.

B. *Monopolistic Competition.*

Although the neo-classical economists recognized the existence of imperfect competition, (a blending of competition and monopoly), it remained for Professors Edward Chamberlain⁸⁶ and Joan Robinson⁸⁷ to endow monopolistic competition with special characteristics. The concepts advanced by Chamberlin and Robinson represented an attempt to construct a theoretical model that corresponded to business realities. This was a sharp break from the neo-classical approach which predicted economic results from a set of preordained economic conditions.

The Chamberlin hypothesis did not accept many of the psychological assumptions of the neo-classical economists. Chamberlain assumed a market with a few sellers of a standard product. These sellers have identical demand and cost curves,—both of which are known to the sellers. Unlike the firms in perfect competition, the sellers in monopolistic competition will take account of the price consequences of their actions. There is a tendency for the sellers to behave like monopolists without conspiring (e.g., price leadership). This is the key distinction from the neo-classical psychological theory which assumed each seller would pursue his own self interest. The second part of the Chamberlin thesis was that rivalry among producers of differentiated goods eliminated any monopoly profits. This rivalry does not mini-

⁸⁶ E. CHAMBERLIN, *THE THEORY OF MONOPOLISTIC COMPETITION* (1933).

⁸⁷ J. ROBINSON, *THE ECONOMICS OF IMPERFECT COMPETITION* (1933). It should be noted that Robinson's theory differs from Chamberlin's in details of logic, but the conclusions reached are essentially the same.

mize costs.⁸⁸ The concepts of monopolistic competition advanced by Chamberlin and Robinson gradually became accepted by most economists as an extension of the neo-classical doctrine.⁸⁹

C. *Destructive Competition.*

In the early 1940's, Professor J. A. Schumter's book, *Capitalism, Socialism and Democracy*,⁹⁰ offered a fundamentally different approach to the issue of industrial concentration. Schumter assumed that oligopolistic firms possessing economic power would behave, not like monopolists as theorized by Chamberlin, but as competitors. His theory was that demands of business would require large size firms. These firms would concentrate their competitive energies and resources on technological progress. As technology advances, certain industries decline and others prosper, at least until a new development reduces the profitability of the industry. The costs of innovation are so great that sufficient market control is needed for the appropriate reward. This concept has been termed "destructive competition". Not only did it assume that the monopolists would compete among themselves, but that all profits would be short run due to technological advancements. To maintain its position, a monopoly would increase costs (reducing profit) to increase its research for new products. This hypothesis was widely debated at the time and the dispute continues to this day.

D. *Workable or Effective Competition.*

As the adherence to the neo-classical market structure approach was being questioned, others were attempting to develop an alternative theoretical concept of competition. Professor J. M. Clark was the first to outline the characteristics of a so-called "workable competition" in an article in the *American Economic Review*.⁹¹ It listed numerous criteria for market structure and performance to evaluate a given industry. Although economic consequences in terms of prices, innovation and allocation of resources, are considered, there is still an analysis of the market.

⁸⁸ G. STOCKING, *WORKABLE COMPETITION AND ANTITRUST POLICY* 120 (1961).

⁸⁹ The foregoing outline of Chamberlin's thesis is elementary. The reader is directed to the cited work for comprehensive treatment, E. CHAMBERLIN, *supra* note 86. The acceptance of different psychological interpretations of business conduct has been one of the strengths of the neo-classical school. It has enabled the models to be constantly modified in accordance with new theories of business behavior.

⁹⁰ J. SCHUMPETER, *CAPITALISM, SOCIALISM, AND DEMOCRACY* (1st ed. 1942).

⁹¹ Clark, *Toward a Concept of Workable Competition*, 30 *AM. ECON. REV.*, 241 (1946).

There have been numerous economists⁹² who have elaborated upon and refined the criteria originally proposed by Professor Clark. Regardless of the denomination of the concepts of "workable competition" or "effective competition", they were an analyzation of the market structure test and the market performance test.⁹³ All sought to evaluate a given market in terms of the possible alternatives and the economic consequences of the degrees of concentration. The members of the antitrust bar are probably most familiar with the synopsis of workable competition presented in the 1955 edition of the Attorney General's National Committee to Study the Antitrust Laws.⁹⁴ The basic characteristic of workable competition, according to the report is "that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more".⁹⁵ Further, the report states, "where there is workable competition . . . the individual seller cannot control his competitor's offerings, and those offerings narrow the individual firm's discretion as to price and production."⁹⁶ There are several factors which according to the report identify workable competition:

