FEDERAL ANTITRUST POLICY

THE LAW OF COMPETITION AND ITS PRACTICE

Third Edition

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Chapter 2

HISTORY AND IDEOLOGY IN ANTITRUST POLICY

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§ 2.1 The Development of American Antitrust Policy

2.1a. The Goals of the Sherman Act: Efficiency and Interest Group Explanations

Few elements of statutory interpretation are more frustrating than the study of legislative history to determine a statute’s meaning. The debates and compromises leading to a statute’s passage often contain conflicting statements, made by persons who were elected to do a statute would do. Sometimes legislative committees achieve compromises by making statutory language intentionally ambiguous, leaving to the courts to decide later which interpretation should prevail.

One solution to this problem is to ignore legislative history and look only to the plain language of the statute. But the antitrust laws are not conducive to such an approach because their language is so vague and malleable. For example, the Sherman Act condemns “every contract, combination * * * or conspiracy in restraint of trade,” or every person who shall “monopolize,” without giving a clue about what those phrases mean. The meaning must be discerned from collateral sources.

Unfortunately, the legislative histories of the federal antitrust laws are not always that helpful either. Their ambiguous language has produced considerable scholarly dispute over Congressional intent. This is particularly true of the Sherman Act, whose expansive text has always been the driving force in American antitrust policy. Some scholars have argued that the framers of the Sherman Act were concerned almost exclusively with allocative efficiency as measured by modern neoclassical economics. Others have concluded that Congress has often expressed concern with “justice” or fairness in business behavior, but has never articulated any concept of efficiency as such, not even in the antitrust laws. Still others have argued that Congress’ chief concern was to arrest wealth transfers away from consumers and toward price fixers or monopolists. Finally, others have argued that the Sherman Act was passed at the behest of particular non-consumer interests groups, such as small firms or farmers. These divergent, conflicting theories of the Sherman Act reflect underlying ideologies about the nature of legislative intent generally, or the nature of the relationship between the Sherman Act and the common law.

At one point the Chicago School of antitrust analysis was dominated by a belief that preserving economic efficiency was the guiding concern of those who drafted the Sherman Act. This Congressional concern was said to have been undermined, however, by judicial interpretations and subsequent legislation, particularly the Robinson-Patman Act and the Cel- ler-Kefauver amendments to the merger law. The Chicago School scholars who did this writing were generally uninformed or uninterested in Public Choice theory, something that later members of the School embraced with considerably more enthusiasm. Under Public Choice theory, or interest group analysis, the efficiency position gave way to the idea that the legislative intent of those passing the antitrust laws has never been economic efficiency. Rather, the Sherman Act was special interest legislation, and the principal protected class was small business.

Clearly, the framers of the Sherman Act did not have Pareto-efficiency in mind when they drafted the statute, for Pareto had not yet developed it at the time the Sherman Act was passed. The concepts of allocative efficiency and deadweight loss from monopoly were almost certainly not known to the framers of the Sherman Act. Most of the modern generally, see Stigler, note 6; and The Causes and Consequences of Antitrust: the Public Choice Perspective (J. Meese & W. Shughart, eds. 1994).

For the great ideological diversity, both at the time the Sherman Act was passed and during its first century of enforcement, see the essays collected in The Political Economy of the Sherman Act: the First Hundred Years (R. T. Sullivan, ed., 1991).

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Few elements of statutory interpretation are more frustrating than the study of legislative history to determine a statute’s meaning. The debates and compromises leading to a statute’s passage often contain conflicting statements, made by persons who were elected to by disparate interest groups, who had different motives and different perceptions about what a statute would do. Sometimes legislative committees achieve compromises by making statutory language intentionally ambiguous, leaving to the courts to decide later which interpretation should prevail.

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See § 2.2b.


On public choice theory and antitrust, see § 2.2c.

See Stigler, note 6.


They were developed mainly in Cambridge University economist Alfred Marshall’s Principles of Economics, which was published in 1890. See H. Hovenkamp, The Marginalist Revolution in Legal Thought, 40 Vand.L.Rev. 305 (1987).
welfare economics of competition and monopoly was developed during the 1930's and after.

Of course, the Sherman Act's framers could have had a less technical conception of efficiency in mind. A great deal of writing in the classical economic tradition defended competitive markets on what we today would call "efficiency" grounds. However, only a few statements in the debates leading up to the Sherman Act sound even remotely like efficiency arguments, and even these are ambiguous. Most of these statements concern the impact of monopoly on consumer prices, or a desire to protect consumers from high prices. As a result, the statements may suggest that the primary intent of the Sherman Act's framers was not economic efficiency at all, but rather the distributive goal of preventing monopolists from transferring wealth away from consumers.15

To characterize the concerns of the framers as "distributive," however, is just as anachronistic as to believe that the framers adopted a theory of allocative efficiency that had not yet been invented. All policies, including those motivated solely by concerns for efficiency, affect the distribution of wealth. An antitrust policy based exclusively on allocative efficiency, for example, may make consumers or large non-retail businesses richer at the expense of small businesses.

The fact that a policy has certain distributive consequences does not mean that it is "distributive." A policy is purposefully distributive only if it is adopted instead of a policy believed to be more efficient, because the adopted policy distributes wealth in a way the policy maker intended — i.e., to smaller, more efficient firms. The fact that the framers of the antitrust laws had no articulated theory of allocative efficiency suggests that they did not articulate a theory of distributive justice either. As a result it is unrealistic to look at a particular concern expressed in the legislative history—such as the concern that monopolies might impoverish consumers—and pronounce it either "efficient" or "distributive." The framers of the antitrust laws did not perceive economic policies within a framework, not even after these terms became an accepted part of economic literature.16

The argument that the passage of the antitrust laws was driven by efficiency concerns has one additional problem: even as the conceptions of allocative efficiency and the social cost of monopoly became articulated in the economics literature, Congress appeared to become less and less concerned with efficiency and more and more preoccupied with protecting small businesses from larger, more efficient competitors.

Most of the substantive federal antitrust laws were passed in four years: 1890, 1914, 1936, and 1950.17 The legislative history of the Sherman Act of 1890 contains the best case for the "efficiency" view: that Congress intended the antitrust laws to protect consumers from the high prices and reduced output caused by monopolies and cartels. The legislative history of the Federal Trade Commission Act and Clayton Act of 1914 is somewhat more concerned with the protection of small businesses from the unfair or "exclusionary" practices of bigger firms.18 The legislative history of the Robinson-Patman Act in 1936,19 and the Cellar-Kefauver Amendments to the antimerger provisions of the Clayton Act in 1950,20 depart much more decisively from any consumer welfare model. In both 1936 and 1950 Congress was concerned chiefly with protecting small businesses from larger competitors who faced lower costs, even though the result of such protection would be lower total output and higher consumer prices.

The trend in the legislative history does not necessarily undermine a general antitrust goal of improving allocative efficiency, however. The legislative history of the Robinson-Patman Act is relevant only in Robinson-Patman Act cases, and the legislative history of the Celler-Kefauver Act is relevant only in merger cases. Cases involving cartels, monopolization and attempts to monopolize are still decided under the 1890 Sherman Act. Nevertheless, Congress' "creation" on the matter of efficiency and consumer welfare is hard to ignore.

Further, both the allocative efficiency theory and the consumer welfare transfer theory of the Sherman Act seem inconsistent with other historical facts. First, the same Congress that passed the Sherman Act also passed the McKinley Tariff, one of the largest and most anticonsumer tariffs in United States history. Senator Sherman himself was a fierce protectionist.21 Second, the decade before 1890 was generally a period of declining rather than increasing prices. Indeed, by some measures the relative and extensiveness of price declines was unprecedented—a general 7% decline in the consumer price index, as output expanded dramatically.22 Although much of the wrath of the Sherman Act's framers was directed at two targets, the Standard Oil Company and the sugar trust, the price of the products produced by those firms had declined precipitously during the preceding decade.23 From 1880 through 1890 the price of refined petroleum had fallen by 61%, and that of raw sugar had increased four-fold.24 Refined sugar prices fell more by than eighteen percent between 1880 and 1899.25 The iron and steel industry, another target of the Sherman Act, was one of rapid economic growth, with the real gross national product increasing by about 23%26 Points two, three and four make it unlikely that a Congress concerned about allocative efficiency would suddenly want federal legislation to intervene in markets and make them work better. Points one, two and three make it unlikely that Congress was really very concerned about consumers' having to pay high prices.

