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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 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.

One solution to this problem is to ignore legislative history and look only to the plain language of the statute.[1] But the antitrust

§ 2.1

1. See Public Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 479, 109 S.Ct. 2558, 2579 (1989); EEOC v. Arabian American Oil Co., 499 U.S. 244, 247, 111 S.Ct. 1227, 1230 (1991) (construing plain language of statute rather than its legislative history). And see A. Scalia, A Matter of Interpretation: Federal Courts and the Law 29–37 (1997) (criticizing use of legislative history to interpret statutes);

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.[2] 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.[3] 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.[4] Still others have argued that Congress' chief concern was to arrest wealth transfers away from consumers and toward price fixers or monopolists.[5] Finally, others have argued that the Sherman Act was passed at the behest of particular non-consumer interests groups, such as small firms[6] or farmers.[7] These divergent, conflicting theories of the Sherman Act reflect underlying ideologies about the nature of legislation generally, or the nature of the relationship between the Sherman Act and the common law.[8]

At one point the Chicago School of antitrust analysis[9] 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 Celler–Kefauver amendments to the merger law.[10] 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.[11] 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.[12]

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.[13] The concepts of allocative efficiency and deadweight loss from monopoly were almost certainly not known to the framers of the Sherman Act.[14] Most of the modern

M. Dorf, Legal Indeterminacy and Institutional Design, 78 N.Y.U. L. Rev. 875 (2003) (Scalia crusade against use of legislative history is designed to combat interest group power by forcing them to get desired goals enacted into explicit statutory language).

2. 15 U.S.C.A. §§ 1, 2.

3. For example, R. Bork, Legislative Intent and the Policy of the Sherman Act, 9 J.L. & Econ. (1966).

4. For example, L. Schwartz, "Justice" and other Non–Economic Goals of Antitrust, 127 U.Pa.L.Rev. 1076 (1979).

5. R. Lande, Wealth Transfers as the Original and Primary Concern of Antitrust: the Efficiency Interpretation Challenged, 34 Hastings L.J. 65 (1982).

6. See G. Stigler, The Origin of the Sherman Act, 14 J. Legal Stud. 1 (1985); T.J. DiLorenzo, The Origins of Antitrust: An Interest–Group Perspective, 5 Int'l. Rev. L. & Econ. 73 (1985).

7. See W. Shughart, Antitrust Policy and Interest Group Politics 11–12 (1990); and for a critique of this view generally, see Stigler, note 6; and The Causes and Consequences of Antitrust: the Public Choice Perspective (F. McChesney & W. Shughart, eds. 1994).

8. 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 (E. T. Sullivan, ed., 1991).

9. See § 2.2b.

10. For example, R. Bork, The Antitrust Paradox: A Policy at War With Itself (1978; rev. ed. 1993).

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

12. See Stigler, note 6.

13. V. Pareto, Manual D' Economie Politique (1909).

14. 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, 46 Vand.L.Rev. 305 (1993).

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 framer 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, low-cost 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 finds more appealing. 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 such 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 Celler–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

15. Lande, note 5.

16. See H. Hovenkamp, Distributive Justice and the Antitrust Laws, 51 Geo.Wash.L.Rev. 1 (1982).

17. 1890: Sherman Act; 1914: Clayton and Federal Trade Commission Acts; 1936: Robinson–Patman Act; 1950: Cellar–Kefauver Amendments to Clayton Act.

18. See E. Fox, The Modernization of Antitrust: A New Equilibrium, 66 Cornell L.Rev. 1140, 1144 (1981); Hovenkamp, *Distributive Justice*, note 16, at 19.

19. See 14 Antitrust Law ¶ 2303 (1999); H. Hansen, Robinson–Patman Law: A Review and Analysis, 51 Fordham L.Rev. 1113 (1983). See § 14.6a.

20. See 4 Antitrust Law ¶¶ 901–904 (2d ed. 2006); D. Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv.L.Rev. 226 (1960); H. Hovenkamp, Derek Bok and the Merger of Law and Economics, 21 J. L. Reform 515 (1988). See § 12.2.

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' "regression" on the matter of efficiency and consumer welfare is hard to ignore.

Further, both the allocative efficiency theory and the consumer wealth 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 rate 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 output had increased four-fold. Refined sugar prices fell by more than eighteen percent between 1880 and 1889.[24] The iron and steel industry, another target of the Sherman Act's proponents, had witnessed declines of about twenty percent. *Third*, railroad rates were also in rapid decline.[25] *Fourth*, the decade preceding the passage of the Sherman Act was one of rapid economic growth, with the real gross national product increasing by about 24%.[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 wealth transfer theories 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

21. See T. Hazlett, The Legislative History of the Sherman Act Re-Examined, 30 Econ. Inquiry 263, 267 (1992).

22. See Hazlett, id. at 273; DiLorenzo, note 6 at 79–81.

23. See H. Hovenkamp, The Antitrust Enterprise: Principle and Execution, ch. 2 (2005); H. Hovenkamp, Antitrust's Protected Classes, 88 Mich.L.Rev. 1, 28 (1989); G. Gunton, The Economic and Social Aspect of Trusts, 3 Pol.Sci.Q. 385, 394 (1888); J. Jenks & W. Clark, The Trust Problem 108 (1929).

24. See L. Telser, A Theory of Efficient Cooperation and Competition 28–29 (1987); J. Jenks & W. Clark, note 23 at 82.

25. Hovenkamp, note 23 at 29; Telser, note 24 at 30–31.

26. Shughart, note 7 at 13.

27. See H. Hovenkamp, Enterprise and American Law: 1836–1937 at 308–315 (1991); T. DiLorenzo & J. High, Antitrust and Competition, Historically Considered, 26 Econ. Inquiry 423 (1988); Gordon, Attitudes Toward Trusts Prior to the Sherman Act, 30 S. Econ. J. 156 (1963).

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 would steal jobs.[28] Although the Sherman Act included provisions for private lawsuits, nearly everyone who spoke on the issue believed that *consumer* lawsuits would be ineffectual. When the Congressmen spoke of private lawsuits, they were thinking of competitor suits.[29]

An alternative explanation that is less consistent with the interest group theory of politics but perhaps more consistent with nineteenth century American ideology generally, is that the antitrust laws were passed out of a pervasive fear of private "bigness" and the political power that it engendered. The nineteenth century American rhetoric on monopoly is concerned at least as much with bigness *per se* as it is with monopoly prices. Further, the American ideal was a market economy into which any entrepreneur could enter and compete on the merits—that was the American worker's escape from the sweatshop. Big firms such as Standard Oil or Carnegie Steel threatened that ideal by signalling that only big firms could survive. If one looks at the ideology of nineteenth century Americans, rather than at the interest groups that may have contributed to the Sherman Act's formation, the anti-bigness rationale seems to be very important.

Ironically, however, if the Sherman Act was directed at bigness, it had precisely the opposite consequence that its framers had in mind. The period 1895–1905 witnessed the largest wave of mergers (measured as a percentage of the economy) in American history. Most likely the mergers occurred because the Sherman Act made looser forms of organization such as joint ventures illegal. Firms were forced to do by merger what they could not longer accomplish by contract.[30]

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 precedent defines 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.[31] The framers of the Sherman Act believed that they were simply "federalizing" the common law of trade restraints, making the common law more effective by creating a forum with jurisdiction over monopolies or cartels that operated in more than a single state.[32] The earliest Sherman Act decisions construed the statute in that way: they generally decided cases by reference to common law precedents.[33]

The federal antitrust laws differed from the common law in at least one important respect, however. At common law most of the agreements 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 not permitted either to enjoin the contract or to obtain damages for injuries.[34] By contrast, § 7 of the original Sherman Act (and later §§ 4 and 16 of the Clayton Act) gave *non*participants in Sherman Act contracts, combinations or conspiracies a right to challenge such practices and obtain either 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 1890, but rather to regard the common 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 always have and probably always will shift as ideology, technology and the American economy changes.[35]

Federal courts have always interpreted the antitrust statutes in a common law fashion,[36] and the result is a substantial divergence between statutory language and judicial decision. For example, the language of the antitrust statutes does not contain anything resembling the distinction between the *per se* rule and the rule of reason, the market power requirement for monopolization cases, the "potential entrant" 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.[37] These words include "antitrust laws," "commerce," and "person." Amazingly, the list does not also include "competition," "monopoly," or "restraint of trade." Congress expressly told the courts what kind of "person" could sue or be sued under the statute[38] but it did not define "competition" or "restraint of trade" or even "monopoly"—effectively yielding the meaning of the most essential terms to the courts.[39]

But the fact that the Sherman Act authorized 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

28. See H. Hovenkamp, *Enterprise*, note 27 at 246–247; J. Blicksilver, Defenders and Defense of Big Business in the United States, 1880–1900 at 122–128 (1985).

