Do Antitrust Laws Preserve Competition?

SYLVESTER PETRO

Dr. Petro, Professor of Law at New York University School of Law, is author of numerous articles and books, the most recent being "The Labor Policy of the Free Society" (New York: Ronald Press, 1957). This article is a compressed transcript from an informal seminar discussion at FEE, summer, 1957.

THE ANTITRUST LAWS are commonly thought to be the institutions that distinguish the economic system of the United States from the rest of the non-Soviet world. But for these laws, it is said, we should be plagued with cartelization as in Great Britain, Germany, or France. Many believe, in short, that the antitrust laws are responsible for our having a competitive society.

Preserving competition might have been the objective about 1890 when the basic act was passed. But certainly for the past generation the antitrust laws have not functioned to that end. Rather than preserve, they have through questionable interpretation and administration in fact impaired competition, by subsidizing and preserving inefficient competitors.

By competition, I refer to a situation that exists when the basic rules of the free society are observed – when everyone possesses the basic rights of private property and freedom of contract. Competition is not a mode of conduct that anyone has to promote institutionally. It develops naturally and necessarily among persons who are free to pursue their own interests. Whatever one's personal interest or objective may be – businessman, sculptor, or preacher – the consequence of pursuing it puts him in competition with all who share

that objective. That being the case, preoccupation with promoting competition is at best a diversion of effort which could have been used to protect private property and freedom of contract. My thesis is that we have erred in the formulation and application of the antitrust laws of the United States.

A List of the Laws

What are these laws? The first is the Sherman Act of 1890. This law makes every contract or combination in restraint of trade and every conspiracy to monopolize the trade or commerce of the United States a misdemeanor.

Next came the Clayton Act in 1914, declaring unlawful specific types of contract, such as a tying agreement, or an exclusive sales contract, when the result may be to lessen competition or tend to create a monopoly. The Clayton Act was intended to clarify or make concrete the general proscriptions of the Sherman Act.

Usually included among the antitrust laws is the Federal Trade Commission Act which broadly states that unfair methods of competition shall be subject to prosecution.

Though Fair Trade laws are laws of particular states, they also come under the heading of antitrust laws. All provide that when a contract is made between the seller or manufacturer of certain goods and a retailer, providing for a specific resale price, then all purchasers of these goods with notice of the main contract are bound to observe the price set in that main contract. These state Fair Trade laws all grew out of what I believe to be unfortunate decisions under the Sherman Act prohibiting a resale price maintenance contract between a manufacturer and a retailer.

Though I see no violation of freedom of contract if a retailer is willing to sell at the resale price stipulated by the manufacturer, the Supreme Court thought restraint of trade was involved and held such resale price maintenance contracts unlawful. Conditions in the 1933 depression prompted many states to pass Fair Trade laws, and Congress suitably amended the Sherman Act to validate such state laws. But these laws now go much further than legitimatizing a reasonable contract between a manufacturer and a retailer; they enable that manufacturer and retailer to fix prices for all persons who come into possession of the goods in question. Such binding without consent appears to violate the principle of freedom of contract – a case of having pushed the Sherman Act to reach an anticompetitive result.

The Robinson-Patman Act of

1936 is the last of the antitrust laws worth noting here. This act, in general, provides that the price – including such things as advertising allowances or brokerage fees – for goods of like grade and quality must be the same to all purchasers, subject to these qualifications: (1) A price discrimination is not unlawful if it can be demonstrated that it has no tendency to limit competition or create a monopoly. (2) If the seller can demonstrate that his costs of selling are lower to buyer A than to buyer B, then he may charge A a proportionally lower price. (3) A seller may discriminate in favor of buyer A if he can show that he had to lower his price in that instance to meet in good faith the offer of a competing seller. Like the Clayton Act, the Robinson-Patman Act was designed to be specific concerning one of the general objectives of the Sherman Act.