The allocative efficiency theory and the consumer welfare transfer theory are also called into question by the fact that the vast majority of economists were opposed to the statute.27 They generally believed that the emergent "trust," or large business firm was efficient and would result in higher output and lower consumer prices. Indeed, the notion that the Sherman Act was pure protectionism for the benefit of small business appears to have been widespread.

A theory with more explanatory power is that the Sherman Act was passed at the behest of small businesses who had been injured by the formation of larger, more efficient firms. This was the one group of people who were injured, were well organized, and had long been effective in making their case to legislative bodies. Among the most effective lobbying organizations of the day were various associations of independent and small businesses, whose positions were threatened by large vertically integrated firms. Senator Sherman himself may have been acting at the behest of such small business interests.28

Shughart, note 7 at 13.


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independent oil producers in Ohio, who wanted protection from the Standard Oil Company and the railroads. Various labor organizations also lobbied Congress, but their principal concern seems to have been that new technology in independent oil producers in consumer markets. The Congressmen spoke of private lawsuits, which they thought would steal jobs. Although the Sherman Act was passed out of a tenth century American ideology generally, is concerned at least as much with bigness as with competion, see G. Canfield, The Large Corporation an Illegal Monopoly under the Sherman Act, 1880-1990 (1992). See H. Hovenkamp, The Sherman Act and the Classical Theory of Competition, 74 Iowa L. Rev. 1019 (1989).

The framers of the Sherman Act believed that they were creating a common law to govern trade restraints, making the common law more effective by creating a forum with jurisdiction over monopolies or cartels that operated in more than one state. The earliest Sherman Act decisions construed the statute in that way: they generally decided cases by reference to common law precedents.

Federal antitrust laws differed from the common law in at least one important respect, however. At common law most of the agreement addressed under § 1 of the Sherman Act were unenforceable but not affirmatively illegal. For example, contracts in restraint of trade could not be enforced by one participant against another. However, a consumer or competitor of the contracting parties was generally permitted either to enjoin the contract or to obtain damages for injuries. By contrast, § 7 of the original Sherman Act (and later §§ 4 and 16 of the Clayton Act) gave nonparticipants in Sherman Act contracts, combinations or conspiracies a right to challenge such practices even if no damages or an injunction. The importance of this expansion should not be overlooked, for it effectively carried the doctrine of contracts in restraint of trade out of the realm of "private" law and into the realm of "public" law.

The idea that antitrust violations are a special kind of common law offense makes statutory language and legislative history less important than the language and legislative history of other statutes. Furthermore, the stated intention was not to "freeze" the common law as it existed in 1880, but rather to regard the Sherman law as an ongoing, ever-changing body of rules. As Sherman Act precedent began to accumulate, the courts began to diverge from the nineteenth century common law. The federal antitrust laws took on a life of their own. In short, the Sherman Act can be regarded as "enabling" legislation—an invitation to the federal courts to learn how businesses and markets work and formulate a set of rules that will make them work in socially efficient ways. The standards to be applied are always evolving and probably always will shift as ideology, technology and the American economic changes.

2.1b. The Common Law and the Federal Antitrust Laws

One solution to the problem of ambiguous statutory language and legislative history is to assume that antitrust violations are a kind of "common law" offense, where judicial precedents define the substance of the legal rules to be applied. Most of the practices challenged under the Sherman Act had previously been addressed under common law rules. The framers of the Sherman Act believed that they were creating a common law to govern trade restraints, making the common law more effective by creating a forum with jurisdiction over monopolies or cartels that operated in more than one state. The earliest Sherman Act decisions construed the statute in that way: they generally decided cases by reference to common law precedents.

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34. See Central Shade-Roller Co. v. Cushman, 143 Mass. 363, 631-634, 9 N.E. 629, 631 (1887); Perkin v. Lyman, 9 Mass. 522, 530 (1813); and see A. Stinchcomb, State Control of Trade and Commerce by National or State Authority 157 (1987); Hovenkamp, Sherman Act, note 31, 74 Iowa L. Rev. 1029 et seq.


38. See, e.g., United States Postal Service v. Flamingo Indus. (USA), Ltd., 540 U.S. 796, 124 S.Ct. 1321 (2004), on the remand, 366 F.3d 789 (9th Cir.2004) (U.S. Postal Service not a "person" who could be sued under the antitrust laws).

39. Judicial definitions of words such as "competition" have gone through quite an evolution in federal antitrust decisions. See H. Hovenkamp, Book Review, 53 Hastings L.J. 765, 769 (2002). Judge Bork has identified five distinct meanings of "competition." See Bork, The Antitrust Paradox: A Policy at War With Itself 66-68 (1978); rev. ed. 1992, at 80-82. "Competition," in the broadest sense, includes all activity that is `potentially en­ trustable' doctrine of conglomerate mergers, the "shared monopoly" theory, or the "indirect purchaser" rule.

The common law approach to antitrust analysis is implicit in Congress' use of statutory language. Section 1 of the Clayton Act, like the opening sections of many federal statutes, defines the terms used later in the Act. These would include "antitrust laws," "commerce," and "person." Amazingly, the list does not include "competition," "monopoly," or "restraint of trade." Congress expressly told the courts what kinds of "person" could sue or be sued under the statute but did not define "competition" or "restraint of trade" or even "monopoly"—effectively yielding the meaning of the most essential terms to the courts.

But the fact that the Sherman Act authorizes a common law approach to antitrust analysis in no way entails that courts interpreting the Sherman Act would be tied to state court judicial precedents of the nineteenth century and earlier. The record is quite to the contrary. Only the earliest Sherman Act decisions paid very much attention to actual common law decisions, and federal courts very quickly deviated from the common law as it existed.
when the Sherman Act was passed. Thus the "common law" approach of the federal antitrust laws refers to a precedent-oriented manner of interpretation, not a set of substantive doctrines.

Indeed, the most famous "common law" interpretation of the Sherman Act actually distorted the common law so badly that it effectively cut the knot between common law and antitrust approaches to combinations in restraint of trade. Judge Taft's opinion in United States v. Addyston Pipe & Steel Co. has often been praised for its expression of the relationship between the Sherman Act and the common law. The great brilliance of the opinion, its admirers have argued, is that Taft was able to show that the common law had always condemned anticompetitive price fixing agreements, while it had approved efficiency creating joint ventures. Under Taft's rule, "naked" restraints such as price fixing were condemned automatically, under a per se analysis, while restraints that were legitimately "ancillary" to an efficiency creating joint venture were approved.

In fact, Judge Taft's vision was much narrower and was based on a deeply flawed view of the common law. The cases that Judge Taft cited for the reasonableness of ancillary restraints actually involved covenants not to compete contained in employment agreements or agreements for the sale of property. Although they were subject to a rule of reason, the content of the rule was generally nothing more than a declaration of whether the noncompetition agreement was limited in duration and confined to a fairly narrow geographic area. The relationship between approval of such agreements and their underlying efficiency is no more than haphazard. Judge Taft's list of rule of reason restraints did not include any production enhancing or transaction cost reducing joint ventures. The ancillary restraint courts generally upheld, Taft said, were:

1. by the seller of property or business not to compete with the buyer in such a way as to derogate from the value of the property or business sold;
2. by a retiring partner not to compete with the firm; and
3. by a partner pending the partnership not to do anything to interfere, by competition or otherwise, with the business of the firm;
4. by the buyer of property not to use the same in competition with the business re­

ained by the seller; and
5. by an assistant, servant or agent not to compete with his master or employer after the expiration of his time of service.

Today very few of the restraints characterized by courts as ancillary and efficiency enhancing, such as production joint ventures, fall within one of Taft's examples. Taft gave these examples because they were the only ones he could find in the law of trade restraints up to that time. In sum, Taft's interpretation of common law decisions to distinguish between "naked" and "ancillary" restraints was little more than an indication that covenants not to compete should continue to be analyzed by a rule of reason under the federal antitrust laws.

At the same time, Taft painted an impressionistic, noninterpretive, picture of the law of ancillary restraints in the context of restraint of trade. His Addyston Pipe opinion was as important for its disingenuousness as for its brilliance. He ignored or misconstrued common law and even Sherman Act decisions that had unambiguously approved naked price-fixing.