29. See H. Hovenkamp, Antitrust's Protected Classes, 88 Mich. L. Rev. 1, 25–27 (1989).

30. See Hovenkamp, *Enterprise*, note 27 at Ch. 20; G. Bittlingmayer, Did Antitrust Policy Cause the Great Merger Wave?, 28 J.L. & Econ. 77 (1985). For a contemporary view, see G. Canfield, Is a Large Corporation an Illegal Combination or Monopoly under the Sherman Anti-Trust Act?, 9 Col. L. Rev. 95, 113 & n. 27 (1909), arguing that the Sherman Act "fosters the very thing it was designed to check.". England was much more tolerant of cartels, with the result that British firms lacked the same incentive to merge and remained inefficiently small. See T. Freyer, Regulating Big Business: Antitrust in Great Britain and America, 1880–1990 (1992).

31. For a survey of the nineteenth century common law decisions, see 1 Antitrust Law ¶ 104 (2d ed. 2000); H. Hovenkamp, The Sherman Act and the Classical Theory of Competition, 74 Iowa L. Rev. 1019 (1989). On the common law nature of antitrust rules, see A. Director and E. Levi, Law and the Future: Trade Regulation, 51 Nw. U. L. Rev. 281 (1956), the symposium in 17 Miss. Col. L. Rev. 1 (1996); and W. Page, Legal Realism and the Shaping of Modern Antitrust, 44 Emory L.J. 1 (1995).

32. Senator Sherman described his bill as setting "out in the most specific language the rule of the common law which prevails in England and this country * * *." 20 Cong.Rec. 1167 (1889); see D. Dewey, The Common-Law Background of Antitrust Policy, 41 Va.L.Rev. 759 (1955); Hovenkamp, *Sherman Act*, note 31, 74 Iowa L. Rev. 1029 et seq.

33. For example, United States v. Addyston Pipe & Steel Co., 85 Fed. 271, 278–291 (6th Cir.1898), affirmed, 175 U.S. 211, 20 S.Ct. 96 (1899); see W. Baxter, Separation of Powers, Prosecutorial Discretion, and the "Common Law" Nature of Antitrust Law, 60 Tex.L.Rev. 661 (1982).

34. See Central Shade-Roller Co. v. Cushman, 143 Mass. 353, 363–364, 9 N.E. 629, 631 (1887); Perkin v. Lyman, 9 Mass. 522, 530 (1813); and see A. Stickney, State Control of Trade and Commerce by National or State Authority 157 (1897); Hovenkamp, *Sherman Act*, note 31, 74 Iowa L. Rev. at 1026–1027.

35. See W. Page, Ideological Conflict and the Origins of Antitrust Policy, 66 Tul.L.Rev. 1, 36 (1991).

36. For example, see the discussion in Apex Hosiery Co. v. Leader, 310 U.S. 469, 497–99, 60 S.Ct. 982, 994–996 (1940).

37. 15 U.S.C.A. § 12.

38. See, e.g., United States Postal Service v. Flamingo Indus.(USA) Ltd., 540 U.S. 736, 124 S.Ct. 1321 (2004), on 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, 33 Hastings L.J. 755, 762 (1982). Judge Bork has identified five distinct meanings of "competition." See R. Bork, The Antitrust Paradox: A Policy at War With Itself 58–61 (1978; rev. ed. 1993). On changing meanings in antitrust litigation, see D. Gifford, The Jurisprudence of Antitrust, 48 SMU L. Rev. 1677 (1995).

when the Sherman Act was passed.[40] 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.[41] 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.[42] 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.[43]

In fact, Judge Taft's vision was much narrower and was based on a deeply flawed view of the common law.[44] 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 consideration 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 restraints that 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; (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 retained 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.[45]

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.[46]

At the same time, Taft painted an impressionistic, noninterpretivist picture of the law of cartels and contracts in 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.[47] He

40. See generally Hovenkamp, *Sherman Act*, note 31; 1 Antitrust Law ¶ 104 (2d ed. 2000).

41. 85 Fed. 271 (6th Cir.1898), affirmed, 175 U.S. 211, 20 S.Ct. 96 (1899).

42. See, for example, R. Bork, The Antitrust Paradox: a Policy at War With Itself 26–30 (1978; rev. ed. 1993).

43. On cartels, joint ventures, and the rule of reason, see Chs. 4 & 5.

44. See 1 Antitrust Law, id. at ¶ 104d; Hovenkamp, *Sherman Act* note 31 at 1041–1044; M. Grady, Toward A Positive Economic Theory of Antitrust, 30 Econ. Inquiry 224, 229–232 (1992).

45. *Addyston Pipe*, 85 Fed. at 281.

46. On the narrow conception of ancillary restraints doctrine contained in the *Addyston Pipe* decision, see H. Hovenkamp, 11 Antitrust Law ¶ 1905 (2d ed. 2005).

47. For example, United States v. Nelson, 52 Fed. 646, 647 (D.Minn.1892) (upholding collusion under Sherman Act); Dolph v. Troy Laundry Mach. Co., 28 Fed. 553, 555–556 (C.C.N.Y.1886), reversed, 138 U.S. 617, 11 S.Ct. 412 (1891) (upholding price fixing under common law); Pierce v. Fuller, 8 Mass. 223 (1811) (upholding naked noncompetition agreement—basically, a horizontal service division agreement); Clark v. Frank, 17 Mo.App. 602 (1885) (same); Skrainka v. Scharringhausen, 8 Mo.App. 522, 527 (1880) (upholding price fixing limited to time and place).

cited half the opinions in order to explain why they were wrong.[48] Some of the cases he cited for the common law position on trade restraints actually relied on statutes that deviated from the common law.[49] 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[50] involved a joint venture that established a uniform grading system for coal and a common sales agency, but also facilitated the fixing of prices. The *Morris Run Coal* case[51] 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 unregulated railroads.[52]

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 in restraint of trade. In the process Judge Taft created the illusion that the law of combinations in restraint of trade had always been concerned with competition as defined in neoclassical economics. The result was a Sherman Act whose ideology was much more economic than that reflected in either the common law or the Congressional history. Congress' own notion that the Sherman Act simply federalized the common law cut the courts free from the Act's legislative history, but Taft's *Addyston Pipe* decision effectively freed the courts from the substance of the historical common law. From that point on, federal courts forged their own set of antitrust rules through an essentially common law process in which only Sherman (and later Clayton) Act precedents counted. Common law precedents were mainly, although not entirely, ignored.

Does the nonspecific language of the Sherman Act entitle the judiciary to engage in such usurpation? When the courts interpret the antitrust laws, they are interpreting federal statutes, and Congress can always respond to an unpopular or ill-conceived decision by amending the statute. Congress has frequently done so, in both liability expanding and liability contracting directions. For example, in 1912 the Supreme Court concluded that the Sherman Act did not condemn tying arrangements.[53] Congress responded in 1914 with § 3 of the Clayton Act,[54] which condemns them if they are anticompetitive (without defining that word). In 1911 the Supreme Court suggested that resale price maintenance was illegal under the Sherman Act,[55] and in 1937 Congress responded by giving the states the

48. For example, Gloucester Isinglass & Glue Co. v. Russia Cement Co., 154 Mass. 92, 27 N.E. 1005 (1891) (upholding combination in restraint of trade because it did not involve a necessity of life); Leslie v. Lorillard, 110 N.Y. 519, 18 N.E. 363 (1888) (upholding naked noncompetition agreement). Other cases are discussed in Hovenkamp, *Sherman Act*, note 31, 74 Iowa L. Rev. at 1043.