- (1) Number of effective competitive sellers: Relative size of competitors.
- (2) Opportunity for entry.
- (3) Independence of rivals.
- (4) Predatory preclusive practice.
- (5) Rate of growth of the industry or market.
- (6) Character of market incentives to competitive moves.
- (7) Product differentiation and product homogeneity,
- (8) Meeting or matching the prices of rivals.
- (9) Excess capacity.
- (10) Price discrimination.⁹⁷

It is obvious that this is basically a market structure case which is a refinement of the monopolistic competition theory. Although alternatives are considered, by definition there must be several com-

⁹² J. DIRLAM & A. KAHN, *FAIR COMPETITION—THE LAW AND ECONOMICS OF ANTI-TRUST POLICY* (1954); Markham, *Alternative Approach to Workable Competition*, 40 AM. ECON. REV. 349 (1950); E. MASON, *ECONOMIC CONCENTRATION AND THE MONOPOLY PROBLEM* (1957).

⁹³ The one exception is the work of Prof. Stocking, *supra* note 88. He placed the emphasis on market performance and relegated market structure to the role of an analytic tool.

⁹⁴ ATT'Y GEN. NAT'L COMM. ANTITRUST REP. (1955).

⁹⁵ *Id.* at 320.

⁹⁶ *Id.*

⁹⁷ *Id.* at 324-36.

petitors in the market.

E. *Economic Consequences.*

The classical economists have generally agreed that adverse economic consequences will result from a concentrated market structure. Recent studies have, however, raised serious doubts as to the validity of the assumption that the results of an oligopolistic or oligoponistic market structure is not economically beneficial.

Innovation. Several recent studies have found that the large corporation and some degree of market power appear to be a concomitant of organized innovative efforts.⁹⁸ One study utilized the number of patent applications to demonstrate that inventive output varies with the firm's sales, but at less than a proportional rate.⁹⁹ Several other economists have undertaken similar studies and analyses, but have reached different conclusions.¹⁰⁰ Another study has decried past attempts and has advocated an empirical analysis of the antitrust laws and growth and innovation.¹⁰¹ After reviewing the economic evidence, this writer cannot accept the concept that a fragmented market structure will always lead to greater innovation than a concentrated market.

Distribution of income. It has long been one of the tenets of many socialist theoreticians that big business uses its economic power to extort part of the profit from its workers. A relatively recent authoritative study established that higher wages are paid to workers in concentrated industries than in more competitive areas.¹⁰² Specific sta-

⁹⁸ Mansfield, *Size of Firm, Market Structure and Innovation*, 71 J. POL. ECON. 556 (1963); Markham, *Market Structure, Business Conduct and Innovation*, 55 AM. ECON. REV. 323 (1965). The Mansfield study seems to indicate that the largest firms do not always introduce a disproportionately large share of innovations. Large firms account for a relatively large share of innovation where there must be a large investment proportionate to competition and the minimum size of the firm required to utilize the technology was relatively large. Mansfield, *supra* at 573-74.

⁹⁹ Scherer, *Firm Size, Market Structure, Opportunity, and the Output of Patented Inventions*, 55 AM. ECON. REV. 1097 (1965). The study also noted: "differences in technological opportunity . . . are a major factor responsible for inter-industry differences in inventive output. . . . Inventive output does not appear to be systematically related to variations in market power, prior profitability, liquidity, or . . . product diversification." *Id.* at 1121.

¹⁰⁰ Fellner, *The Influence of Market Structure and Technological Progress*, 55 Q.J. ECON. 556 (1951); Hamberg, *Size of Firm, Oligopoly and Research: The Evidence*, 30 CAN. J. ECON. AND POL. SCI. 62 (1964).

¹⁰¹ Massel, *Antitrust & Patent Laws: Effects on Innovation*, 56 AM. ECON. REV., Papers and Proceedings of the seventy-eighth annual meeting of the Am. Econ. Assoc., Dec. 28-30, 1965 at 284 (pub. bound 1966).

¹⁰² Weiss, *Concentration and Labor Earnings*, 56 AM. ECON. REV. 96, 114-15

tistical analysis is used to show the higher wage scale in various concentrated industries such as steel and automobiles.