He cited half the opinions in order to explain why they were wrong. Some of the cases he cited for the common law position on trade restraints were highly distorted from the common law. Some of the opinions he cited as condemning "naked" restraints in fact condemned joint ventures with great efficiency-creating potential. For example, People v. Sheldon involved a joint venture that established a uniform grading system for coal and a common sales agency, but facilitated the fixing of prices. The Morris Run Coal case rejected the defense that the coal grading and selling joint venture at issue was designed in part "to lessen expenses," because the resulting restraint was "too general" for that end. In other words, the court applied the traditional common law rule that the restraint could not be broader than necessary to protect the parties' business. In addition, Taft failed to acknowledge that the restraint at issue in the Trans-Missouri case, where the Supreme Court had applied the Sherman Act to a railroad joint venture, was ancillary—an efficiency creating cargo-transfer, scheduling, and freight rate division agreement among the railroads.

Disingenuous or not, all of this was immensely valuable to emergent federal antitrust policy. One of the great accomplishments of Taft's Addyston Pipe opinion was to fuse the emerging economic model of competition with the traditional legal doctrine of combinations by trust, and to derogate from the value of the property or business of the firm; (2) by a retiring partner not to compete with the firm; (3) by a partner pending the partnership not to do anything to interfere, by competition or otherwise, with the business of the firm; (4) by the buyer of property not to use the same in competition with the business re­

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Today very few of the restraints characterized by courts as ancillary and efficiency enhancing, such as production joint ventures, fall within one of Taft's examples. Taft gave these examples because they were the only ones he could find in the law of trade restraints up to that time. In sum, Taft's interpretation of common law decisions to distinguish between "naked" and "ancillary" restraints was little more than an indication that covenants not to compete should continue to be analyzed by a rule of reason under the federal antitrust laws.

At the same time, Taft painted an impressionistic, noninterpretive, picture of the law of ancillary restraints in the context of restraint of trade. His Addyston Pipe opinion was as important for its disingenuousness as for its brilliance. He ignored or misconstrued common law and even Sherman Act decisions that had unambiguously approved naked price-fixing.

He cited half the opinions in order to explain why they were wrong. Some of the cases he cited for the common law position on trade restraints were highly distorted from the common law. Some of the opinions he cited as condemning "naked" restraints in fact condemned joint ventures with great efficiency-creating potential. For example, People v. Sheldon involved a joint venture that established a uniform grading system for coal and a common sales agency, but facilitated the fixing of prices. The Morris Run Coal case rejected the defense that the coal grading and selling joint venture at issue was designed in part "to lessen expenses," because the resulting restraint was "too general" for that end. In other words, the court applied the traditional common law rule that the restraint could not be broader than necessary to protect the parties' business. In addition, Taft failed to acknowledge that the restraint at issue in the Trans-Missouri case, where the Supreme Court had applied the Sherman Act to a railroad joint venture, was ancillary—an efficiency creating cargo-transfer, scheduling, and freight rate division agreement among the railroads.

Disingenuous or not, all of this was immensely valuable to emergent federal antitrust policy. One of the great accomplishments of Taft's Addyston Pipe opinion was to fuse the emerging economic model of competition with the traditional legal doctrine of combinations by trust, and to derogate from the value of the property or business of the firm; (2) by a retiring partner not to compete with the firm; (3) by a partner pending the partnership not to do anything to interfere, by competition or otherwise, with the business of the firm; (4) by the buyer of property not to use the same in competition with the business re­

ained by the seller; and
5. by an assistant, servant or agent not to compete with his master or employer after the expiration of his time of service.
right to authorize resale price maintenance for sales within their borders. Forty years later, Congress changed its mind.46 On many other occasions Congress has either passed or considered legislation that would overrule unpopular antitrust decisions.

Ideology, politics and theory have always changed and undoubtedly will always will. American economic and business policy invariably changes with them. The federal antitrust laws were designed in a way that will enable courts to respond to those changes. Congress, if it wants, may rejoin. Perhaps the most isolationist and regressive of views is that in 1890 or today we have all the right answers. We did not, nor do we.

2.1c. A Thumbnail History of Federal Antitrust Policy

The history of American antitrust policy has been told many times, at varying levels of detail and sophistication. The following is an extremely brief overview, with citations to other historical works. 57

Most early enforcement of the Sherman Act was by the federal government, and its main target was cartels and the array of tighter combinations then known as "trusts." Many of the earliest attempts succeeded, because the federal courts interpreted the Act under the general common law rules that (1) agreements to increase price not accompanied by any coercive actions against third parties were not illegal; and (2) cartels were generally not illegal unless they controlled virtually all of the affected market.64 Equally pessimistic was the first Supreme Court decision interpreting the Sherman Act, the E. C. Knight case of 1895, which held that the Act did not reach a combination of sugar producers because the combination neither manufactured, and manufacturing itself was not interstate commerce. As a result, the indictment was outside the federal government's jurisdictional reach under the commerce clause.65

Blame for the early failures of the Sherman Act is sometimes laid at the feet of Richard Olney, President Cleveland's Attorney General, who was not an enthusiastic trustbuster. But an alternative view of Olney is that he was highly restrained because he predicted—correctly, it turned out—that the courts were unlikely to cooperate in any attempt to use the Sherman Act expansively.66 The one place the Sherman Act did accord some deference to the horror of some of its early supporters, was as a tool against labor union organizing. Indeed, twelve out of the first thirteen Sherman Act convictions, obtained between 1889 and 1897, were against labor unions.64 Congress eventually responded to labor's concerns by exempting most labor organizing from the antitrust laws, first in § 6 of the Clayton Act, and later in the Norris-LaGuardia Act.67


58. See for example In re Greene, 52 Fed. 104, 114 (C.C.Ohio 1892) (merger of distilleries intending to control entire market not illegal where the agreement acquisitions did not prevent sellers from re-entering; United States v. Miller, 152 Fed. 297, 447 (D.Minn 1896) (merger processors cartel not illegal unless the companies controlled or intended to control entire market; United States v. Green, 52 Fed. 465, 470 (D.Mass 1899) (liquor processors, same).
of exclusive dealing, which was condemned when anticompetitive by the Clayton Act.79

The 1930's was a highly ambiguous, turbulent and contradictory period for both economic theory and antitrust policy. On one side were those who believed that price competition was unworkable and inefficient, and who advocated broad freedom from antitrust prosecution for joint ventures, trade associations or other group activities thought to increase efficiency.80 On the other were those who insisted on aggressive antitrust enforcement against all combinations. The first group temporarily won out during the New Deal, when Roosevelt's "Codes of Fair Competition" virtually legalized various forms of collusion. But after the Second World War intervened, Arnold pursued vertical predation in the antitrust division.81

Undoubtedly the last legacy of the problems attending the New Deal and the recovery was the increasing attempt by antitrust policy makers after World War II to take efficiency concerns more seriously, and to recognize that bigness and even a certain amount of oligopoly were a fact of life.82 This required a more sophisticated dialogue between antitrust and economic theory.83 The economic theory of the day placed a heavy emphasis on industrial organization theories but generally disregarded the efficiencies that were attributable to the principal non-price restraints, and numerous challenges to tying arrangements, exclusive dealing and vertical mergers.84

The most prominent antitrust policy document of the period was the Report of the Attorney General's National Committee to Study the Antitrust Laws (1965), which was mildly expansionary by the standards of that time. The report advocated stricter merger standards that relied heavily on structural factors but generally disregarded the efficiencies that could result from mergers. Even Carl Kaysen and Donald P. Turner's Antitrust Policy,85 which was more rigorous economically, identified the promotion of "fair" conduct and the limiting of growth of big business as desirable antitrust goals.86 Indeed, they even suggested that a legitimate goal of antitrust policy is the equitable distribution of income.87

Much of the foundational analysis for this thinking, but without the explicit normative concerns, was contained in Harvard economist Joe S. Bain's 1960's work on barriers to entry, industry structure, and oligopoly.88 By 1950, when the Cellier-Kefauver amendments to § 7 of the Clayton Act were passed, concern with market imperfections had become the most pronounced feature of antitrust policy. Economists' concerns about oligopoly and concentration were translated and greatly exaggerated into legal-political policies that were suspicious of business expansion and even hostile toward efficiency. At the same time, Congress may have been overly responsive to lobbying organizations of small businesses who were injured by the efficient practices of larger firms. The culmination of this thinking was a 1960's antitrust policy that was openly hostile toward innovation89 and large scale development, and a zealous protector of the right of small business to operate independently.90

The literature criticizing 1960's antitrust policy for its numerous excesses routinely blames the Warren Court. But the first party to blame is the enforcement agencies of the government, particularly the Federal Trade Commission. The great majority of Warren era decisions that are characterized today as overly aggressive came in suits brought by the government, in which the Court did precisely what the government asked it to do.91 For this reason, arguments such as those analyzed in § 2.2c below that competitors are inferior plaintiffs, or that most antitrust litigation should be pursued by the government, must be seen in historical perspective. Over the 120 year history of the antitrust laws most of the zealotry and expansiveness in doctrine has been requested by the government itself. The aggressive private plaintiff has done no more than pick up where the government left off. Today the tables are turned, and the private plaintiff is generally viewed as the enforcer who pushes antitrust to its limits. But these are contingent rather than eternal positions, and they could change once again.