49. Gibbs v. Consolidated Gas Co. of Baltimore, 130 U.S. 396, 9 S.Ct. 553 (1889) (relying on statute that prohibited a gas company from combining with another gas company); Ford v. Chicago Milk Shippers' Ass'n, 155 Ill. 166, 39 N.E. 651 (1895) (relying on statute forbidding combinations by trust); People v. Sheldon, 139 N.Y. 251, 34 N.E. 785 (1893) (same); Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. 173 (1871) (same).

50. Note 49.

51. Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. 173, 184 (1871) (decided by a Pennsylvania court applying New York law).

52. United States v. Trans-Missouri Freight Assn., 166 U.S. 290, 17 S.Ct. 540 (1897). See the lower court's opinion, 58 Fed. 58, 67–80 (8th Cir.1893); H. Hovenkamp, *Enterprise*, note 27 at 144–148. The efficiency of the *Trans-Missouri* joint venture is discussed in § 5.2a.

53. Henry v. A.B. Dick Co., 224 U.S. 1, 32 S.Ct. 364 (1912).

54. 15 U.S.C.A. § 14.

55. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 31 S.Ct. 376 (1911).

right to authorize resale price maintenance for sales within their borders. Forty years later, Congress changed its mind.[56] 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 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 isolationistic and regressive of views is that in 1890 or today we have all the right answers. We did not and we do not. The common law nature of antitrust policy permits us to make the best of what we have.

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 foundered, 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.[58] 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 mainly affected manufacturing, and manufacturing itself was not interstate commerce. As a result, the indictment was outside the federal government's jurisdictional reach under the commerce clause.[59]

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.[60] The one place the Sherman Act did find aggressive use, much 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 1890 and 1897, were against labor unions.[61] Congress eventually responded to labor's concerns by exempting most labor organizing from the antitrust laws, first in § 6 of the Clayton Act,[62] and later in the Norris–LaGuardia Act.[63]

56. The Miller–Tydings Act of 1937, 50 Stat. 693, permitted states to authorize resale price maintenance. The authorization was withdrawn and the *per se* rule restored for all states by the Consumer Goods Pricing Act of 1975, 89 Stat. 801. See § 11.5a.

57. The classic, highly factual account is Hans B. Thorelli, The Federal Antitrust Policy: Origination of an American Tradition (1955). A few of the others are R. Peritz, Competition Policy in America, 1888–1992: History, Rhetoric, Law (1996); W. Letwin, Law and Economic Policy in America: the Evolution of the Sherman Antitrust Act (1981); M. M. Sklar, The Corporate Reconstruction of American Capitalism, 1890–1916: the Market, the Law, and Politics (1988); H. Hovenkamp, Enterprise and American Law: 1836–1937 (1991); T. Freyer, Regulating Big Business: Antitrust in Great Britain and America, 1880–1990 (1992). The legislative history of the antitrust laws is collected in E. Kintner, The Legislative History of the Antitrust Laws (1978).

58. See for example In re Greene, 52 Fed. 104, 114 (C.C.Ohio 1892) (merger of distillers intending to control entire market not illegal where the acquisition agreements did not prevent sellers from re-entering); United States v. Nelson, 52 Fed. 646, 647 (D.Minn.1892) (lumber producer cartel not illegal unless the companies controlled or intended to control entire market); United States v. Greenhut, 50 Fed. 469, 470 (D.Mass.1892) (liquor producers; same).

59. United States v. E.C. Knight Co., 156 U.S. 1, 15 S.Ct. 249 (1895). See H. Hovenkamp, *Enterprise*, note 57 at 241–245.

60. Letwin, note 57 at 117–118.

61. H. Hovenkamp, *Enterprise*, note 57 at 229.

62. 15 U.S.C.A. § 16, passed in 1914.

63. 29 U.S.C.A. §§ 101–110, 113–115, passed in 1932. On antitrust's labor exemption today, see § 19.7b, infra; and 1A Antitrust Law ¶¶ 255–257 (2d ed. 2000).

The federal government's first major Sherman Act successes were against railroad cartels operating mainly in the midwest,[64] and in 1904 against a railroad merger.[65] By the turn of the century the government's win record in cases against capitalists rather than labor began to improve, with victories against cartels,[66] and major convictions against the Standard Oil Company and the tobacco trust in 1911 for monopolization by predatory practices and merger to monopoly.[67]

The period 1895–1905 witnessed an enormous wave of mergers, caused in part by the Sherman Act itself. Many entrepreneurs believed that the Act would prohibit cartels but be quite tolerant of tighter combinations involving asset acquisitions or holding companies.[68] At any rate, following the great merger wave, the United States became deeply involved in merger policy—a concern that has not subsided to the present day.

Two things account for the great interest in antitrust during the 1912 Presidential election. One was the great merger wave noted above. The other was the development of the "rule of reason" in the *Standard Oil* and *American Tobacco* decisions of 1911.[69] Notwithstanding the convictions in those cases, many Progressive Era liberals believed that the rule of reason would greatly weaken the Sherman Act, a position reinforced by rulings such as Henry v. A.B. Dick & Co.[70] that tying arrangements should be considered reasonable under the Sherman Act. The new Wilson administration responded with the Clayton Act[71] and the Federal Trade Commission Act.[72] The Clayton Act explicitly condemned anticompetitive price discrimination, tying and exclusive dealing, expanded private enforcement, created an early but rather ineffectual exemption for labor organizing,[73] and condemned mergers on a far more aggressive standard than the Sherman Act had done. The FTC Act created the Federal Trade Commission, an administrative body that could summon expertise unavailable to the courts,[74] and also created a more expansive basis for liability, namely § 5 of the FTC Act, which condemned unfair methods of competition. Under that statute, as eventually interpreted, the FTC could go after practices it deemed anticompetitive, but which did not violate one of the other antitrust laws.[75]

The period from the end of the Progressive Era, through World War One and up to the New Deal is generally characterized by a very moderate merger policy[76] and greatly increased attention to joint ventures and trade associations.[77] The government also became heavily involved in enforcing the law against resale price maintenance, which had been condemned by the Supreme Court in 1911,[78] and

64. United States v. Trans–Missouri Freight Assn., 166 U.S. 290, 17 S.Ct. 540 (1897); United States v. Joint–Traffic Assn., 171 U.S. 505, 19 S.Ct. 25 (1898).

65. Northern Securities Co. v. U.S., 193 U.S. 197, 24 S.Ct. 436 (1904).

66. For example, United States v. Addyston Pipe & Steel Co., 85 Fed. 271, 278–291 (6th Cir.1898), affirmed, 175 U.S. 211, 20 S.Ct. 96 (1899).

67. Standard Oil Co. (N.J.) v. United States, 221 U.S. 1, 31 S.Ct. 502 (1911); United States v. American Tobacco Co., 221 U.S. 106, 31 S.Ct. 632 (1911).

68. See H. Hovenkamp, *Enterprise*, note 57, ch. 20; R. Nelson, Merger Movements in American Industry, 1895–1956 (1959); S. Bruchey, Enterprise: the Dynamic Economy of a Free People (1990); N. Lamoreaux, The Great Merger Movement in American Business, 1895–1904 (1985).

69. See note 67.

70. 224 U.S. 1, 32 S.Ct. 364 (1912).

71. 15 U.S.C.A. § 12 et seq.

72. 15 U.S.C.A. § 41 et seq.

73. See Hovenkamp, *Enterprise*, note 57 at Ch. 19.

74. The best detailed history remains Gerard C. Henderson, The Federal Trade Commission: A Study in Administrative Law and Procedure (1924).

