Ideally,

the political support for antitrust would come from consumers clamoring for lower prices and a greater selection of products. But... it often comes from competitors who fear they will lose in the marketplace. Or it comes from workers and communities who fear the changes that rapidly advancing technology or restructuring through merger might bring.... Antitrust has capitalized on the public's fear of big business and even on its fear on the unknown.... Despite antitrust's long history, we know remarkably little about the ultimate effects of the wide variety of practices it seeks to prohibit....

The current debate over antitrust in high-technology industries offers an opportunity to review what antitrust can and cannot do. The promise of antitrust over the last century has been that it will make the economy more productive. In the 1930s, Franklin Roosevelt's colorful antitrust chief, Thurman Arnold, vowed to remove "the bottlenecks of business."
The record shows something else. Antitrust has in fact often constructed bottlenecks for business. This should not surprise us: Antitrust is a creature of politics, and its execution depends on interest-group pressures and the self-interest of a bureaucracy. When GM and Toyota proposed a joint venture to produce cars in the United States, Chrysler raised antitrust objections. A divided Federal Trade Commission nearly blocked the deal. When Microsoft proposed to merge with Intuit, maker of the successful financial software Quicken, an anonymous group of Silicon Valley companies funded efforts to convince the Antitrust Division to stop the deal. Faced with protracted legal hurdles, Microsoft walked away.

WHY ANTITRUST?

Ideally, the political support for antitrust would come from consumers clamoring for lower prices and a greater selection of products. But, as these cases illustrate, it often comes from competitors who fear they will lose in the marketplace. Or it comes from workers and communities who fear the changes that rapidly advancing technology or restructuring through merger might bring. A half century ago, Judge Learned Hand argued that the antitrust laws reflected “the desire to put an end to great aggregations of capital because of the helplessness of the individual before them.” Antitrust has capitalized on the public’s fear of big business and even on its fear of the unknown. Not surprisingly, antitrust in practice — frequently a blunt, costly, and unstable policy — than they do about the effects of the challenged business practices themselves. Commenting on the two basic antitrust statutes, the late Nobel laureate George Stigler wrote that “there have been no persuasive studies of the effects of the Sherman and Clayton Acts throughout this century.”

A demand for answers frequently generates a supply, even when the answers are not very good. Antitrust provides ample illustration. Our meager empirical knowledge notwithstanding, merger cases are in fact filed. Since the assertion that all mergers are monopolistic would probably not gain widespread support, at least not today, judges seek advice from experts to help them separate good mergers from bad. Experts will gladly testify that a given merger (or licensing agreement or clause in a contract) has “likely anticompetitive effects.” Unfortunately, such assertions are not based on hard fact. No studies exist that compare, say, the effects on prices and output in 50 instances in which merger was allowed and 50 instances in which it was denied, holding (as well as economic science focused on practices that involve an agreement — that is, something that can be cast in terms of a “conspiracy” between two or more parties — antitrust has also been used to challenge actions by a single firm, such as expansions of capacity. During the FTC’s most recent “activist phase,” it filed suit against DuPont for building a large, low-cost plant in Louisiana for making white pigment.

Despite antitrust’s long history, we know remarkably little about the ultimate effects of the wide variety of practices it seeks to prohibit. This is especially true of the long-term effects. Do mergers, joint ventures, and other practices raise prices and reduce the spectrum of available products? Economists do not know — certainly not in the same sense as they know that printing money causes inflation, or that price controls cause shortages. However, even if economists did know that the answer was “Yes” under particular conditions, they would still have to see whether antitrust intervention as actually carried out in the sausage factory of daily politics proved effective. Not surprisingly, economists know even less about the effects of antitrust in practice — frequently a blunt, costly, and unstable policy — than they do about the effects of the challenged business practices themselves. Commenting on the two basic antitrust statutes, the late Nobel laureate George Stigler wrote that “there have been no persuasive studies of the effects of the Sherman and Clayton Acts throughout this century.”
An important development of the last few decades has been the growth of an antitrust industry. The financial interest of the lawyers and economists who make up this industry does not lie in the promotion of clear, efficiency-enhancing policies, but rather in the promotion of complex and ever-changing “rules of the game” that inflate the demand for their services.

possibly could) all other things equal. That is the sort of evidence we expect when the government decides to approve or deny a new drug, or when it requires us to buckle our seat belts. Rather, the prediction of “likely anti-competitive effects” is routinely the prediction of an economic model — a simplified, stylized, “toy” world of an economist standing at a blackboard. These models have their place. They promote consistency in economic discussion, and they generate assertions — “hypotheses” or views of how the world works — that can be checked against the facts. However, they are not a substitute for facts and they cannot claim to predict what will actually happen if a particular merger does take place.