This brief history concludes here, with the end of the Warren Era. The Chicago School, which was in large part energized by the expansive antitrust policy of the 1950's and 1960's, is discussed in §§ 2.2b. From that point on, we are speaking not of history but of current policy, and that is the subject of the rest of this book.

§ 2.2 ROLE OF ECONOMICS IN ANTITRUST

2.2a. Antitrust and Economics Before 1960

As noted in § 2.1b, great early antitrust opinions such as Taft's Addyston Pipe decision period that is more optimistic than the one given here, see T. Koveleski, Business and Government During the Eisenhower Administration: A Study of the Antitrust Policy of the Antitrust Division of the Justice Department (1958); and see Peritz, note 57.

effectively freed the antitrust laws from both Congressional intent and the substantive rules of the common law. From that point the federal courts forged their own antitrust policy, taking advantage of the best applied economics of the day. One of the great myths about American antitrust policy is that courts first began to adopt an “economic approach” to antitrust problems after the relatively recent past. This belief has led some to argue that antitrust could escape from ever-changing, indeterminate economic theories by looking to its common law heritage.

Antitrust has always been closely tied to prevailing economic doctrine. To be sure, antitrust policy makes sometimes applied economic inferences, sometimes gravitated toward the fringes of economic theory rather than the center, and sometimes pushed good points too far. But even the common law was driven largely by the then-prevailing rules of classical political economy concerning the nature of competition and the efficiency consequences of various anticompetitive practices. The older common law was quite tolerant of collusion and most vertical practices simply because classical political economy had an extremely robust view of the market, particularly of the role of potential competition and easy entry in disciplining any attempt to raise prices above the competitive level. With the rise of neoclassicism in the 1870’s and 1880’s (best identified with the development of the marginal cost and marginal revenue curves in the analysis became more subtle and economists became increasingly aware of market imperfections that might allow various anticompetitive practices. Antitrust policy was not far behind.

One of the great difficulties in defining the role of economics in early judicial interpretations of the Sherman Act, is that the neoclassical revolution in economics was occurring at the very time that statute was passed. During the period from 1890 to 1920, economics was unsettled, with numerous battles between old-line classicists and emerging neoclassicists, and a great variety of views about the harmfulness of various practices.

If a case can be made that antitrust was ever out of touch with prevailing economic theory, it would have to be made about the earliest period of Sherman Act enforcement. At that time most traditional economists condemned the statute as at best irrelevant and at worst harmful, since it would likely challenge the ability of large business firms to achieve lower prices through economies of scale. But many of the new breed of economists, those most heavily infected by the neoclassical revolution, were more suspicious of big business and inclined to see the antitrust law as a good thing. The best explanation of antitrust enforcement during this period is that it gradually came to reflect the views of a younger generation of post-classicist economists, rather than the more established classicists.

As noted in § 2.1c, the New Deal period saw substantial inroads of economic theory into antitrust policy. But at that time the dominant economic ideology was also quite suspicious of unregulated markets and inclined to believe that government regulation would work better. Beginning after 1935 or so, American antitrust policy became increasingly aggressive against mergers and various vertical practices. Once again, the change did not occur in spite of prevailing economic doctrine. On the contrary, it was driven by economic theories such as those developed in Edward Chamberlin’s theory of monopolistic competition, a New Deal classic that emphasized the role of imperfections such as product differentiation in American markets. Within this framework competition was regarded as a fragile state of affairs that could be maintained only by constant antitrust supervision. The reaction to this New Deal ideology led directly to the concept of “workable competition,” which was extremely influential on American antitrust policy in the 1940’s and 1950’s. That theory was incorporated in the 1955 Report of the Attorney General on antitrust policy, which attempted to develop an antitrust policy based on the Chicago School’s theory of organization theory. Competition was seen not as something inherent in many American industries, but rather as something that could be made workable, even in highly imperfect markets, provided that the government was willing to intervene and challenge anticompetitive practices.

Even the relative aggressiveness of the Warren Court era was grounded in economic theory, although antitrust cases often pushed it too far. The economic theory that prevailed in the 1960’s was quite different from the economics of the 1980’s, and economists of the earlier period were much more suspicious of the unregulated market. For example, Joe C. Bain, probably the most influential antitrust economist of the day, based his relatively interventionist theories on three important economic premises. The first was that economies of scale were not substantial in most markets and dictated truly anticompetitive concentration levels in only a small number of industries. As a result, many industries contained larger firms and were more concentrated than necessary to achieve optimal productive efficiency. The second theory was that barriers to entry by new firms were very high and could easily be manipulated by dominant firms. The third was that the noncompetitive performance (monopoly pricing) associated with oligopoly began to occur at relatively low concentration levels. The combination of these views created an antitrust policy that was quite concerned with deconcentrating oligopolistic markets and, to a degree, with protecting small firms from larger rivals. The underlying theory was generally that a large number of small firms would yield lower prices than a relatively small number of larger firms. Although Warren Era antitrust enforcement policy may seem excessive even in light of these economic theories, antitrust enforcement policy was largely defined by them. For example, the 1968 Justice Department Merger Guidelines, while far more aggressive than the Guidelines of the 1980’s and 1990’s, were based squarely on Bainian views about the relation between competition and market concentration.

The revolution in market economics that took place at the University of Chicago in the late 1880’s and early 1890’s was very important.

2.2. The Chicago School and its Aftermath

The revolution in market economics that took place at the University of Chicago in the late 1880’s and early 1890’s was very important.
1950's and after was a full assault on the New Deal/Chamberlain/Bain conception of the frailty of markets and the appropriate scope of antitrust intervention. 18

Very briefly (and thus at some risk of misstatement) the Chicago School stands for the following ten propositions:

(1) Economic efficiency, the pursuit of which should be the exclusive goal of the antitrust laws, consists of two relevant parts: productive efficiency and allocative efficiency. Productive efficiency is a fraction in which the value of a firm’s output is the numerator and the value of its inputs is the denominator; the higher this ratio, the more efficient the firm. Gains in productive efficiency come about mainly by research and development. Allocative efficiency refers to the general efficiency of markets, generally measured by the Pareto criterion. 19 As a general matter, markets attain optimal allocative efficiency when they are competitive—that is, when price equals marginal cost. Because monopoly profits provide an important incentive to research and development, however, increases in productive efficiency often operate to reduce the market’s allocative efficiency. For example, construction of a large plant and acquisition of a large market share may increase a firm’s productive efficiency by enabling it to achieve economies of scale; however, these actions may simultaneously reduce allocative efficiency by facilitating monopoly pricing. A properly defined antitrust policy will attempt to maximize net efficiency gains. 20


19. A situation is Pareto optimal when no person can be made better off without making someone else worse off. 21

20. For example, R. Bork, The Antitrust Paradox: A Policy toward High 91 (1978; rev. ed. 1988): “The whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.”

21. See, for example, Y. Bronen, Concentration, Mergers and Public Policy (1985); J. McGee, In Defense of Industrial Concentration (1971).

22. For example, F. Easterbrook, The Limits of Antitrust, 83 T. Am. Econ. Assn. 2 (1964) (in the long-run markets become competitive; the goal of antitrust is merely to “speed up the arrival of the long run.”)