75. See FTC v. Brown Shoe Co., 384 U.S. 316, 86 S.Ct. 1501 (1966); FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 92 S.Ct. 898 (1972).

76. For example, United States v. United Shoe Machinery Co., 247 U.S. 32, 38 S.Ct. 473 (1918); United States v. United States Steel Corp., 251 U.S. 417, 40 S.Ct. 293 (1920); United States v. Southern Pacific Co., 259 U.S. 214, 42 S.Ct. 496 (1922).

77. For example, Board of Trade of City of Chicago v. United States, 246 U.S. 231, 38 S.Ct. 242 (1918); American Column & Lumber Co. v. United States, 257 U.S. 377, 42 S.Ct. 114 (1921); Maple Flooring Mfrs'. Ass'n v. United States, 268 U.S. 563, 45 S.Ct. 578 (1925).

78. Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 31 S.Ct. 376 (1911). United States v. Colgate & Co., 250 U.S. 300, 39 S.Ct. 465 (1919); United States v. A. Schrader's Son, Inc., 252 U.S. 85, 40 S.Ct. 251 (1920); FTC v. Beech–Nut Packing Co., 257 U.S. 441, 42 S.Ct. 150 (1922); and numerous others.

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 National Recovery Administration was struck down by the Supreme Court, Roosevelt changed course. He made Thurman Arnold head of the antitrust division. Until World War II intervened, Arnold pursued vertical integration,[81] collusion and, for the first time, oligopoly aggressively, going after obvious collusion facilitators such as price-posting as well as tacit agreements.[82] He also greatly expanded the use of antitrust consent decrees as a mechanism for obtaining government relief faster and more predictably than more protracted litigation would produce. At the same time, Congress expanded § 2 of the Clayton Act by passing the Robinson-Patman Act,[83] which greatly limited the ability of firms to charge lower prices to large customers than they did to smaller ones. With that statute, the government enforcement agencies embarked on the highly anticompetitive policy of trying to protect small business from more efficient, larger firms.[84]

Undoubtedly the most lasting 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.[85] This required a more sophisticated dialogue between antitrust and economic theory.[86] The economic theory of the day placed a heavy emphasis on structural issues. Concern for concentration, entry barriers, and the linkage between structure and oligopoly dominated the post-war period.[87] At the same time American enforcement agencies became highly concerned—in fact, almost paranoid—about vertical practices that were thought to increase entry barriers, facilitate collusion, or enable firms to leverage additional monopoly profits out of secondary markets. The result was continued aggressive enforcement of the laws against resale price maintenance, new attention to vertical nonprice restraints, and numerous challenges to tying arrangements, exclusive dealing and vertical mergers.[88]

The most prominent antitrust policy document of the period was the Report of the Attorney General's National Committee to

79. For example, FTC v. Sinclair Refining Co., 261 U.S. 463, 43 S.Ct. 450 (1923). On other early decisions, see 11 H. Hovenkamp, Antitrust Law ¶ 1801 (2d ed. 2005).

80. See generally E. Hawley, The New Deal and the Problem of Monopoly (1974); E. Hawley, Herbert Hoover and the Sherman Act, 1921–1933: an Early Phase of a Continuing Issue, 74 Iowa L. Rev. 1067 (1989); R. Himmelberg, The Origins of the National Recovery Administration, Business, Government, and the Trade Association Issue, 1921–1933 (1976).

81. For example, United States v. Paramount Pictures, Inc., 334 U.S. 131, 68 S.Ct. 915 (1948); United States v. Pullman Co., 330 U.S. 806, 67 S.Ct. 1078 (1947).

82. For example, American Tobacco Co. v. United States, 328 U.S. 781, 66 S.Ct. 1125 (1946); United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 60 S.Ct. 811 (1940). See also Sugar Institute v. United States, 297 U.S. 553, 56 S.Ct. 629 (1936); Interstate Circuit, Inc. v. United States, 306 U.S. 208, 59 S.Ct. 467 (1939).

83. See ch. 14.

84. See § 14.6; and 14 Antitrust Law, ch. 23 (2d ed. 2006).

85. For example, J. Clark, Toward a Concept of Workable Competition, 30 Am. Econ. Rev. 243 (1940).

86. See Thurman Arnold's call for more economics in antitrust. Arnold, Antitrust Law Enforcement, Past and Future, 7 L. & Contemp. Prob. 10 (1940); and see generally W. Kovacic, Failed Expectations: the Troubled Past and Uncertain Future of the Sherman Act as a Tool for Deconcentration, 74 Iowa L. Rev. 1105 (1989).

87. For example United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir.1945); United States v. Columbia Steel Co., 334 U.S. 495, 68 S.Ct. 1107 (1948).

88. Among the long list of examples are United States v. Yellow Cab Co., 332 U.S. 218, 67 S.Ct. 1560 (1947); International Salt Co. v. United States, 332 U.S. 392, 68 S.Ct. 12 (1947); United States v. Griffith, 334 U.S. 100, 68 S.Ct. 941 (1948); Standard Oil Co. of California v. United States, 337 U.S. 293, 69 S.Ct. 1051 (1949).

Study the Antitrust Laws (1955), 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's and Donald F. Turner's *Antitrust Policy*,[89] which was more rigorous economically, identified the promotion of "fair" conduct and the limiting of growth of big business as desirable antitrust goals.[90] Indeed, they even suggested that a legitimate goal of antitrust policy is the equitable distribution of income.[91] Much of the foundational analysis for this thinking, but without the explicit normative concerns, was contained in Harvard economist Joe S. Bain's 1950's work on barriers to entry, industry structure, and oligopoly.[92]

By 1950, when the Celler–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 in Congressional 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 innovation[93] and large scale development, and a zealous protector of the right of small business to operate independently.[94]

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.[95] 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 On the 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

89. C. Kaysen & D. Turner, Antitrust Policy: An Economic and Legal Analysis (1959).

90. Id. at 11–17.

91. Id. at 11: ("[E]quitable distribution of income" is a "desirable economic result," against which antitrust policy should be tested.).

92. See J. Bain, Barriers to New Competition: the Character and Consequences in Manufacturing Industries (1956).

93. It was particularly hostile toward innovations in distribution systems that tended to replace small, independent entrepreneurs.

94. For example, Brown Shoe Co. v. United States, 370 U.S. 294, 82 S.Ct. 1502 (1962). For an evaluation of the period that is more optimistic than the one given here, see T. Kovaleff, Business and Government During the Eisenhower Administration: A Study of the Antitrust Policy of the Antitrust Division of the Justice Department (1980); and see Peritz, note 57.

95. For example, *Brown Shoe*, note 94; United States v. Von's Grocery Co., 384 U.S. 270, 86 S.Ct. 1478 (1966); FTC v. Procter & Gamble Co., 386 U.S. 568, 87 S.Ct. 1224 (1967); United States v. Arnold, Schwinn & Co., 388 U.S. 365, 87 S.Ct. 1856 (1967); FTC v. Consolidated Foods Corp., 380 U.S. 592, 85 S.Ct. 1220 (1965). See H. Hovenkamp, The Antitrust Enterprise: Principle and Execution, Ch. 9 (2005).