While the public benefits of antitrust remain unclear, the private benefits do not. An important development of the last few decades has been the growth of an antitrust industry. The financial interest of the lawyers and economists who make up this industry does not lie in the promotion of clear, efficiency-enhancing policies, but rather in the promotion of complex and ever-changing “rules of the game” that inflate the demand for their services. Not surprisingly, this industry makes conspicuous use of the “revolving door.” For example, James Rill was a 25-year veteran of the antitrust bar when he was appointed by President Bush to head the Antitrust Division in 1989. After leaving office, he returned to private practice, where his current law firm advertises that he “was responsible for the publication of the joint Department of Justice/FTC Horizontal Merger Guidelines 1992.” Clearly, Mr. Rill’s long-term fortunes have been tied to the private antitrust bar. It does not seem likely that he forgot that fact when he brought cases and formulated policy — new merger guidelines, for example — during his relatively short tenure as the nation’s antitrust chief. Just as most tax lawyers and tax accountants would be horrified, at least when their clients are not listening, by the prospect of a simplified tax code, members of the antitrust industry would be opposed to an antitrust policy slimmed down to what it demonstrably can do well.

THE RECORD

In evaluating the applicability today of laws that were passed a hundred years ago, two questions arise. Why were they passed? And what have been the consequences of enforcement down to the present day?

The Sherman Act. The Sherman Act signed by President Benjamin Harrison in 1890 outlawed “every contract, combination, or conspiracy in restraint of trade” and “monopolization.” That language reflected centuries of common law usage, but the law was in fact a response to very recent events. Much as new technologies today are creating winners and losers, the rapid growth of some industries — steel, chemicals, and petroleum, for example — and the precipitous decline of such others as agriculture and traditional handicrafts created economic upheaval in the late 19th century. Many of the new industries also adopted novel and alarming organizational forms like the “trust” and the holding company. Turn-of-the-century discussion in
fact often focused on a single “trust and corporation problem.”

Against this background, it would be misleading to assert that the Sherman Act was purely a public-spirited response to high prices. Early defenders of the Sherman Act, like President William Howard Taft (1909-13), explicitly sought to turn back the clock, dispense with the modern corporation, and return to an earlier, idealized “competition.” Early antitrust proved ineffective in reaching its basic aims, and it also led to some unintended consequences. By virtue of the 1895 Sugar Trust decision, merger received blanket protection under the Sherman Act. Merger was always legal but cartels were not. Roughly half of U.S. industrial capacity merged in the decade that followed. Ironically, a policy designed to slow the growth of big business actually hastened its growth. Under pressure from Theodore Roosevelt (President during 1901-9), the Supreme Court then narrowly reversed itself and finally brought merger under the Sherman Act in 1904.

The new power to break up companies proved to be a mixed blessing. Roosevelt sued to divest Standard Oil and several other large industrial firms in late 1906 and 1907. When stock prices and economic activity declined sharply, the business press and even some of Roosevelt’s allies linked the “Panic of 1907” with his assault on big business. Roosevelt denied the charges, claiming that not he but rather “malefactors of great wealth” had deliberately caused the panic to discredit his monopoly policy. But he soon shifted course. His successor Taft then fired up the antitrust machinery a second time. Taft’s attorney general even promised to break up the hundred largest corporations and send corporate officials to jail. This new assault again provoked widespread charges that trust-busting was responsible for “the disturbed business conditions” of 1911-12.

Antitrust does not loom as large today as it did in 1912. However, much as the study of extreme or “hyper” inflation illuminates the causes and consequences of inflation, the dramatic events at the turn of the century illuminate the causes and consequences of antitrust. When Taft left office, the Sherman Act could claim one partial success and two failures. It had driven explicit cartelization underground or into merger without eliminating it. Antitrust had also accelerated the growth of big business, and it had implicated itself in two major recessions.

The Clayton Act. Unhappy with court interpretations of the Sherman Act, Congress amended the antitrust laws with the 1914 Clayton Act. The new law outlawed a variety of such controversial business practices as price discrimination, but the major change was the explicit prohibition of mergers that “tend to create a monopoly.” Although the antitrust authorities enforced the law sporadically during and following the First World War, a major shift occurred with the death of President Harding in 1923. Calvin Coolidge (1923-29) assumed office and succeeded in essentially dismantling antitrust, in particular merger enforcement. By the late 1920s, prominent antitrust experts declared antitrust a dead letter. Unsurprisingly, a wave of mergers took place at the same time, and the stock market and economy boomed from 1925 until 1929. The 1920s merger wave was similar to 1980s and 1990s merger activity in that much of it involved the high-tech, high-growth industries of the day: automobiles, radios, moving pictures, and aircraft, for example.