23. For example, H. Demsetz, Barriers to Entry, 72 Am. Econ. Rev. 47 (1982).

24. See the debate between John McGee (Chicago School) and F.M. Scherer (critic), in Industrial Concentra-

(2) Most markets are competitive, even if they contain relatively few sellers. Even if firms in concentrated markets are able to coordinate prices, they will continue to compete in other ways, such as by increasing customer services. It is very difficult for oligopolies or cartels to close off every possible avenue of competition. Further, product differentiation tends to undermine competition far less than was formerly presumed, and it makes collusion far more difficult to maintain. As a result, neither high market concentration nor product differentiation are the anticompetitive problems earlier oligopoly theorists believed them to be. 21

(3) Monopoly, when it exists, tends to be self-correcting: that is, the monopolist’s higher profits generally attract new entry into the monopolist’s market with the result that the monopolist’s position is quickly eroded. About the best that the judicial process can do is hasten the correction process. 22

(4) “Natural” barriers to entry are more imagined than real. As a general rule, investment will flow into any market where the rate of return is high. The one significant exception consists of barriers to entry that are not natural—that is, barriers that are created by government itself. In most markets society would be best off if the government left entry and exit unregulated. 23

(5) Economies of scale are far more pervasive than economists once believed, largely because earlier economists looked only at intra-plant or production economies, and neglected economies of distribution. 24


27. A firm “satisfices” when its management adopts a certain goal for profits, sales, or market share and then tries to meet the goal but not necessarily to exceed it. Under the theory, management will not be inclined to set an extremely high goal if it does not want to be viewed later as failing. The theory of satisficing is part of a more general theory of the firm, emphasizing the separation of decision-making and management. See, for example, M. Greenwald & D. Trzcinka, Corporate Exit and Performance, 84 Mich. L. Rev. 102 (1986).


30. See, for example, P. Easterbrook, Antitrust Casebook, 8th ed. (1999).


(6) A firm generally maximizes its own profits when downstream and upstream firms behave competitively; so it has no incentive to facilitate monopoly in vertically related markets. Further, a monopolist cannot possibly “leverage” additional monopoly profits by using its monopoly position in one market to foreclose access to a vertically related market. 55 As a result, virtually all instances of vertical integration, including resale price maintenance and vertical nonprice restraints, are efficient. 54

(7) Business firms are profit maximizers. That is, their managers generally make decisions that they anticipate will make the firm more profitable than any alternative. The model would not be undermined, however, if it should turn out that many firms are not profit maximizers but are motivated by some alternative goal, such as revenue maximization, sales maximization, or “satisficing.” 26 The integrity of the market efficiency model requires only that a few firms be profit-maximizers. In that case, the profits and market shares of these firms will grow at the expense of the non-profit-maximizers.

(8) Antitrust enforcement should be designed in such a way as to penalize conduct precisely to the point that it is inefficient, but to tolerate or encourage it when it is efficient. 29 Further, competitors in a market are generally benefited by collusive behavior: the New Learning 15-118 (H. Goldschmid, H. Mann & P. Wettstein, eds., 1984).


33. See, for example, P. Easterbrook, Antitrust: Cases, Economic Notes and Other Materials 650-657 (34 ed. 1981).


35. See, for example, F. Easterbrook, Antitrust Casebook, 8th ed. (1999).


38. See, for example, P. Easterbrook, Antitrust: Cases, Economic Notes and Other Materials 650-657 (34 ed. 1981).


40. See, for example, F. Easterbrook, Antitrust Casebook, 8th ed. (1999).


43. See, for example, P. Easterbrook, Antitrust: Cases, Economic Notes and Other Materials 650-657 (34 ed. 1981).

looses to business. The member of the Chi­
cago School can thus argue that he is not
taking sides in any political dispute about
how wealth should be distributed among
conflicting interest groups. Such things should always go
where they do the most net good.

Some of these principles are empirically
robust and have become all but uncontrover­
sial in antitrust writing. Others have no more than
ideology to support them and must be
characterized as acts of faith. The substance of
each is taken up at various points in this book,
characterized as acts of faith. The substance of
SUMER SUITS; PRIVATE V. PUBLIC
appropriateness of government intervention in
maintenance to be competitive under certain
theories to be anticompetitive. But which theory ex­
novates to rest by substituting entirely competitive
explanations. This writing revolutionized anti­
trust theory in such areas as resale price main­
tenance, tying arrangements, and predatory
pricing. But the last two decades have pro­
duced a mountain of post-Chicago scholarship that
has substantially changed the landscape
once again. 38 The “free rider” explanation of
resale price maintenance was a good one, but
it only applies to a small percentage
of RPM situations. 39 The Chicago School
models showing vertical integration to be invariably
efficient rested on assumptions that firms
could not vary the proportions of the inputs
that they use; when that assumption is relaxed the
conclusion is much more ambiguous. 40 Strategic
behavior, which appears in a variety of
disguises, is both plausible and anticompeti­
tive under a host of situations that standard
Chicago Scholarship failed to acknowledge. 41
Finally, the Chicago theory that market power
is a relative rarity has given way to numerous
econometric procedures for measuring market
power with greater precision than we have had
in the past. These procedures indicate that
significant market power is not all that rare,
even in markets that do not have dominant
firms. 42 Just as there is no ratchet in antitrust
law, so there is no ratchet in antitrust economics.

Like the Chicago School scholar, the anti­
trust moderate also believes in markets, and
even believes that the self-interest of business
firms most often works to the benefit of con­
sumers and the economy. But the antitrust
moderate is more likely to believe that (a)
busines firms act only in their self-interest;
(b) markets contain imperfections that
permit self-interest and the public interest to
diverge. In robustly competitive markets, the
presumption that a challenged practice is sim­
ply “a way of competing” should be very
ambiguous. 43

33. See H. Hovenkamp, The Antitrust Movement
and the Rise of Industrial Organization, 68 Texas L. Rev. 105
(1989).
34. On predatory pricing, see ch. 8.
35. On horizontal mergers, see ch. 12.
36. On price-fixing, see ch. 4.
37. See, for example, the citations in notes 21–25 above.
38. F. Easterbrook, Is There a Ratchet in Antitrust
39. See H. Hovenkamp, Post-Chicago Antitrust: A
40. See §§ 11.2–11.3.
41. See §§ 9.2–9.3.
42. See generally J. Tirole, The Theory of Industrial
43. See Ch. 3, and see, e.g., J. Baker & T. Bresnahan,
Empirical Methods of Identifying and Measuring Market
Power, 61 Antitrust L.J. 3 (1992); J. Kattan, Market
Strong. In more concentrated markets where
the exercise of market power is possible, that
presumption should simply disappear. Both
the Chicagoan and the moderate draw a line in
the sand, trust competition to take care of
things on one side, but warn business firms
not to step across. However, they draw the line
in different places.

The Chicago School antitrust scholar is
likely to believe that courts should not inter­
vene unless the economic case against a prac­
tice is so strong that all reasonable dissenting
voices have been squelched. When in doubt, let
the market take care of itself. By contrast, the
antitrust moderate is more willing to weigh
conflicting economic theories and decide which
one, competitive or anticompetitive, is a better
fit for the case at hand. This process ad­
mittedly involves some trial and error. Mistakes
of overdeterrence may occur. Whether they occur
more often than Chicago School mistakes of
underdeterrence is an empirical question.

The process by which courts decide anti­
trust law is not much different from all other law pro­
cess generally. Overall, the process is arguably
efficient. If a common law rule is inefficient,
the losses it produces are greater than the gains.
In that case the rule will be challenged
relatively more times, because the challengers
have a much better chance of success.
Again, the common
law process gradually gravitates toward effi­
cient rules, 44 or at least toward rules that are
efficient most of the time. 45

Notwithstanding antitrust’s common law
nature, one can doubt whether this process
occurs in antitrust litigation. Competitive mar­
kets have many of the characteristics of a
public good. The beneficiaries of competition
tend to be scattered widely across a large
group of consumers, each of whom experiences
Power in the Presence of an Installed Base, 62 Antitrust
44. G. Priest, The Common Law Process and the
Selection of Efficient Rules, 6 J. Legal Stud. 65 (1977); G.
Priest & J. Turow, The Selection of Disputes for Litigation,
45. On this point, see R. Cooter & L. Kornhauser, Can
Ligitation Improve the Law Without the Help of Judges? 9
J. Legal Stud. 139 (1980).
relatively small gains. By contrast, those who benefit from anticompetitive practices are few and individual benefits are quite large. For example, the victims of anticompetitive resale price maintenance in the market for blue jeans may be 10,000,000 consumers, each of whom pays $5 or perhaps $10 more per year. The beneficiaries may be a small group of manufacturers or retailers, each of whom gains several million dollars annually. The major players in resale price maintenance litigation may both have the wrong incentives. Those wishing to impose it may be facilitating collusion. Dealers who challenge it may be wishing to take a free ride on the efforts of other dealers. The group whose interests are most closely aligned with the competitive outcome, consumers, may lack either the organization or the awareness of injury that would make them effective plaintiffs.