The Northern Securities Case

On the basis of this brief outline of the various antitrust laws, let us proceed to examine how these laws have been interpreted and used. I mentioned earlier that one consequence of antitrust action has been to preserve inefficient competitors to the impairment of competition. In other words, the antitrust laws have been perverted from a supposed charter of economic liberty into a demagogic onslaught against large and successful business with a kind of vote-buying subsidy, not for small business, but for inefficient business.

Both historically and doctrinally this process can be traced to a famous case involving Messrs. Hill and Harriman – the Northern Securities case. Hill and Harriman, after what some people called a titanic financial war, decided that it would be to their advantage if they merged a couple of railroads running along the northern tier of states out West. The railroads were the Great Northern and the Northern Pacific. The United States sued under the Sherman Act, charging that this was a violation of both Sections 1 and 2 of that Act–a combination in restraint of trade, and an attempt to monopolize a certain portion of the trade or commerce in the area of the United States that these railroads covered. The decision was close. A majority of one held that the holding company violated the antitrust act. Justice Harlan, grandfather of the present Justice Harlan, reasoned for the majority along these lines: In prohibiting combinations in restraint of trade, what the Sherman Act intended was to outlaw any impairment of competition. Though these companies did not compete for 74 per

cent of their business, there was an overlap of 26 per cent; and when they decided to merge, that 26 per cent was destroyed. Therefore, there was a restraint of trade within the meaning of the Sherman Act.

Holmes Was Right

Justice Holmes, dissenting, reasoned from the fact that the Act does not say that any reduction in the number of competitors is a misdemeanor; it says that a combination in restraint of trade is a misdemeanor. He argued that since the words "in restraint of trade" were used, the Court ought to follow the meaning generally given those words under common law – the classical theory of interpretation. He was right. The assumption is, and has to be – except in the case of deliberate specification to the contrary on the part of Congress – that the words of any statute are used in the sense of existing law. Holmes went into an exhaustive survey of the relevant common law and pointed out that there was nothing whatsoever in its history to imply that such a merger is a restraint of trade.

Holmes further said in effect: The Court must remember that the rule it is making in this case is a rule that must be applied equally to all persons engaged in mergers. If it be said that these two railroads cannot merge because they compete for 26 per cent of their business, one must say that two corner groceries who compete for 26 per cent of their business cannot merge. It would be the same for other persons. Furthermore, by this case the Court is establishing a precedent to the effect that if one of these persons should buy out the other, he is violating the law. Without realizing it, Holmes said, the Court majority is construing the Sherman Act as destructive of one of the leading principles of society in this country, that is the free, inalienable right of voluntary association.

I believe Holmes was right in this case. He was right both as a technical legal analyst and in his forebodings. Establish the premise that voluntary mergers are bad, and you have a basis for challenging normal, common business procedure in an economy based on freedom of contract. This is the daily fare of business and of capital. If a business feels that its affairs may be more rational if it combines with another firm, it merges or acquires assets or stocks of another corporation. And yet, each time this perfectly normal thing is done, the participants are in danger of antitrust prosecution.

One must recognize the real nature of the hidden menace here. The fact is that not every merger

can be prosecuted. It is a physical impossibility. A market economy could not function if every such action were prosecuted. However, from the point of view of legal science, the resulting situation is very bad. Instead of having a universal rule of law applicable equally to all members of society in free and open competition, what we have is selective prosecution.

What is the basis of selection? There isn't any legal basis for selection, and if you haven't a legal nonarbitrary basis for selection, what is your basis going to be? The answer is perfectly clear. It is going to be political and ideological. And these two things have tended to merge inextricably over the last 40 years or so.

There is a great preoccupation with timing of antitrust prosecutions; suits are brought against mergers whenever the Democrats, or the Republicans, want to make political hay by showing how rough they are on business. Add to the mix the Marxian theory that business is bound inevitably to get bigger and bigger until we are all at the mercy of the exploiting monopolists, and you have two primary qualifications for antitrust prosecution. First of all, it has to be a big business, big enough to scare people. And secondly, the occasion has to be politically propitious.