The 1920s merger wave, stock boom, and economic expansion ended in October 1929. The crash has remained a puzzle for over 60 years, but an intriguing fact came to light recently, namely that it coincided with a sharp reversal of antitrust policy. On October 25, 1929, in a speech delivered to the annual meeting of the American Bar Association, the attorney general of newly elected President Hoover (1929-33) explicitly renounced the lax policies followed by Coolidge: The Hoover administration would break with recent tradition and strictly
Trust-busting may be dead, but the vague prohibitions of the antitrust laws can still cause mischief.

Columbia University law professor Mark Roe demonstrates in Strong Managers, Weak Owners, state and federal policies had seriously undermined shareholder control of corporations. As a result of government policy, managers rather than shareholders controlled America's large corporations. The second legal development was the 1950 Celler-Kefauver Amendment to the Clayton Act and subsequent court opinions like that in Von's that essentially ruled out horizontal mergers. With the door to horizontal merger closed, and without effective control by shareholders, managers who were intent on expansion diversified into unrelated businesses. Far-flung and inefficient empires such as Charles Bluhdorn's Gulf & Western and Harold Geneen's ITT emerged.

Though tighter merger policy can stop mergers, it is often powerless against underlying economic forces. In the 1966 Von's Grocery decision, the Supreme Court held illegal a merger of two grocery chains with a combined Los Angeles market share of 7.5 percent. The justices feared creeping concentration of the grocery store market. Nonetheless, in the 30 years since the case was decided, the "Ma and Pa" stores and small chains in California have withered as they have elsewhere. However, though it is more concentrated, grocery retailing has also become more efficient and marked by intense competition between major national and regional chains.

The conglomerate merger wave of the 1960s provides yet another illustration of the unintended consequences of merger policy. It also offers an additional lesson for today, specifically, that antitrust is poorly suited for dealing with policy defects that have their origins elsewhere. Two legal developments played a role in the conglomerate merger wave. First, as

INNOVATION MARKETS

Sharp reversals of policy like those that occurred under Teddy Roosevelt and Herbert Hoover are unlikely today. We've learned to live with the corporate form and merger. No attorney general today would threaten to dismanl America's hundred largest firms, in part because politicians now pay attention to capital markets. At the turn of the century, stocks were owned by relatively few wealthy individuals. Today, a large fraction of the population owns stocks directly or through pension or mutual funds. Consequently, a serious threat of widespread forced divestiture would be politically risky. Possible capital market reaction also explains why antitrust authorities today have only nipped at Microsoft's heels so far.

Trust-busting may be dead, but the vague prohibitions of the antitrust laws can still cause mischief. For example, the Federal Trade Commission and the Department of Justice have advanced the concept of "innovation markets." These are markets involving the production of knowledge but not the production of any tangible good or service. A case involving an "innovation market" might arise if two firms with similar R&D agree to merge or cross-license future patents. Under the innovation market approach, the government agencies claim the right to file suit even if the two firms do not produce competing products and have no concrete plans for doing so. For example, when Sensormatic, a producer of
The two antitrust agencies, created to deal with issues that arose a hundred years ago, have reason to fear that events will pass them by.

electronic surveillance systems, proposed to acquire Krogo’s non North American assets, in particular its patented “SuperStrip” technology, the FTC forced a consent decree by which Sensormatic obtained only nonexclusive rights for North America.

Though the Federal Trade Commission remains enthusiastic about the idea of “innovation markets,” the antitrust industry — the private attorneys and economists who advise defendants — has not. When the FTC held hearings on the “changing nature of competition in a global and innovation-driven age” last fall, a series of witnesses from leading antitrust firms criticized the idea. “The witnesses were concerned...with the enormous practical difficulties in applying the concept,” according to a newsletter from Arent Fox Kintner Plotkin and Kahn, a Washington-based law firm. For example, conventional merger analysis relies heavily on the use of market share data, but analysis of an “innovation market” merger would result in a very slippery and speculative discussion of possible future market shares for products whose characteristics and potential uses are not yet known.

The current debate over innovation markets illustrates the “political economy of antitrust.” The antitrust authorities are rightly concerned that a good deal of economic deal-making will fall outside of their traditional grasp as the production of knowledge becomes less centralized and gains in importance compared to the production of physical goods. The two antitrust agencies, created to deal with issues that arose a hundred years ago, have reason to fear that events will pass them by.