Higher prices. Extensive research is being conducted to ascertain the degree to which profits correspond to market power. The indications are that a firm with economic power does not always exercise such power to obtain maximum profits out of fear of attracting competitors.¹⁰³ Modern trends toward product differentiation, advertising and trade agreements have obscured any competitive price analysis.¹⁰⁴ The fact is that there has been an absence of research to show a causal relationship between economic power and higher prices.¹⁰⁵ Too often, it has been mistakenly assumed that higher profits in concentrated industries were indications of higher prices. This is exactly the fallacy underlying the report of the White House Task Force on Antitrust Policy favoring stricter legislation for concentrated industries.¹⁰⁶ The Report stated that there was an impressive body of economic evidence to show the adverse effects of industry concentration on product prices.¹⁰⁷ More research and analysis is necessary before this writer

(1966). In this writer's opinion, this study presents an example of the effective use of statistical studies to substantiate a conclusion.

¹⁰³ J. BAIN, *BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES* (1956).

¹⁰⁴ Rothschild, *Price Theory and Oligopoly*, 57 *ECON. J.* 299 (1947).

¹⁰⁵ The recent articles includes Stern & Morgenroth, *Concentration, Mutually Recognized Interdependence and the Allocation of Marketing Resources*, 41 *J. OF BUS.* 56 (1968); Dixon, *Price Wars in Oligopoly: A Case of Goal Divergence*, 26 *UNIV. OF WASH. BUS. REV.* 17 (1967).

¹⁰⁶ REPORT OF PRESIDENT JOHNSON'S TASK FORCE ON ANTITRUST POLICY (1968) ("THE NEAL REPORT"); *Hearings on the Role of Giant Corporations Before the Subcomm. on Monopoly of the Senate Select Committee on Small Business*, 91st Cong. 1st Sess., Pt. 1A, App. IX, 877-905.

¹⁰⁷ The author wrote directly to Dean Phil C. Neal, University of Chicago School of Law, Chairman of the Task Force, *supra* note 106, to inquire as to this impressive body of economic evidence. Mr. S. Paul Posner, the Staff Director of the project, replied in a letter dated June 16, 1969:

... Bain, *Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-1940*, *Quarterly Journal of Economics* 298 (1951);

Collins, & Preston, *Industry Structure and Price-Cost Margins*, presented at Antitrust Policy Seminar, Graduate School of Business Administration, University of California, Los Angeles (mimeographed March 1968);

Comanor & Wilson, *Market Structure, Advertising, and Market Performance: An Empirical Analysis*, presented at the Econometric Society Meetings (mimeographed, December 1965);

Mann, *Seller Concentration, Barriers to Entry and Rates of Return in Thirty Industries, 1950-1960*, *Review of Economics and Statistics* 296 (1966);

Miller, *Marginal Concentration Ratios and Industrial Profit Rates: Some Empirical Results of Oligopoly Behavior*, 34 *Southern Economic Journal* (1968); and

Weiss, *Average Concentration Ratios and Industrial Performance*, *Journal of Industrial Economics* 237 (1963).

After checking all of the articles which were published, this writer must question

will be convinced of the prevailing assumption that there is a direct relationship between market structure and price.

Allocation of resources. There is an absence of empirical evidence which demonstrates that a fragmented market will allocate the nation's resources more effectively and accurately than an oligopolistic or monopolistic market. The economies of scale in certain industries necessitate large enterprises. It has also been questioned whether there is a point where diseconomies of scale actually begin.¹⁰⁸

The existing body of economic knowledge based on research and analysis concerning the consequences of market concentration is rather small. Most of the work has been based on theory rather than hard facts. If additional research is to be undertaken, it is necessary that the business world be placed in proper perspective.

IV. THE BUSINESS PERSPECTIVE

Unfortunately, antitrust policy cannot be formulated in a vacuum. The businessman must make his decisions in a set of circumstances and in the midst of countervailing pressures not contemplated by the neo-classical economists. These factors must be considered and be evaluated in devising an appropriate means of controlling business.

First, the markets for products are no longer subject to regional limitations, but span the globe. These markets are calculated in terms of millions of dollars. The character of the domestic market has shifted to a consumer orientation. The foreign markets are also accessible to American firms. All of these markets require tremendous amounts of financial and technical resources.

In the United States, the existing market structures in key industries are highly concentrated. Not only are there few firms in the relevant market, but these firms have tremendous assets and invested capital, technical skill, manpower, established lines of supply, production and distribution. A recent Federal Trade Commission report indicates that this concentration is increasing at a rapid rate.¹⁰⁹ There can be no question that bigness is a characteristic of American business.¹¹⁰ The

whether these articles actually show a relationship of concentration and price. The articles primarily deal with the relation of profit to market structure.