What is to happen to a country in which success in the market place is to be a signal for prosecution by politicians anxious to curry public favor? It is a serious question, prompted by the situation which prevails today. Danger of antitrust prosecution threatens any firm that manages to grow and to out-produce its competitors.

It would really be a comfort to know that each business was doing its utmost to get as much of the market as it possibly could, that each firm was striving to put out the greatest possible production at the lowest possible cost, that, in short, it was being directed in accordance with the public good. But because of so many interventionist devices, the measuring sticks provided by a free market are no longer available. You can't be sure that a move or a failure to move on the part of a business is dictated by economic considerations in response to the desires of the people.

Prosecutions for Price Fixing

Further insight into the absurdities and frustrations of the antitrust laws is afforded by review of the prosecutions under the Sherman Act for price fixing. The famous Morton Salt case dealt with that issue. And there have been a great many others – perhaps 30 or 40 before the Supreme

Court. But what on earth can be the consequence of a judgment that a price-fixing agreement is unlawful? What can anyone do about it if 20 firms have agreed to charge a certain price for a product? Assuming that it is a homogeneous product, how can 20 different firms be expected to sell it at 20 different prices? If A charges 98 cents, B a dollar, and Z $1.26, how is Z to gain a sale?

The point is that such prosecutions are nothing but ceremonial political promotions of the party line: "Watch those businessmen!" We are great at berating the businessman for doing what is as natural to him as breathing. The function of the market is to find the right price, to bring competing goods toward the same price, and to screen out those producers who can't meet the price.

The Cement Institute case illustrates the point. All over the country, cement manufacturers were submitting bids that were identical to five decimal places; and the Supreme Court thought this was inherently incredible without some evil conspiracy. But if this seems incredible, try to sell cement at as much as a fraction of a cent higher than competitors are charging. When cement prices begin showing variations, it will be time to look for collusion and conspiracy.

So we find that the Sherman Act itself, the basic antitrust law, has been and is being used, not to promote and maintain competition, but to discourage the abler firms from operating to the limit of their abilities. Add to this the Fair Trade and the Robinson-Patman designs to handicap the larger more efficient merchandisers, and there is no escaping the conclusion that the so-called antitrust laws are in fact anticompetitive and antisocial. They are pushing toward a rigid, inflexible, industrial structure which interferes with the free play of market forces.

Why the Market Works

I have already mentioned some important requirements for the functioning of a free society – for the free play of market forces. The right to private property is one. Freedom of contract is another. Beyond these is a need for better understanding of the market process – more faith in it and less fear of it.

The market works because of man's desire to make a profit, to get more out than he puts in. Capital formation and use rests on this premise. People act in order to better themselves, increase their profits, decrease their losses. And the best opportunity for profit lies in the production of things others want – in service to others. This means that the profit motive is

morally as well as economically sound.

The free play of market forces also calls for freedom to trade. Free trade policies are the most effective and successful of all possible antitrust actions. Free trade is the best kind of curb on all forms of government intervention, including subsidies to farmers, monetary tricks, or any other interference you could name. One of the grim features of our day is the great preoccupation with international peace and harmony while at the same time we have the erection of all sorts of trade barriers.

How Many Competitors?

On the domestic front we glory in the productive accomplishments of the industrial revolution and freely acknowledge the advantages of large scale mass production. But we seem bound to try to stop the spreading of such advantages when it comes to distribution and retailing of these goods and services. Our politicians count noses and find more small retailers than chain store operators. So they enact Fair Trade laws and Robinson-Patman acts deliberately designed as barriers to the development of mass distribution methods which could mean better living for all as consumers. Perhaps this simply reflects a general fear of bigness in business — a feeling that the greater the number of competitors, the better.