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 in the relatively recent past.[1] This belief has led some to argue that antitrust could escape from ever-changing, indeterminate economic theories by looking to its common law heritage.[2]

Antitrust has always been closely tied to prevailing economic doctrine. To be sure, antitrust policy makers sometimes applied economics ineptly, 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.[3] 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.[4] 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), the analysis became more subtle and economists became increasingly aware of market imperfections that might allow various anticompetitive practices.[5] 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 emergent neoclassicism, 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.[6] 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 laws as a good thing.[7] 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.[8] 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.[9] That theory was incorporated in the 1955 Report of the Attorney General on antitrust policy, which attempted to develop an antitrust policy based on then prevailing industrial organization theory.[10] 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 antitrusters 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 S. 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.[11] As a result, many industries contained larger firms and were more concentrated than necessary to achieve optimal productive efficiency.[12] The second theory was that barriers to entry by new firms were very high and could easily be manipulated by dominant firms.[13] The third was that the noncompetitive performance (monopoly pricing) associated with oligopoly began to occur at relatively low concentration levels.[14] 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.[15] The underlying theory was generally that a large number of small firms would yield lower prices than a relatively small number of larger firms.[16] Although Warren Era antitrust enforcement policy may seem excessive even in light of these economic views, government 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.[17]

2.2b. The Chicago School and its Aftermath

The revolution in market economics that took place at the University of Chicago in the

§ 2.2

1. See, for example, P. Gerhart, The Supreme Court and Antitrust Analysis: The (Near) Triumph of the Chicago School, 1982 Sup. Ct. Rev. 319; R. Posner, The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision, 45 U. Chi. L. Rev. 1, 5, 12–13 (1977). But the view is not limited to members of the Chicago School. See, e.g., R. Peritz, Competition Policy in America, 1888–1992: History, Rhetoric, Law (1996), which proceeds as if pre-New Deal antitrust policy was largely ignorant of economics. See Hovenkamp, Book Review, 28 J. Interdisciplinary History 156 (1997).

2. For example, T. Arthur, Farewell to the Sea of Doubt: Jettisoning the Constitutional Sherman Act, 74 Calif. L. Rev. 263 (1986).

3. See H. Hovenkamp, The Sherman Act and the Classical Theory of Competition, 74 Iowa L. Rev. 1019 (1989).

4. See H. Hovenkamp, The Antitrust Movement and the Rise of Industrial Organization, 68 Texas L. Rev. 105 (1989).

5. In addition to the articles cited at notes 3 & 4, see H. Hovenkamp, The Marginalist Revolution in Legal Thought, 46 Vand. L. Rev. 305 (1993).

6. See Hatfield, The Chicago Trust Conference, 8 J. Pol. Econ. 1, 6 (1899) (noting that most economists of the day believed that large firms were efficient, and the "outgrowth of natural industrial evolution," and that the Sherman Act would be positively harmful).

7. For example, H. C. Adams, Relation of the State to Industrial Action, 1 Pub., Am. Econ. Assn. 465 (1887) (arguing for more aggressive intervention against monopolies); R. Ely, Monopolies and Trusts (1900); C. Van Hise, Concentration and Control: A Solution to the Trust Problem in the United States 76–87, 255–256 (1912).

8. E. Chamberlin, The Theory of Monopolistic Competition (1933).

9. See J. Clark, Toward a Concept of Workable Competition, 30 Am. Econ. Rev. 241 (1940).

10. Report of the Attorney General's National Committee to Study the Antitrust Laws (1955).

11. See J. Bain, Economies of Scale, Concentration, and the Condition of Entry in Twenty Manufacturing Industries, 44 Am. Econ. Rev. 15, 38 (1954).

12. J. Bain, Barriers to New Competition: their Character and Consequences in Manufacturing Industries 53–113 (1956); J. Bain, Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936–1940, 65 Q.J.Econ. 293 (1951).

13. J. Bain, *Barriers*, note 12 at 1–42, 114–43.

14. Ibid. On oligopoly, see ch. 4.

15. The concerns were exacerbated by the fact that the first post-war census appeared to show rapidly increasing industrial concentration. The data are discussed in the second edition of F.M. Scherer, Industrial Market Structure and Economic Performance, ch. 3 (2d ed. 1980).

16. See C. Kaysen & D. Turner, Antitrust Policy: An Economic and Legal Analysis (1959), discussed in § 2.1c.

17. On the Merger Guidelines, see § 12.1.

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]

(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]

18. On the development of the Chicago School generally and in antitrust see E. Kitch, The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932–70, 26 J.L. & Econ. 163 (1983); R. Posner, The Chicago School of Antitrust Analysis, 127 U.Pa.L.Rev. 925 (1979). See also H. Hovenkamp, The Antitrust Enterprise: Principle and Execution, ch. 2 (2005).

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

20. For example, R. Bork, The Antitrust Paradox: A Policy at War with Itself 91 (1978; rev. ed. 1993): "[t]he 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. Brozen, Concentration, Mergers and Public Policy (1982); J. McGee, In Defense of Industrial Concentration (1971).

22. For example, F. Easterbrook, The Limits of Antitrust, 63 Texas L. Rev. 1, 2 (1984) (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 Concentration: the New Learning 15–113 (H. Goldschmid, H. Mann & J. Weston, eds. 1974).

(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.[25] As a result, virtually all instances of vertical integration, including resale price maintenance and vertical nonprice restraints, are efficient.[26]

(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."[27] 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.[28]

(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 benefitted by collusive practices and injured by efficient practices; as a result, they have precisely the wrong set of incentives to sue. Most competitor lawsuits for alleged antitrust violations should be thrown out, and private enforcement limited to consumers.

(9) Even if markets are imperfect and prone to anticompetitive outcomes, government intervention is justified only if the result is an improvement, taking the costs of intervention into account. As a general matter, claims that government intervention is better should be treated skeptically. We probably know very little about the optimal structure of markets or firms, and the complexity of some models of industry behavior tend to strengthen this view. In that case it is highly presumptuous to think that State-administered relief will yield more efficient outcomes than natural market processes.[30]

(10) The decision to make this market efficiency model the exclusive guide for antitrust policy is nonpolitical. That is, it is adopted without regard for the way that wealth or entitlements are distributed in society, but only so as to maximize society's overall wealth.[31] Thus if a practice produces greater gains to business than losses to consumers, it is efficient and should not be illegal under the antitrust laws. But the same should be said about practices that produce larger gains to consumers than

25. E.g., W. Bowman, Tying Arrangements and the Leverage Problem, 67 Yale L.J. 19 (1957).

26. L. Telser, Why Should Manufacturers Want Fair Trade? 3 J.L. & Econ. 86 (1960); R. Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division (part 2), 75 Yale L.J. 373 (1966); R. Posner, The Rule of Reason and the Economic Approach: Reflections on The *Sylvania* Decision, 45 U.Chi.L.Rev. 1 (1977).

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, because they do 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 ownership and control, suggesting that managers and stock holders often have different motives, and that these interfere with profit maximization. See, for example, A. Berle, Jr., and G. Means, The Modern Corporation and Private Property (1932). For a firm rejection, see F. Easterbrook & D. Fischel, The Economic Structure of Corporate Law (1991).

28. See R. Posner & F. Easterbrook, Antitrust: Cases, Economic Notes and Other Materials 855–857 (2d ed. 1981).

29. W. Landes, Optimal Sanctions for Antitrust Violations, 50 U.Chi.L.Rev. 652 (1983). On the "optimal deterrence model," see §§ 17.1–17.2.

30. See, for example, F. Easterbrook, Ignorance and Antitrust 119, in Antitrust, Innovation, and Competitiveness (T. Jorde & D. Teece, eds., 1992); F. Easterbrook, Workable Antitrust Policy, 84 Mich. L. Rev. 1696 (1986).

31. For example, R. Bork, note 20 at 90: "Antitrust * * * has nothing to say about the ways prosperity is distributed or used." For a critique, see H. Hovenkamp, Distributive Justice and the Antitrust Laws, 51 Geo. Wash. L. Rev. 1, 16–26 (1982).

losses to business. The member of the Chicago School can thus argue that he is not taking sides in any political dispute about how wealth or entitlements ought to 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 uncontroversial 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, but two deserve particular mention here.

2.2c. *Skepticism; Competitor v. Consumer Suits; Private v. Public Suits*

On point (9), to be skeptical about the appropriateness of government intervention in the market means that we do not trust our judgment about which theory explains the particular situation in front of us or about government's ability to make things better. For example, we have theories showing resale price maintenance to be competitive under certain circumstances, and other theories showing it to be anticompetitive. But which theory explains the defendant's actions in the case before us?[32] A commonly given Chicago School answer is that unless we are extremely sure about a monopoly explanation, we are obliged to assume a competitive explanation and should refrain from intervening.