¹⁰⁸ Diwan, *Alternative Specification of Economies of Scale*, 33 *ECONOMICA* 442 (1966).

¹⁰⁹ *Hearings on S.R. 40 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 91st Cong., 1st Sess. pt. 8A (1969) (Staff Report of the FTC, Economic Report on Corporate Mergers).

¹¹⁰ REPORT OF PRESIDENT JOHNSON'S TASK FORCE ON ANTITRUST POLICY, *supra* note 106, at 883.

present antitrust policy actually protects entrenched economic power. The emphasis on preventing the concentration of economic power in its incipency by the application of Section 7 of the Clayton Act serves to give existing large firms a competitive advantage. In addition to the present concentration in American business, there is a growing threat of competition from foreign firms.

The twentieth century has witnessed the development of international cartels in the formation of multi-nation economic trading blocs. Advances in transportation and distribution methods have created a world market. Not only are American firms competing in foreign markets, but they are also faced with competition from foreign manufacturers in the United States—once a closed market. The rise in the importation of small automobiles has become a major factor in the automobile market. No longer can the United States be considered “safe” for American firms. From an international perspective, the development of American business organizations as strong industrial competitors is a prerequisite for national survival in the world market. One wonders whether a small firm with limited assets can hope to effectively compete with foreign competitors.

In addition to competitors in the marketplace, the individual firms must operate in an environment of countervailing powers. Those groups having countervailing power, by their action, force firms to adopt business policies requiring accumulation of economic power and expansion of these markets.

Concurrent with the rise of big business, organized labor has developed into an economic factor through gains won at the bargaining table and through legislation. Since labor is a substantial factor in the costs of most industrial operations, labor organizations present a countervailing power that must be considered in any major business decision. In some industries, where a market is totally fragmented, unions have become the dominant force in the industry and control many business decisions. The garment industry in New York is a prime example.

Finally, the business firm must operate in the shadow of the largest economic giant in the world—the United States Government. Because of vast government operations and because of the scope of federal power, conflicting policies toward the size of business firms have developed. While the Antitrust Division of the Justice Department is busily attacking conglomerates and monopolies, other departments of the government are pursuing policies which actually encourage bigness

in business. A brief review identifies some of the conflicting policies that encourage economic concentration.

Government procurement policies. Increasingly, the government is turning to "big" business to assist in accomplishing its programs. Traditionally, large corporations have coordinated and furnished most of the country's defense needs. Recently, even welfare programs, such as job-training, have been subcontracted to the industrial giants. Apparently there are certain departments that believe that only the large firm has the physical and technical capability to handle certain tasks.

Tax policies. The Internal Revenue Code contains several provisions which prevent small corporations from growing larger and thus protects economic concentration. For example, one of the key sources of capital for any firm is internally generated funds. Section 531¹¹¹ of the Internal Revenue Code levies a surtax on corporations which fail to distribute as a dividend a reasonable portion of corporate earnings. While this would appear to apply to all corporations, the tax is imposed on only those corporations which retain earnings for the purpose of avoiding the income tax on shareholders. Such an illicit intent can only be inferred in a closely held corporation and is not present in the larger publicly held enterprises. There are numerous other instances in the Internal Revenue Code where larger corporations obtain an advantage over their smaller competitors.

Securities regulations. In the field of securities regulations, the 1964 amendments to the Securities Exchange Act of 1934, complicated the life of many smaller corporations.¹¹² As a result, all corporations, not exempted, with a minimum of 500 shareholders and assets in excess of one million dollars are required to file a registration form with the Securities and Exchange Commission.¹¹³ Not only are they required to file or register their securities, but they also become subject to the proxy regulations of the SEC.¹¹⁴ This has meant that many smaller companies have been forced to expend large sums relative to their size in the preparation of forms and documents.

Monetary policy. In the recent period of tight money, the main business victims have been the smaller firms. Larger firms with substantial economic power have access to bank loans at prime rates. In addition, the larger firms have greater power to generate internal

¹¹¹ 26 U.S.C. § 531 (1964).

¹¹² See 15 U.S.C. § 78 (1964), amending 15 U.S.C. § 78 (1954).

¹¹³ 15 U.S.C. § 78(1) (1964).

¹¹⁴ 15 U.S.C. § 78(n) (1964).

funds by forcing quicker payments out of their customers and delaying payments to suppliers.