A free competitive market is not a condition which requires for its existence large numbers of producers. It only requires freedom on the part of all people to produce if and when they wish. If the unlikely situation should exist that in a certain line of production a single firm could most economically satisfy the whole market, then, of course, you would have a condition which might be called monopoly. But this is not the aspect of monopoly that people fear. What really disturbs people about monopoly is not that a single person or firm has control over a commodity but that force, compulsion, or special privilege has been used to keep other people out.

The Origin of Monopoly

Some history is useful here. Monopoly became a problem in the Anglo-American legal system owing to its origin. Monopoly originated in crown grants to certain people of exclusive privileges maintained by the force of government. Queen Elizabeth granted a monopoly in salt, playing cards, and a number of other things. She did this only because she was dissatisfied with the fact that Parliament controlled the purse strings in England. Parliament had insisted on the exclusive power to

tax, but Queen Elizabeth had certain ends and aims of her own, and the money needed to attain them came from the persons or groups to whom monopoly powers were granted.

It's very plain that this situation has nothing to do with the free market, which grants no exclusive franchise. But the market does not preclude a monopoly. In fact, monopoly in the purely descriptive sense and the right of private property are the same thing. Each of us is a monopolist. We are in exclusive control of our person and all that we legitimately create. If we legitimately create the best and most efficient organization, so productive and so efficient that no one else can compete, we have a monopoly in that descriptive sense. But there is no social harm done as long as everyone else has an equal right to get into production. There can't be any social harm because the social interest lies in the most efficient production of goods. Monopoly in this sense means only that society has achieved that end. One person, one firm, in a free competitive market, has proved to be more efficient than any other. Anyone else is free to produce, if he thinks he can compete.

We have a pretty good example of that sort of thing in the automobile industry in this country. The industry operates in as free a market as one can have in this imperfect market economy. Unlike some other industries, this one is not plagued by an overweeningly jealous attitude toward patents. Anyone can get into it. But more are getting out than getting in. Is something drastically wrong in that industry in the sense that a social harm is being done? It seems to me, if you are fair about it, you would have to say that the big three in the automotive industry are simply better public servants in this line than anyone else.

There's quite a difference between monopoly in the descriptive sense of being the only producer, and in the exploitative sense of using force or state aid to exclude competition. The latter is something that free men should fear. And they should know that the government itself is apt to be the culprit behind genuinely antisocial monopoly.

A Useful Antitrust Action

I want to make clear that one phase of antitrust policy is in my opinion of real social utility. That is the phase concerned with secondary boycotts and other predatory oppressive practices which I consider harmful interferences with the free market. Let us assume that 30 or 40 retailers, with a common supplier, have an arrangement to avoid competing and

to split up territories. Along comes an interloper, a true competitor, who wants to buy from the same supplier. If the other retailers then threaten to quit buying unless the supplier refuses to deal with the interloper, they are held to be in violation of the antitrust laws – and I think rightly so.

Though the market eventually would rectify such a situation, substantial harm could be done to the interloper in the interim. Also, such collusion might lead to a generally cartelized economy, to everyone's detriment. So I have no objections to antitrust laws as a curb on secondary boycotts and other oppressive action, though I'd prefer that such abusive practices be subject to prosecution under common law rather than special statute law.

Actually, secondary boycotts are rarely used by businessmen, the most flagrant offenders being the trade unions. However, the unions seem to be immune to prosecution under that single phase of antitrust policy that could be socially useful.

A Positive Program

If I were responsible for preserving competition in the United States, I should not turn to the antitrust laws for help. The common law affords all the legal action needed, and its great merit is that people in significantly similar legal circumstances have to be treated the same way. Politics are excluded.

A long step toward preserving or restoring competition in this country could be taken by abolition of the discriminatory, anticapitalistic, progressive income tax, which skims off the cream of the risk capital – takes the ammunition away from the competitors. They can't compete without ammunition, any more than boxers can perform with their hands tied behind their backs. So my platform would include a plank for repeal of the discriminatory tax laws.