Skepticism goes only so far. For example, within the classical competition model, entry by new firms in response to monopoly prices was presumed to be easy and instantaneous. Several conclusions might flow from this assumption:[33] (a) predatory pricing is irrational because as soon as the predator drives out a rival and increases price, competitors will flood the market and prices will return to competitive levels;[34] (b) the law against horizontal mergers is unnecessary, for new entrants will always discipline any attempt by the postmerger firm to charge monopoly prices;[35] and (c) even the law against price-fixing is unnecessary, for any attempt to fix prices will be met with new entrants who will undermine the cartel.[36]

Few scholars, Chicago School or otherwise, accept all three of these propositions. At the risk of some overgeneralization, the Chicago School position is that (a) is correct, (b) must be modified at least to permit condemnation of horizontal mergers that create dominant firms or that obviously facilitate collusion, and (c) is false. The question is not whether intervention is *ever* appropriate, for nearly everybody believes it is appropriate sometimes. The question is when. Within the Chicago School model, the economic case for condemning naked price fixing is generally regarded as very strong; the economic case for condemning alleged predatory pricing is regarded as weak to nonexistent.

The rhetoric of skepticism in Chicago School analysis is based on numerous economic studies during the 1960's which found that practices once thought to be anticompetitive were really not so.[37] But many of those studies are now dated, and some of their assumptions have been called into question. One detects a certain resistance among Chicago School antitrust scholars to new developments in economic theory that undermine favorite Chicago School ideas. Chicagoans themselves have attacked the idea that there should be a "ratchet" in antitrust law—that is, that antitrust can appropriately proceed in the direction of increasing liability, but it may not go "backward" and approve some practices that were previously condemned.[38] But the same argument applies to economics. Chicagoans are quick to cite voluminous Chicago school scholarship that laid older anticompetitive theories

32. On the manifold theories of resale price maintenance, see §§ 11.2, 11.4.

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 21–26 above.

38. F. Easterbrook, Is There a Ratchet in Antitrust Law?, 60 Texas L. Rev. 705 (1982).

to rest by substituting entirely competitive explanations. This writing revolutionized antitrust theory in such areas as resale price maintenance, tying arrangements, and predatory pricing. But the last two decades have produced a mountain of post-Chicago scholarship that has substantially changed the landscape once again.[39] The "free rider" explanation of resale price maintenance was a good one, but it probably applies to only a small percentage of RPM situations.[40] The Chicago 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.[41] Strategic behavior, which appears in a variety of disguises, is both plausible and anticompetitive under a host of situations that standard Chicago scholarship failed to acknowledge.[42] 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.[43] Just as there is no ratchet in antitrust law, so too there is no ratchet in antitrust economics.

Like the Chicago School scholar, the antitrust moderate also believes in markets, and even believes that the self-interest of business firms most often works to the benefit of consumers and the economy. But the antitrust moderate is more likely to believe that (a) business firms act only in their self-interest; and (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 simply a "way of competing" should be very 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 intervene unless the economic case against a practice 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 admittedly 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 antitrust cases is much like the common law process 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 more to gain. As a result, the common law process gradually gravitates toward efficient 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 markets 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

39. See H. Hovenkamp, Post-Chicago Antitrust: A Review and Critique, 2001 Col. Bus. L. Rev. 257 (2001).

40. See §§ 11.2–11.3.

41. See §§ 9.2–9.3.

42. See generally J. Tirole, The Theory of Industrial Organization (1988).

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 Power in the Presence of an Installed Base, 62 Antitrust L.J. 1 (1993).

44. G. Priest, The Common Law Process and the Selection of Efficient Rules, 6 J. Legal Stud. 65 (1977); G. Priest & B. Klein, The Selection of Disputes for Litigation, 13 J.Legal Stud. 1 (1984).

45. On this point, see R. Cooter & L. Kornhauser, Can Litigation 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.[46] 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.[47] Producer groups are small and their interests are unified. Consumer groups are large, and the individuals differ greatly from one another. 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 competitor standing to bring antitrust actions should be greatly restricted or perhaps eliminated.[48] 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 monopoly, or at a much earlier stage. Remember, the social cost of monopoly is a function not only of its size but also of its duration.[49] Likewise, competitors generally feel the injury in much more perceptible ways. An exclusionary practice may create a monopoly that raises the price of photocopying by one cent per page. 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 critiques of competitor lawsuits. When a competitor complains of predatory pricing, the basis could be either that the defendant is pricing predatorily, 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 situations, competitor suits challenging predation themselves become a powerful anticompetitive weapon.

46. On these aspects of resale price maintenance, see §§ 11.2–11.3.

47. See D. Farber & P. Frickey, Law and Public Choice: A Critical Introduction (1991); H. Hovenkamp, Legislation, Well–Being and Public Choice, 57 Univ.Chi. L.Rev. 63 (1990).

48. For example, E. Snyder & T. Kauper, Misuse of the Antitrust Laws: the competitor Plaintiff, 90 Mich. L. Rev. 551 (1991); for a response, see W. Page & R. Blair, Controlling the Competitor Plaintiff in Antitrust Litigation, 91 Mich. L.Rev. 111 (1992).

49. See § 1.3.

The solution proposed by some members of the Chicago School is to give the predatory pricing lawsuit only to consumers.[50] 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.[51] 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. Second, one must identify 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 on evidence that the prices charged by the dominant firm were below some measure of cost.[52] 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.[53] 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 that (1) alleged 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.[54]

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 nonmeritorious.

50. F. Easterbrook, Predatory Strategies and Counterstrategies, 48 Univ.Chi.L.Rev. 263 (1981); R. Bork, The Antitrust Paradox: A Policy at War With Itself 144–55 (1978; rev. ed. 1993).

51. See ch. 8.

52. See § 8.4.

53. On antitrust class actions, see 2 Antitrust Law ¶ 331 (2d ed. 2000).

54. See H. Hovenkamp, The Antitrust Enterprise: Principle and Execution, ch. 3 (2005).

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 monopolistic strategy;[55] and close attention to price-cost relationships to help us determine whether prices were indeed predatory. The law has been moving in that direction, although it still has some distance to go.[56] More generally, the law must continue to develop a rigorous conception of "antitrust injury" to enable it to distinguish competitive from anticompetitive uses of the antitrust laws.[57]

Finally, any argument that private antitrust enforcement should generally yield to public enforcement aborts in the face of one powerful historical fact: over time, the government has not done much better. The truly scandalous decisions in the Chicago School lexicon are cases such as *Brown Shoe*, *Von's Grocery*, *Procter & Gamble*, and *Schwinn*.[58] But only antitrust scholars with the shortest of memories believe that the plaintiff in *Von's Grocery* was Sally's Family Foods, or in *Schwinn* was Pop's Bike & Trike. Most of the overdeterrent antitrust law based on innovative or even crackpot economic theories was made in cases brought by the United States Department of Justice and the Federal Trade Commission. At least private plaintiffs are consistent about one thing: they sue in order to further their own interests. Courts can began with that premise and limit standing or remedies accordingly. When the government sues, it may be difficult to tell what interest is being vindicated. To be sure, the record of government enforcement in the 1980's and 1990's is considerably different than the record in the 1960's, but the historical record is there just the same, and the fault cannot be lain entirely at the feet of a liberal judiciary unable to understand economics. To be sure, the Warren Court decided the four antitrust decisions listed above. But they did no more than give the executive branch what it asked for. If history has taught us anything, it is that government plaintiffs are not invariably better than private parties in identifying meritorious suits.

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 vulnerable to such 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 some antitrust statutes reveals that Congress was hostile to efficiency concerns.[59] Both Chicago School scholarship and the courts themselves have deviated substantially from Congress' original concern.