In the field of economics called "public choice," which studies the workings of democratic government, this kind of structure works to the advantage of special interest groups, who are generally producers, at the expense of consumers. Producer groups are small and their interests are unified. Consumer groups are large, and the individuals differ greatly in their preferences. The tendency to shirk is large, because each consumer is motivated to take a free ride on the work of others. As a result, government regulation is often inefficient, benefitting small special interest groups at the expense of the public at large.

The public goods nature of competition tends to be at odds with the Chicago School position, outlined in (8) above, that competition standing to bring antitrust actions should be greatly restricted or perhaps eliminated. According to this position, consumers have the correct incentives while competitors do not. Consumers are injured by monopoly overcharges, but competitors are injured most often by the increased efficiency of the firms whose conduct is being challenged.

Competitors are simultaneously the worst and best of antitrust plaintiffs. First, their incentives are almost always questionable. Although competitors are injured by monopolistic exclusionary practices, they are also injured by increased efficiency. Since competitors, just as any private party, sue to vindicate private rights they cannot be expected to distinguish efficient from inefficient practices. They will sue if they have a cause of action and the value of the expected remedy exceeds the cost of suit.

But competitors are also the best antitrust plaintiffs. Competitors are knowledgeable participants in a market, who generally know about an anticompetitive practice long before consumers do, assuming that consumers find out at all. Competitors are well placed to pursue an antitrust violation before it produces a monopoly, or at a much lower cost. Remember, the social cost of monopoly is a function not only of its size but also of its duration. Likewise, competitors generally feel the injury in much more perceivable ways. An exclusionary practice may create a monopoly that raises prices later. But the same practice may drive a rival out of business. This gives the rival an incentive to sue that consumers often lack.

For some of the same reasons, the value of consumer suits has been greatly exaggerated. First of all, just as both efficient and inefficient exclusionary practices injure competitors, efficient and inefficient practices also give a firm power to raise price above marginal cost or to limit consumer choice. In the consumer suit, the plaintiffs must run the same set of gauntlets to prove an anticompetitive exclusionary practice that competitors must prove.

Consider predatory pricing, a favorite for Chicago School critics of competitor law. When a competitor complains of predatory pricing, the basis could be either that the defendant is pricing predatory, or else that the defendant has lower costs than the plaintiff or is undercutting the plaintiff's comfortable monopoly profits. If the law against predatory pricing is applied in the latter situation, competitor suits challenging predation themselves become a powerful anticompetitive weapon.

The solution proposed by some members of the Chicago School is to give the predatory pricing lawsuit only to consumers. The classic theory of predatory pricing is that the predator uses a temporary period of below cost pricing to discipline rivals or drive them from the market so that it can charge monopoly prices later. Are consumers really better placed than rivals to prove such claims? First, we must trust that consumers are as aware of what has been going on in the market as competitors were, that the consumers can organize themselves, and that their suit will be cost-effective. Consumers must investigate whether there has been a post-predation price hike to monopoly levels. The fact that a market experienced a period of low prices, one or more bankruptcies or shutdowns by established firms, and then a period of higher prices, could describe a competitive situation as well as a monopoly situation. For example, when a market is subject to excess capacity, prices will be low. Later, when some firms have exited from the market, prices could rise considerably. How do we distinguish whether the earlier low price was competitive or predatory? A court would have to use a set of screening devices in consumer brought predatory pricing cases, just as they use in competitor suits. The court would insist on a market structure conducive to predatory pricing, and an evidence that the prices charged by the dominant firm were below some measure of cost. But the consumers are in no better a position to do this, and they may be in a far worse position, particularly if the consumer suit comes later than the competitor suit. Further, basic consumer incentives are no more righteous than competitor incentives. The consumer's main interest is in the anticipated recovery, not in the more abstract question whether a price hike was caused by predation or something else. Incidentally, it is no answer that devices such as class actions can unify consumers and permit them to pursue antitrust cases effectively. Although class actions have been effective against cartels and some tying arrangements, they have not been very successful in challenges to exclusionary practices. In any event, the class action solves only the organizational problem; it does nothing to change basic incentives or standards of proof.

In sum, we can concede that competitors have the wrong set of incentives. However, consumers do not automatically have the correct set. They sue to reap private benefits, and their incentives will be driven by anticipated gains. In order for consumer suits to be superior to competitor suits we must be confident that consumer suits are better mechanisms for showing facts. First, high prices are in fact monopoly prices; and (2) the mechanism that gave the firm the market power to charge high prices was anticompetitive rather than efficient.

To be sure, limiting standing to consumers would reduce the number of antitrust suits. But there is no good reason for thinking that those eliminated would be the nonmeritorious suits, while the meritorious suits would survive. Rather, the number of suits would be reduced simply because information costs are much higher for consumer groups, because consumer groups are much less well organized than competitors are, and because individual consumer injuries tend to be much smaller. These reasons presumably cut across all antitrust challenges, both meritorious and non-meritorious.
This author believes that a better way to reduce the number of nonmeritorious antitrust suits is to develop substantive and procedural rules that distinguish good lawsuits from bad. For example, the cure for excessive predatory pricing suits is not the elimination of the competitor plaintiff, whose early challenge can be far more effective than the later challenge of any consumer group. The cure is rigorous use of market structure and market-share thresholds that will enable us to determine whether predatory pricing is a plausible use of market structure and market share.

2.2d. Politics and Democratic Policy

On point (10) in the above list of Chicago School principles, the claim that a particular policy has managed to transcend politics is both appealing and dangerous. Its appeal is that it permits the creation of a stable policy that will not change with every change in political leadership. Antitrust policy has been particularly subject to political changes. The danger, on the other hand, is that the assertion takes a particular policy out of the political process altogether—which means, in the case of a democracy, that it is taken out of the democratic process. At the extreme, Chicago School antitrust policy may even permit the antitrust policy maker to ignore Congressional intent in passing the antitrust laws. For example, the legislative history of Congress was hostile to efficiency concerns. Both Chicago School antitrust policy and the courts themselves have deviated substantially from Congress’ original concern.

2.2e. Antitrust Policy in the Wake of the Chicago School

As noted previously, antitrust policy has always tracked prevailing economic theory to one degree or another. Problematically, economic theory has not been much more stable than legal theory. The revolution of antitrust policy that occurred during the 1970’s and 1980’s is closely associated with the Chicago School. The antitrust student begins with a grasp of the theories that question芝加哥 School theories. The problem, of course, is to separate the plausible from the implausible, and the workable from the purely theoretical. These are fundamentally exercises in judgment.

This book takes a manifestly economic approach to antitrust analysis. But the author’s position differs from that of the Chicago School in two important ways. First, the range of relevant economic theories is more catholic, and takes seriously at least some economic theories that question芝加哥 School theories. The problem, of course, is to separate the plausible from the implausible, and the workable from the purely theoretical. These are fundamentally exercises in judgment.

Second, this book tries to preserve a perspective both economic and political. Economic efficiency is dominant but necessary attention is paid to non-economic concerns when these have been articulated by Congress. Much Chicago School analysis is written as if there were only one antitrust statute and it read “Promote business efficiency.” But that is not the antitrust statute that we have. The antitrust student begins with a body of statutes in which economic efficiency plays a disturbingly small part. The relative weight given to efficiency concerns in this book depends on both the proportions justified by the legislative history of the major antitrust statutes. But competing concerns, such as those for protecting consumer wealth transfers (whether caused by efficient or inefficient practices), and even more unorthodox concerns, such as protecting other interest groups that Congress determined to protect, simply cannot be ignored. If these are, then we are not living in a democratic society.

The role of economics in antitrust is not to eliminate political concerns from policy making. Rather, it is to enable policy makers to make judgments about the costs or effectiveness of a particular policy. The relative weight to be given to efficiency concerns varies with the ability of the relevant economic model to identify efficient policies in the real world. If the efficient solution is clear, and the degree to which alternative solutions deviate from the efficient solution is also quite clear, then policy makers are likely to weigh efficiency concerns heavily.

But by contrast, if economics’ relevance to some problem is not particularly clear, or if the economic model is complex, then the efficient solution will not necessarily emerge as obvious. In that case, distributive or political concerns, which are always present, will weigh much more heavily. For example, if the relevant economic model does not reveal unambiguously (1984). For the principal discussions of these cases, see chs. 7, 10, 11 & 14. See also L. Kaplow, Antitrust, Economic Policy, and the Courts 51 L. & Contemp. Probs. 181 (1984) (arguing that federal judges have been driven more by political ideology than by Chicago School economics).
usually that big business is more efficient than small business, but the small business lobby is powerful or democracy’s other participants value small businesses for reasons unrelated to cost, small business welfare is likely to be present as a legislative concern. The antitrust policy maker may not ignore it.