Interestingly, representatives of the private antitrust industry, who would ordinarily stand to gain from a new antitrust initiative, urge caution. Strictly from the standpoint of private gain, it is not hard to understand why. If the antitrust laws are very clear, there is little role for lawyers and economists. On the other hand, if the implications of antitrust concepts are unpredictable even to specialists in the field, lawyers and economists could offer little useful advice to their clients. As with legal rules generally, the interests of “transactions costs specialists” are served if the rules are complex enough to require specialists, but not chaotic and unpredictable to the specialists themselves. Though the agencies may be successful initially in stopping mergers or technology transfers, or in wringing consent decrees on “innovation market” grounds, widespread use of the concept may lead to unpleasant surprises and a backlash against antitrust.

THE FUTURE

The Hippocratic oath requires physicians above all to do no harm. Unfortunately, medical knowledge lagged behind medical ethics, and doctors bled patients as recently as 150 years ago — only a short half century before the Sherman Act was signed. A Hippocratic oath for antitrust officials would require them also to do no harm, taking into account the state of empirically based economic knowledge. Here too, severe and unnecessary bleeding has taken place.

Over its hundred-odd years, antitrust has caused the most harm when it succumbed to short-term political pressure. George Shultz, former dean of the University of Chicago business school and former Secretary of State, once told a group of graduate students: “The most important thing in politics is to know when to sit on your hands.” New technologies and the emergence of new large firms generate political pressures, partly from those who have something to fear and partly from those who do not. Given the hard-won experience of the waning 20th century, antitrust in the 21st century will serve the public best if it learns to sit on its hands.

George Bittlingmayer is a professor of economics and finance at the Graduate School of Management, University of California, Davis.
A NOTE FROM THE INSTITUTE

"Los Angeles: Rebuilding for the Next Five Years" is a conference sponsored by the Milken Institute for Job & Capital Formation, which has long been involved in the study of America's inner cities, in conjunction with Rebuild L.A. (RLA) and the Los Angeles Office of the Mayor. The conference is co-sponsored by the Asian Business League of Southern California, Bank of America, the Economic Development Corporation of Los Angeles County, the Latino Business Association, the Los Angeles Area Chamber of Commerce, the Los Angeles County Federation of Labor, the Los Angeles Urban League, the National Association of Women Business Owners - Los Angeles Chapter (NAWBO), the Valley Industry and Commerce Association (VICA), the Ralphs Grocery Company, and other leading business and community organizations.

This important gathering on April 23, 1997 at the Los Angeles Convention Center brings together leaders from throughout the city, including businesspeople, entrepreneurs, community activists, public officials, journalists, academics, and economic experts to focus on the progress that has been made in creating new jobs and economic opportunity in Los Angeles' neglected communities.

The day includes commentary by RLA board member and current chairman Kathleen Brown, who will moderate an opening session that includes presentations by Mayor Richard Riordan, RLA president and CEO Linda Griego, and Los Angeles author, commentator, and Institute adjunct scholar Joel Kotkin. A speaker from outside Los Angeles will give a broader perspective on opportunities for economic development in disadvantaged neighborhoods.

Key to the success of the conference will be four workshops focusing on the economic barriers and opportunities facing Los Angeles in the areas of education and job training, capital access, taxes and regulation, and political and institutional reforms.

Joel Kotkin, John M. Olin Fellow with the Pepperdine University Institute for Public Policy, has recently joined the Milken Institute as an Adjunct Scholar. He is currently working on some urban finance issues and is developing conference programs in urban economic development.

Joel is also a business trends analyst for KTTV/Fox Television, where he won the Golden Mike Award (1994) for business reporting on the changing dynamics of the entertainment industry. He has testified before the Joint Economic Committee of the Congress and the State of California Economic Strategy Panel; is a contributing editor to the Los Angeles Times Opinion section, a columnist with the Jewish Journal, and a frequent contributor to The Wall Street Journal and Inc. magazine. His interests include the importance of ethnicity and the new economy of cities, and his articles have appeared in such publications as the New York Times, the Washington Post, Los Angeles magazine, Reason, Buzz, American Enterprise, City Journal, and the New Democrat. He is seen frequently on national news programs. Kotkin co-authored the Center for the New West's report, "California: A 21st Century Prospectus," and edited the Pepperdine University Institute for Public Policy's October 1996 report, "The Emerging Latino Middle Class." He is author of four books: TRIBES: How Race, Religion, and Identity Determine Success in the New Global Economy; California, Inc.; The Valley; and, with Yoriko Kishimoto, The Third Century: America's Resurgence in the Asian Era.

The Milken Institute is pleased to announce the release of "Taxes and Fees in Los Angeles: A Comparison Across Residents and Businesses: A Report for the City of Los Angeles," by Elaine Reardon. The full text of this city-commissioned report is now available. An executive summary will be available shortly as a Milken Institute Policy Report.