55. As, for example, in Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 113 S.Ct. 2578 (1993). See § 8.8.

56. See § 8.4.

57. On antitrust injury, see § 16.3. For a critique of this view, see E. Snyder & T. Kauper, Misuse of the Antitrust Laws: the Competitor Plaintiff, 90 Mich. L. Rev. 551 (1991) (concluding that the "antitrust injury" doctrine has done little to deter inefficient competitor suits).

58. Brown Shoe Co. v. United States, 370 U.S. 294, 344, 82 S.Ct. 1502, 1534 (1962); United States v. Von's Grocery Co., 384 U.S. 270, 86 S.Ct. 1478 (1966); FTC v. Procter & Gamble Co., 386 U.S. 568, 579, 87 S.Ct. 1224, 1230 (1967); United States v. Arnold, Schwinn & Co., 388 U.S. 365, 87 S.Ct. 1856 (1967).

59. For example, the Celler-Kefauver amendments to § 7 of the Clayton Act, governing mergers. See §§ 12.1–12.2. See also D. Bok, Section 7 of the Clayton Act and the Merging of law and Economics, 74 Harv. L. Rev. 226, 233–238 (1960) (criticizing Congressional concern with protecting small business); H. Hovenkamp, Derek Bok and the Merger of Law and Economics, 21 J. L. Reform 515 (1988).

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 Chicago 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 in which economics 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 already exceeds by a wide margin the proportion justified by the legislative history of the major antitrust statutes. But competing concerns, such as those for protecting consumers from wealth transfers (whether caused by efficient or inefficient practices), and even more unholy concerns, such as protecting other interest groups that Congress was determined to protect, simply cannot be ignored. If they are, then we are not living in a democratic society.

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 revision of antitrust policy that occurred during the 1970's and 1980's and is closely associated with the Chicago School should not be viewed as antitrust's "discovery" of economics. Rather, it was simply a change in the prevailing economic model. Of course, one might characterize the change differently, perhaps by saying that during the 1970's and 1980's the courts and perhaps the Reagan Era antitrust division first recognized economic efficiency as the *exclusive* goal of antitrust policy. In that case, one could say with some meaning that the rise of the Chicago School represented the triumph of an "economic approach" to antitrust analysis.

But such a characterization considerably overstates the case. To this day, the Supreme Court has not come close to saying that economic efficiency is the exclusive concern of the antitrust laws, and many recent decisions are extraordinarily hard to rationalize if one considers only economics.[60]

Chicago School arguments notwithstanding, federal courts deciding antitrust cases have not eliminated noneconomic concerns from antitrust policy. Indeed, one must doubt whether such concerns can ever be eliminated from policy making in a democratic society. The public purpose of economics 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.

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 unambig-

60. For example, Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451, 112 S.Ct. 2072 (1992); Texaco, Inc. v. Hasbrouck, 496 U.S. 543, 548, 110 S.Ct. 2535, 2538 (1990); Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 105 S.Ct. 2847 (1985); Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 104 S.Ct. 1464 (1984). For the principal discussions of these cases, see chs. 7, 10, 11 & 14. See also L. Kaplow, Antitrust, Economics, and the Courts 50 L. & Contemp. Prob. 181 (1987) (arguing that federal judges have been driven more by political ideology than by Chicago School economics).

uously 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 a correspondingly smaller domain for inefficient ones. Further, the model itself is both simple and elegant. The monopolistic competition model that drove post-New Deal 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 praise and condemn economies of scale in the production process. On the one hand, economies of scale reduced costs and facilitated lower consumer prices. On the other, they made it more difficult for new firms to enter the market and, at least in concentrated industries, facilitated oligopoly behavior.[61] 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 firms participating in the differentiation will be injured rather than benefitted, for customers will refuse to buy.[62] Likewise, economies of scale are an unmixed blessing in all but extremely concentrated markets.[63]

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.[64] 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 democratic policy maker 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 results.[65] This new complexity makes it much more difficult for enforcement agencies and courts to make judgments about whether a particular practice is competitive or anticompetitive. Supreme Court decisions such as *Kodak*, while seemingly quite unsophisticated in their economics, clearly reflect some of these doubts.[66]

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, firms have a harder time achieving consensus on price and output; as a result, collusion is harder to sustain. But the 1992

61. On Bain's work, see § 2.2a.

62. See, for example, R. Bork, note 20 at 312–313.

63. Id. at 312–329.

64. See B. Kobayashi, Game Theory and Antitrust: a Post–Mortem, 5 Geo. Mason L. Rev. 411 (1997); S. Peltzman, The Handbook of Industrial Organization: a Review Article, 99 J.Pol.Econ. 201 (1991).

65. See H. Hovenkamp, Post–Chicago Antitrust: A Review and Critique, 2001 Col. Bus. L. Rev. 257 (2001); O. Williamson, Predatory Pricing: A Strategic and Welfare Analysis 87 Yale L.J. 284 (1977); S. Salop & D. Scheffman, Raising Rivals' Costs, 73 Amer.Econ.Rev. 267 (1983); J. Tirole, The Theory of Industrial Organization (1988); J. B. Baker, Recent Developments in Economics that Challenge Chicago School Views, 58 Antitrust L.J. 645 (1989).

66. Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451, 112 S.Ct. 2072 (1992). The decision denied summary judgment against a plaintiff's claim that a nondominant firm in the primary market for photocopiers could manipulate the aftermarket for its replacement parts in an anticompetitive manner.

Guidelines once again recognize, as economists from the 1930's through the 1970's had often noted, that product differentiation can facilitate unilateral price increases under the right set of circumstances.[67] Further, the Guidelines at least implicitly make room for game theoretic considerations that seem to make anticompetitive behavior more likely.

When markets are both concentrated and complex, characterized by product differentiation, relatively high fixed costs, and aftermarkets closely tied to primary markets, the current economic literature is less helpful in providing robust and unambiguous answers. This has several implications for antitrust policy. *First*, as the *Kodak* case held, simple answers are not likely to work, and more information must be gathered. This may make early grants 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 certainly not 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.

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.

§ 2.3 On the Need for Economics in Antitrust

2.3a. The Domain of Antitrust Economics

The economic model of markets and industry structure outlined briefly in Chapter one is rigorous, elegant and intuitively appealing. But using the model to guide legal policy is invariably more difficult and involves many softer questions of policy and judgment. First of all, fact finders are never able to collect all relevant information. Invariably they must fill in gaps, resolve inconsistencies, or deal with facts that do not fit a given paradigm. Sometimes the litigation process yields facts that appear inconsistent with the predictions offered by the economic model.[1] This may be because the process has not generated enough facts, or because one or more of the facts is inaccurate. It may also be because the model itself needs some adjusting to account for "anomalies"—things that the model in its current form is unable to explain.[2]

The antitrust policy maker also faces a second, more pervasive problem. The model may work perfectly, and the fact finder may be amply supplied with the information necessary for a prediction. However, some value that the model does not take into account may force a different decision than the model suggests. The perfect competition model does one thing quite well: given sufficient data it can predict whether a certain practice is efficient or inefficient, by a given definition of efficiency. What the model cannot do is tell us whether efficiency is the only thing that counts.

The issue of economics' appropriate role in antitrust actually evokes two questions. *First*, should economic efficiency be the only goal of antitrust policy, or should it share that role with other values or perhaps even other disciplines? *Second*, what kind of economics should antitrust policy use?

For decades antitrust writers have debated whether economic efficiency should be the exclusive goal of antitrust policy, or whether antitrust should incorporate a broader set of

67. These concerns are developed in § 12.3.

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1. As in Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451, 112 S.Ct. 2072 (1992), where the model said that a firm that lacked market power in its primary market must also lack market power in the markets for replacement parts. Nevertheless, the facts suggested little market power in the former, but substantial market power in the latter. See §§ 3.3a, 10.3b; H. Hovenkamp, Market Power in Aftermarkets: Antitrust Policy and the *Kodak* Case, 40 UCLA L. Rev. 1447 (1993).