One important difference between the Chicago School market efficiency model and earlier economic models is that the Chicago model claims a much larger domain for efficient practices and, accordingly a correspondingly smaller domain for inefficient ones. Further, the model itself is both simple and elegant. The monopolistic competition model that drove post-NewDeal policy was far more complex and made it far more difficult to examine a particular business practice and proclaim it efficient or inefficient. For example, within that model product differentiation could increase consumer choice or encourage innovation; however, it could also be a mechanism by which large firms in concentrated industries avoided price competition. Likewise, Joe S. Bain’s complicated notion of entry barriers appeared simultaneously to raise and condemn economies of scale in the production process. On the one hand, economies of scale reduced costs and facilitated low entry barriers. On the other, they made it more difficult for new firms to enter the market and, at least in concentrated industries, facilitated oligopoly behavior. Within the Chicago School model, by contrast, both of these problems have unambiguous solutions. Product differentiation is almost always a blessing for consumers. When it is not, the policy maker may not ignore it.

The same thing can be said of modern game theory in industrial organization. The theories are complex and many of them may not even be testable. As the present time the principal impact of game theory is negative rather than positive—it serves to undermine our confidence that the market is always as efficient as traditional Chicago economics implied, but we don’t really know very much about the nature or extent of the deviations. When the economic theory model acts under this kind of uncertainty about the efficacy of the unregulated market, then noneconomic justifications for intervention begin to carry more weight.

Increasingly, antitrust economics is being driven by “post-Chicago” theories that are both more complex and more ambiguous than Chicago orthodoxy. For example, modern theories of industrial organization give much wider play to the possibilities of strategic behavior that can facilitate noncompetitive outcomes. This new complexity makes it much more difficult for enforcement agencies and courts to make judgments about whether a particular practice is competitive or anti-competitive. Supreme Court decisions such as Kodak, while seemingly quite unsophisticated in their economic claims, clearly reflect some of these doubts. The Horizontal Merger Guidelines adopted by the Antitrust Division and the Federal Trade Commission in 1992 reflect some of this complexity as well. Earlier Guidelines issued in 1982 and 1984 had followed the dominant Chicago School line of regarding product differentiation as a mitigating factor in merger analysis. When products in a market are not identical, it has been more coherent, and the noneconomic (and constitutionally mandated) values of the jury will receive relatively greater weight as economics is increasingly characterized by internal conflict and indeterminacy. These results are disturbing. The Chicago School offers simplicity, elegance and often relatively easy answers to antitrust questions. The alternatives are almost always messier, more expensive, and less determinate. But policy has to reflect the world we live in, and the world is a messy place.

The economic model of markets and industry structure outlined briefly in Chapter one is complex, and policy makers must consider the additional concerns of antitrust policy. First, as the Kodak case held, simple answers are not likely to work, and more information must be gathered. This may create early claims of summary judgment less likely. Second, another implication of Kodak—judges are going to be less likely to find certain practices to be harmless as a matter of law; more is going to go to juries. The outcomes will be more coherent, but the noneconomic (and constitutionally mandated) values of the jury will receive relatively greater weight as economics is increasingly characterized by internal conflict and indeterminacy.

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noneconomic as well as economic values. As § 2.1 notes, the legislative history of most of these statutes fails to reveal that economic efficiency concerns dominated. Indeed, Congress was generally willing to tolerate a great deal of allocative inefficiency in order to protect certain classes of people, such as small business. Does this mean that merger law today (which is still governed by the same, anticompetitively motivated statute as amended by Congress in 1950) should ignore economics? Conversely, does it mean that courts should ignore the legislative history of federal merger legislation and read economic efficiency into the statute? Section 7 of the Clayton Act, after all, is a democratically passed statute. The United States Code is filled of inefficient, democratically passed statutes, many of which are regularly enforced.

There is a principled position that antitrust policy must admit certain noneconomic values. At the same time, no one believes that efficiency concerns are irrelevant to antitrust policy. Today the most important debate about how to enforce antitrust is between those who believe that allocative efficiency should be the exclusive goal of the antitrust laws, and those who believe that antitrust policy should consider certain “competing” values—that is, values that either cannot be accounted for within the economic model, or values that can be asserted only at the cost of a certain amount of efficiency. These competing values include maximization of consumer welfare, protection of small businesses from larger competitors, protection of easy entry into business, concern about large accumulations of economic or political power, protection of the impersonality or “facelessness” of giant corporations, encouragement of morality or “fairness” in business practice, and perhaps some others.

These alternative goals can be inconsistent with the economic goals of maximizing allocative and productive efficiency. In addition, many are inconsistent with each other. If there are no mixture of goals, antitrust is likely to be guided by conflicting policies which must then be balanced against each other.4 To be sure, this is not a unique phenomenon. Constitutional law is filled with decisions that balance conflicting policies. Antitrust could similarly be used to protect the right of small businesses to set low consumer prices against a policy of protecting small businesses from larger competitors, and choose different policies to win in different cases.

By contrast, those who believe that antitrust should be concerned exclusively with efficiency can offer a relatively consistent policy, provided there is consensus about the relevant elements of the economic model. If vertical integration is inefficient, then the “efficiency only” advocate believes it should be legal, even if it injures small businesses, makes big businesses even larger, and makes it more difficult for newcomers to enter a particular field. She will not attempt to balance these competing “concerns against economic efficiency, because she does not see them as competing. They are simply ignored.

Before someone can “balance” competing values, however, he must have a fairly good idea about what is being thrown into the scales. This means that the multi-valued policy maker, who believes that antitrust should consider small business welfare as well as economic efficiency, must have a good basic knowledge of prices, markets and industrial organization. There is no basis for the view that the adoption of some “competing” noneconomic policy for antitrust, such as the protection of small business welfare, permits one to do antitrust without knowing economics. Even the multi-valued policy maker needs economics to help her estimate the relative costs of protecting certain noneconomic values and determine whether society is willing to pay the price. The fact that there are no mixture of goals does not mean policy is to protect small businesses. If that were the policy, even price fixing by small businesses would be legal.

Further, economic theory will often help the multi-valued policy maker determine whether a particular legal rule will effectively protect the interest she wants to protect. The history of American antitrust is strewed with the corpses of small businesses who fell victim to antitrust rules designed to protect them. In a dissenting opinion in Standard Oil Co. of California v. United States,6 Justice Douglas, who placed a high value on the protection of small business, chastised the Court for undermining its own policy. The majority had condemned an exclusive dealing contract imposed by a major oil refiner on its independent retail dealers. The restrictions reduced Standard’s distribution costs, but they also restricted the freedom of dealers to make independent choices and made it more difficult for new, independent dealers to enter the market. Justice Douglas accurately predicted the effects of the decision: the need to reduce costs would force Standard to eliminate independent dealers and open its own, company-owned retail outlets. The result would be far more harmful to the competitive gasoline station owners than the cost-reducing restrictions struck down by the Court.

The same phenomenon has occurred often in merger law. In the 1980’s and 1990’s the Supreme Court and the lower courts struck down a number of mergers between major brewers and small regional brewers, generally on the ground that the mergers were destroying the small, locally owned brewery. The major brewers then entered the new markets not by merger, but by building their own competing plants. These new plants were more efficient than those operated by the local brewers, and the national brewers had the advantage of large, well established distribution systems.

Many of the local brewers were forced out of business and could not legally sell out to the larger firm. The monopolistic antitrust policy can be crafted without a coherent economic model is absolutely untenable. Absent the model antitrust will fall much too easily to constantly fluctuating interest group politics. Worse yet, there will be a very poor fit between the articulated goals of an adopted antitrust rule and its success in achieving these goals.

Critics of economic analysis in antitrust sometimes argue that the economic approach to antitrust is a function of economists’ myopia—their inability to see all the manifold issues that make up value systems in the real world. Economists, it is alleged, are uncomfortable with such competing values, so they create models that purport to account for everything. Nothing is left to chance, philosophy, or humanitarianism.

Perhaps the world is overrun by myopic economists. However, in this particular instance a far better case can be made for the converse of the above argument: antitrust writers who are untrained in economics rely heavily on noneconomic values because this enables them to have an antitrust policy without undertaking the (sometimes difficult) task of learning how the market system works. That approach may be easier in the short run, but it is calculated to have painful consequences in the long run.