There are many more instances of government policies which are inconsistent with the efforts of the Justice Department to prevent concentration. The important lesson to be learned from these contradictory policies is that antitrust legislation cannot, and does not, exist within a vacuum. In this writer's opinion, the antitrust law must be in accord and in harmony with the total framework of the social control of business. The antitrust policy must integrate law and economics in a pragmatic manner.

V. THE COALESCENCE OF LAW, ECONOMICS AND REALITY

The model of pure competition as devised by the neo-classical economists bears no relation to existing market structures. There is absolutely no way for the government to fragmentize the economy to obtain a state of pure competition. Any such attempt would result in a fantastic dislocation of resources. An example of the calamitous economic consequences can be seen in the Red Chinese attempts to shift the peasant from a form of controlled free market activity to total communal life.

Regardless of its philosophical appeal, the myth of pure competition cannot be adopted as a guide to the social control of an economy already endowed with entrenched, and seemingly inevitable, economic power. Policymakers must look anew for a practical means to regulate business. It is the opinion of this writer that new legislation is necessary to create a standard which will encourage economically beneficial results. The following is the suggested basis for such a revision.

The most important lesson that can be learned from the foregoing discussion of the recent economic theories is that the size of a firm and the degree of economic power possessed by a firm should not be held to be an evil *per se*. It is suggested that the economic power of an oligopoly or oligopsony might be necessary for maximum production and minimum prices. It is this author's hypothesis that the market power of a firm is not a proper or accurate standard for evaluating the economic worth or the social value of the firm. The accumulation or acquisition of corporate assets should not be condemned unless the resulting social and economic consequences are not beneficial.

The sole criterion of the social worth or the legality of any economic unit should be the effects of the use of the economic power possessed by that unit. It is here the role of the economist becomes crucial. The

economists have the necessary tools to analyze the pertinent statistical data to ascertain in a particular industry the economic effect of the actions of a specific firm.

It is further recommended that the primary emphasis of government regulation of business should be directed against trade practices which produce adverse economic results. Market structure should not be regulated unless there is clear evidence of the development of undesirable economic effects such as higher prices, a lower rate of technological growth, product deterioration, or an inability to satisfy consumer needs. In most situations, the existing countervailing political and economic power groups will force the firm to function at an efficient level. Furthermore, appropriate tax legislation could eliminate any profit not commensurate with the amount of capital invested.

The key to whether the market is performing properly should rest in an analysis of the policies within the industry to raise prices and create "excessive" profits, encourage technological advancement, maintain and improve product quality, and satisfy the consumer's demand for the product. This approach should be termed, "pragmatic competition" as it evaluates a market solely on its performance (i.e., the actual economic results). The concept of pragmatic competition should enable the lawyer and the economist to reconcile their differences. The economists will be able to focus their attention on economic results and on the establishment of business norms. The lawyer will be able to concentrate on harmful trade practices and delve into market structure only when concrete adverse economic results are present or probable. Both professions will no longer be required to rely upon the nebulous concept of "competition" as a yardstick in their analysis. Under pragmatic competition, an examination is first made of the economic results, such as prices, quality of the product, innovation and resource allocation. These factors become the criteria in adjudicating the social worth of the firm and the legality of any power possessed by that firm. Only after a finding of adverse economic consequences would the market structure be investigated in attempting to devise the appropriate remedial action.

CONCLUSION

It is doubtful that the policymakers will heed the suggestions advanced herein, but what is important is that an immediate re-examination be undertaken of the existing legislation regulating economic power and trade practices. It is only by self-analysis that the myths

and misconceptions that arise can be challenged, and, if necessary, eliminated. A national committee should be created to re-examine the underlying concepts of business regulation and to recommend the future direction of the social control of business. This committee should include not only antitrust specialists but also representatives of business, labor, government and the oft-forgotten consumer. The primary task of this committee would be to evaluate "competition" as a guideline for business organization and operation. Preceding the national evaluation, there must be a comprehensive empirical analysis undertaken of various industries to ascertain the facts with respect to prices, rate of profit, technological progress and resource allocation. This study could serve as a reservoir of information from which the committee, Congress and the courts could develop a coherent policy for controlling business.

It is imperative for this country to undertake this introspective analysis in order to maintain a strong and prosperous economy composed of privately owned firms. The basis of the government's framework of control must involve a coalescence of law, economics and the real world of business. A pragmatic evaluation is a prerequisite to such unification.