Another plank in my platform to preserve competition in the United States would involve repeal of the laws which have granted so many special privileges and exemptions to labor unions and other pressure groups. In this, I take comfort from the fact that the greatest of all legal scholars, Sir Henry Maine, drew the same conclusion – an elaborate intricate code of laws is a sign, not of a sophisticated society, but of a primitive society. English law, until toward the end of the eighteenth century, was characterized by a practically solid network of laws regulating the most intimate affairs, especially when they were economic affairs. There were laws fixing the amount of flour in bread.

A wheelwright couldn't be a wainwright. There were laws against forestalling, engrossing, and regrating, and so on, and on and on. Someone remarked that forward-looking men toward the end of the eighteenth century and the beginning of the nineteenth century were spending most of their time wiping laws off the books and, as you know, the impetus toward that very helpful form of human conduct was supplied by laissez faire theory.

Mankind's Eternal Task

All people interested in having a free society, I think, should be concerned with spreading ideas of freedom; let the actual, detailed measures take care of themselves, as they inevitably will. The ideas have to come first. The most important thing to a society is that its idea factories are really well run. The scholars, writers, and philosophers of a society have to be good or there is really little hope. How does one bring about a change in the idea factories? I have no answer except that hard one of slow self-discipline, more rigorous and objective pursuit of truth; all the things that take forever. This is mankind's eternal task. • • •

The Survival of Ideas

MOST INTELLIGENT PEOPLE are now beginning to realize that democracy is declining and peaceful society disintegrating with hopes of world peace receding. They imagine that the solution lies in finding some political leader who can lead us to salvation. They forget that the one group of the community which can never save us is that which comprises the politicians for, in a democracy, they have to follow public opinion or accept defeat at the polls. The survival of liberty and democracy does not depend on the survival or the change of governments. Whether liberty and democracy will remain with us depends entirely upon the survival of ideas. The socialists grasped this truth and that was why, in every town and village, they set up their cells of education to cultivate the belief in the philosophy of Karl Marx. So successful have they been that they have almost conquered the world, for their opponents have never had sufficient understanding of the problem to offer any opposition.

Hauraki Plains Gazette, New Zealand, February 1, 1957

The GREAT SWINDLE

HENRY HAZLITT

A YEAR AGO (*Newsweek*, June 25, 1956) I printed here, under the above title, a table showing the depreciation, in terms of domestic purchasing power, of the currencies of 53 countries in the ten years from 1946 to 1955. This table had been compiled by Franz Pick. He has now carried it forward, for the nine-year period from January 1948 to December 1956, in the 1957 edition of his *Currency Yearbook*. I present the results below, showing the depreciation of 56 currencies in that period.

It is important to keep this appalling world-wide picture constantly before our minds. For it reminds us that inflation is nothing but a great swindle, and that this swindle is practiced in varying degrees, sometimes ignorantly and sometimes cynically, by nearly every government in the world. This swindle erodes the purchasing power of everybody's income and the purchasing power of everybody's savings. It is a concealed tax, and the most vicious of all taxes. It taxes the incomes and savings of the poor by the same percentage as the incomes and savings of the rich. It falls with greatest force precisely on the thrifty, on the aged, on those who cannot protect themselves by speculation or by demanding and getting higher money incomes to compensate for the depreciation of the monetary unit.

Why Inflation?

Why does this swindle go on? It goes on because governments wish to spend, partly for armaments and in most cases preponderantly for subsidies and handouts to various pressure groups, but lack the courage to tax as much as they spend. It goes on, in other words, because governments wish to buy the votes of some of us while concealing from the rest of us that those votes are being bought with our own money. It goes on because politicians (partly through the second- or third-hand influence of the theories of the late Lord Keynes) think that this is the way, and the only way, to maintain "full employment," the