2.3. The Substance of Antitrust Economics

Antitrust policy has changed dramatically over the century since the Sherman Act was passed, but changes in economic theory have
been equally dramatic. In 1890 the marginalist revolution in economics was just taking hold. Alfred Marshall’s great Principles of Economics, which did much to formalize our modern conceptions of marginal cost, marginal revenue, the demand curve, consumers’ surplus and allocative efficiency, was published the same year as the Sherman Act. Most likely none of the framers of the Sherman Act knew anything about marginalism. During the first four decades of the twentieth century the economic study of markets was dominated by two groups of liberals, Progressive and New Dealers, who had relatively little faith in markets, a great deal of faith in regulation, and believed that a wide variety of business practices were harmful to both competitors and consumers.9 But the 1960’s and after witnessed a great revitalization of Anglo-American economics’ traditional commitment to the market, and a concurrent distrust of government regulation or other forms of market intervention. Today, thanks largely to the incursions of game theory into industrial organization, a stronger case is beginning to re-emerge that many business practices are inefficient and that stronger forms of government intervention may be appropriate.10

One distressing part of this century long debate is that it does not seem to be heading toward an equilibrium. Relatively few of the important questions are permanently settled. Further, the debate is increasingly buried in technical notation, it is more technologically oriented than productive. Productive efficiency is more complex than productive or other forms of market intervention. Today, the debate is increasingly buried in technical mathematics known only to practitioners of the discipline. Marshall intimidated other economists in 1890 with his mathematics, but they are child’s play compared to the mathematics almost any graduate student in economics knows today. Finally, notwithstanding an increasing technical notation, it is becoming clear that many of economics’ most relevant conclusions cannot be verified in the strict sense. Rather, many economic conclusions should be described as stories that explain certain behavior and tend to be confirmed by the available data. But the lack of


### 2.3. The Meaning of “Efficiency” and “Consumer Welfare” in Antitrust Economics

The two kinds of efficiency relevant to antitrust analysis are productive efficiency and allocative efficiency. Productive efficiency is most simply understood as a ratio of a firm’s productive output to its inputs. A firm that produces a product valued at $100 and requires inputs valued at $60 is more efficient than a firm that produces a product valued at $100 but requires inputs valued at $90. Firms achieve higher levels of productive efficiency by building efficient plants, developing cost-saving procedures, using employees more effectively, and a host of other ways. Many acts that arguably violate the antitrust laws are mechanisms by which firms increase their productive efficiency. These include mergers, vertical integration, exclusive dealing or tying arrangements, and even certain agreements among competitors.

The attitude of the antitrust laws toward productive efficiency is affirmative but passive. On the one hand, antitrust policy generally permits activities that increase a firm’s productive efficiency, unless the activity also enhances the firm’s market power. On the other hand, a firm does not generally violate the antitrust laws simply by being inefficient. For example, although vertical integration may reduce a firm’s costs and permit it to produce and deliver a product at a lower price, failure to integrate is not illegal under the antitrust laws. The market itself disciplines inefficient firms.

Allocative efficiency is a more theoretical and controversial concept than productive efficiency. Allocative efficiency refers to the welfare society as a whole. Given a certain amount of inputs or resources, what use and assignment of these resources will make society best off, economically measured? The concept of allocative efficiency is not self-defining, and different economists and philosophers prefer different definitions. The most influential definition was given by Vilfredo Pareto early in the twentieth century: a given assignment of resources is most efficient (“Pareto-optimal”) if no alternative assignment will make at least one person better off without making at least one person worse off as well.12 If one begins with an imperfect economy, a change is

The gain to the monopolist, however, is only rectangle 2-3-5-4. The other part of the consumer loss, triangle 4-5-6, is lost to both the consumers and the monopolist. This is the traditional deadweight loss that is caused by monopoly. Although monopolists are richer as a result of monopolization, consumers are poorer by an even greater amount. For that reason a move from monopoly to competition is efficient by the potential Pareto measure.

The same thing is generally true of actions that increase a firm's productive efficiency without increasing its market power. Cost-reducing vertical integration, for example, makes both consumers and the vertically integrating firm better off, while it makes the firm's competitors worse off. But the integrating firm and its customers gain more than the injured competitors lose.

Potential-Pareto efficiency can be a useful guide for antitrust policy, but it is subject to two important qualifications. First, as with other economic measures of allocative efficiency, potential Pareto analysis is indifferent to how resources are distributed in society. If it could be shown that a certain practice made monopolists richer by exactly the same amount that it made consumers poorer, and no one else was affected, the practice would be judged "neutral" under potential Pareto criteria. However, the legislative history of the Sherman Act shows a great deal of concern for the fact that monopolists transfer wealth away from consumers, but no concern at all for any articulated concept of efficiency.

Second, although the change from orthodox Pareto-efficiency to potential Pareto-efficiency makes an antitrust policy based on efficiency theoretically possible, the change comes with one enormous cost. The efficiency of a social change is relatively easy to measure by the traditional Pareto criterion: if the change produces one identifiable loser, it is inefficient. The potential Pareto criterion, however, requires someone to discover all persons benefited by the change and sum the value of their benefits, and then to identify all losers and sum their losses. The identity of all such people and the amount of their relative gains and losses is often neither obvious nor easy to calculate. Even the above demonstration that monopoly is inefficient is necessarily valid only if one considers the single market depicted in the figure. But the destruction of monopoly in this market may create monopoly power in other markets. The total allocative losses in those other markets might exceed the gains in the market at hand. These criticisms aside, the potential Pareto criterion can help us obtain some idea whether the net effect of a practice is a social gain or a social loss. It may help us estimate the gain or loss, even though we likely cannot quantify it precisely. Furthermore, the ambiguities in the potential Pareto criterion are a disabling factor only in relatively close cases. Many cases are not close, and it is easier to predict that the social gains outweigh the social losses, or vice-versa.

Figure 1

HISTORY AND IDEOLOGY IN ANTITRUST POLICY

Although economists often advocate potential Pareto-superiority or some variation of it as the guiding policy for antitrust, you will look a long time to find a judicial opinion articulating antitrust policy in such terms. The term "potential Pareto-efficiency" is an imposing one, carrying with it many implications of technical economic rules and quantification that makes lawyers uncomfortable. Antitrust analysts commonly use a substitute, the "consumer welfare" principle. Many people who probably believe that maximizing allocative efficiency should be the exclusive goal of antitrust, state that the goal of antitrust should be to maximize the welfare of consumers. Spoken in such terms, the goal sounds very attractive and certainly less technical than "potential Pareto efficiency." Although "maximizing consumer welfare" is an appealing term, its content is ambiguous. To say that antitrust should maximize consumer welfare is one thing; to discern an antitrust policy that will do it is quite different. In fact, the consumer welfare principle is predicated on the observation that one is a consumer. An antitrust policy of maximizing small business welfare would have to be regarded as distributive, because it would force transfer payments from one group of people (consumers or large businesses) to another group of people (small businesses) even though such a transfer might not make society as a whole better off. Since all of us are consumers, however, an antitrust policy of maximizing consumer welfare is really a policy of maximizing everyone's welfare, at least in their capacity as consumers.

But this observation about the consumer welfare principle brings us right back where we started. All definitions of allocative efficiency purport to describe what will make society better off, economically speaking. If "maximizing consumer welfare" is simply a synonym for "maximizing everybody's welfare," then we still do not have a useable prescription for antitrust policy, but only a homily that the best antitrust policy is one that makes everyone better off.

The consumer welfare principle in use has become identical with the principle that the antitrust laws should strive for optimal allocative efficiency. Perhaps an only slightly cruder alternative is that antitrust policy under the consumer welfare principle chooses that option which leads to highest output and lowest prices in the market in question.

17. There is one important difference between maximum consumer welfare and maximum allocative efficiency. Allocative efficiency is maximized when the sum of consumers' surplus and producers' surplus is maximized. See Figure One in § 1.1. By contrast, consumer welfare is presumably maximized when the consumers' surplus triangle is maximized. A situation in which the area of the consumers' surplus triangle was ten units and the area of the producers' surplus triangle was five units would be more efficient than a situation in which consumers' surplus plus was twelve units and producers' surplus was one unit. The latter alternative, however, would maximize the welfare of consumers.

15. Even this rectangle probably overstates the gain to the monopolist. See the discussion of the social cost of monopoly in § 1.3.

16. Perfect price discrimination is such a practice. See § 14.3.