2. For one view of the relationship between scientific models, anomalies, and scientific progress, see T. Kuhn, The Structure of Scientific Revolutions (2d ed. 1970).

noneconomic as well as economic values. As § 2.1 notes, the legislative history of most of the antitrust statutes fails to reveal that efficiency concerns dominated. Indeed, Congress was generally willing to tolerate a great deal of allocative *in*efficiency 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 full of inefficient, democratically passed statutes, many of which are regularly enforced.

There is a principled position that antitrust policy must admit certain noneconomic values.[3] At the same time, no one believes that efficiency concerns are irrelevant to antitrust policy. Today the most important debate about basic principles in antitrust is between those who believe that allocative efficiency should be the exclusive goal of the antitrust laws,[4] 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 wealth, protection of small businesses from larger competitors, protection of easy entry into business, concern about large accumulations of economic or political power, prevention of the impersonality or "facelessness" of giant corporations, encouragement of morality or "fairness" in business practice, and perhaps some others.

All 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 courts adopt any mixture of goals, antitrust is likely to be guided by conflicting policies which must then be balanced against each other.[5] To be sure, this is not a unique phenomenon. Constitutional law is filled with decisions that balance conflicting policies. Antitrust could reasonably be expected to balance a policy of 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 efficient, then the "efficiency only" advocate believes it should be legal, even if it injures small businesses, makes big businesses even bigger, 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

3. See H. Hovenkamp, Distributive Justice and the Antitrust Laws, 51 Geo.Wash.L.Rev. 1 (1982); H. Hovenkamp, Antitrust Policy After Chicago, 84 Mich. L. Rev. 213 (1985); L. Schwartz, "Justice" and Other Non-Economic Goals of Antitrust, 127 U.Pa.L.Rev. 1076 (1979); R. Pitofsky, The Political Content of Antitrust, 127 U.Pa.L.Rev. 1051 (1979); L. Sullivan, Book Review, 75 Colum.L.Rev. 1214 (1975).

4. See R. Posner, Antitrust Law, chs. 1 & 2 (2d ed. 2001); R. Posner, The Chicago School of Antitrust Analysis, 127 U.Pa.L.Rev. 925 (1979); and R. Bork, The Antitrust Paradox: A Policy at War With Itself (1978; rev. ed. 1993).

5. For development of this point, see 1 Antitrust Law ¶¶ 111–112 (2d. ed. 2000).

certain noneconomic values and determine whether society is willing to pay the price. Presumably, it is not worth *any* price 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 strewn 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 independent gasoline station owners than the cost-reducing restrictions struck down by the Court.

The same phenomenon has occurred often in merger law. In the 1950's and 1960'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 firms. The economics of beer production had determined their fate. The Supreme Court's decisions simply made their painful exit from the market even more painful and expensive than it need have been.[7]

The robustness of economics as problem solver is easily exaggerated. Nonetheless, the notion that a nonarbitrary 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.[8]

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.

2.3b. 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

6. 337 U.S. 293, 69 S.Ct. 1051 (1949). See § 10.9.

7. See Y. Brozen, Concentration, Mergers, and Public Policy 366–67 (1982); FTC, The Brewing Industry 64–65 (1978).

8. For example, E. Fox, The Modernization of Antitrust: A New Equilibrium, 66 Cornell L.Rev. 1140, 1156 (1981).

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.[9] 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, Progressives 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.[10] 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.[11]

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 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 increasingly 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 finality suggests that today's story will be replaced by a different one tomorrow.

What is the student of antitrust to make of this inconsistency and complexity in economic analysis? Two extremes seem particularly ill-advised. The first is to throw up one's hands and simply abandon any effort to develop a coherent antitrust policy driven by economic assumptions. The second is to leap at every new economic theory that sounds plausible and attempt to incorporate it into antitrust policy analysis.

Any consideration of the kind of economics antitrust should use must consider that an important purpose of economics in antitrust is rhetorical: we use it to tell consistent and relevant stories that make sense out of the world we face. In order to be helpful, the story must be understood by those who make policy. Of course, policy makers have an obligation to learn the tools of their trade, but economists also have an obligation to make their theories meaningful to a large audience. This is particularly true in a democracy. Excessive reliance on technical expertise can yield a kind of totalitarianism if policy makers blindly enact what experts recommend without really understanding what the experts are saying.

The best economics for antitrust is generally that which is relatively uncontroversial and well established in the literature. More complex theories certainly have policy implications, and someday they may become economic orthodoxy. But until that time occurs, they are best left to academics, who often write for the future rather than the present.

2.3c. 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

9. A. Marshall, Principles of Economics (1890).

10. See H. Hovenkamp, Enterprise and American Law, 1836–1937, esp. chs. 22–25 (1991).

11. See, e.g., J. Tirole, The Theory of Industrial Organization (1992); D. Baird, R. Picker, & R. Gertner, Game Theory and the Law (1994). For an application to collusion, see C. R. Leslie, Trust, Distrust, and Antitrust, 82 Tex.L.Rev. 515 (2004).

output to its inputs. A firm that produces a product valued at $100 and requires inputs valued at $80 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 of 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 "Pareto-superior" if it makes at least one person better off and makes no one worse off.

The concept of Pareto-superiority is so rigorous that it would be satisfied by only the most trivial of social changes. A change in a social policy is Pareto-superior only if no one objects. All legal changes—even outrageously good ones—have adverse affects on at least one person. The adoption of a rule condemning robbery, for example, makes robbers worse off. Likewise, the adoption of a legal rule against monopolization or price fixing is not Pareto-superior for the same reason: it makes monopolists and price fixers worse off than they were before the rule was adopted.

For this reason antitrust economists sometimes use a variation of Pareto-efficiency called "potential" Pareto-efficiency. A change is efficient under the potential Pareto measure if the gainers from the change gain enough so that they can fully compensate all losers out of their gains—that is, if the total value placed on the gains exceeds the total value placed on the losses. If those who are made better off by the adoption of a rule against price fixing gain more than those who are made worse off lose, then the rule is efficient under the potential Pareto criterion even though its adoption produces some losers. Whether the gainers *actually* compensate the losers out of their gains is irrelevant to the determination of efficiency. For example, it is unlikely that potential price fixers would be compensated for any losses they suffer from the adoption of a rule that makes price fixing illegal.

Figure 1 (next page) suggests why the adoption of a rule against monopolization or price fixing is efficient under the potential Pareto criterion. In a competitive market, with price at marginal cost, consumers' surplus would equal triangle 1–3–6 in the figure. The monopolist or cartel will reduce output to Q_m and raise price to P_m. Consumers' surplus will be reduced to triangle 1–2–4, and the loss to consumers that results from the monopoly pricing will equal quadrilateral 2–3–6–4.

12. V. Pareto, Manual D' Economie Politique (1909).

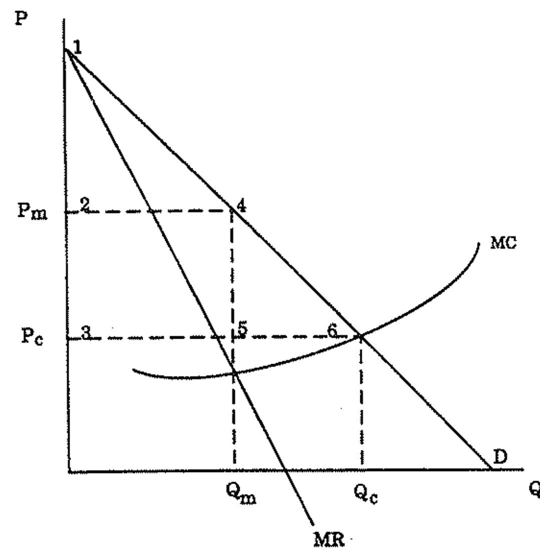

Figure 1

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The gain to the monopolist, however, is only rectangle 2–3–5–4.[13] 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.[14] 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.[15]

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 benefitted 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.[16]

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.

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

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

15. See § 2.1.

16. On these "second best" problems, see § 1.5e.

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 *everyone* 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.[17]

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 was twelve units and producers' surplus was one unit. The latter alternative, however, would maximize the welfare of consumers.