#### Shaping U.S. Antitrust

Stephen Martin

6 June 2013

#### Introduction

- In 1965, Richard Hofstadter published "What happened to the antitrust movement?"
- My answer (so far):
  - What happened to U.S. antitrust can be traced to a change in the views about the role of government among University of Chicago economists.
  - The reasons for that change remain to be understood.
- In what follows, I
  - outline the views of the First Chicago School,
  - compare these views with those of the Second Chicago School, with emphasis on Aaron Director and George Stigler, and
  - lay out open research questions.

#### Chicago I Henry Simons

The work of Henry Simons characterized the views of University of Chicago economists between the world wars (Director, 1948, p. v):

Through his writings and more especially through his teaching at the University of Chicago, he was slowly establishing himself as the head of a "school." Just as Lord Keynes provided a respectable foundation for the adherents of collectivism, so Simons was providing a respectable foundation for the older faith of freedom and equality."

# Chicago I Henry Simons

#### In his 1934 pamphlet, A Positive Program for Laissez Faire

- Simons advocated policies to maintain effective competition, in markets where effective competition was consistent with technical efficiency, not only for reasons of market efficiency, but because maximizing the role of effective competition would make it possible to minimize the role of the state (Simons, 1948 [1934], p. 42).
- He deprecated what would later come to be called rent-seeking, as destructive of democratic institutions and leading to corporatism (1936, p. 75).
- He concluded that experience had shown that regulation would not work (1934 [1948], pp. 50-51).
- Advocated government ownership of (1934 [1948], p. 51) "both the railroads and the utilities, and all other industries in which it is impossible to maintain effectively competitive conditions" as the lesser of the two evils, relative to regulation.

#### Chicago I Henry Simons

- Simons was skeptical about the existence of widespread economies of scale, but was willing to give up some productive efficiency to maintain a system of dispersed power (1934 [1948], p. 52).
- To this end, he advocated federal chartering of corporations, prohibiting corporations from holding shares in other corporations, and establishing industry-specific upper bounds on firm sizes (1934 [1948], p. 59).
- He advised lowering tariffs, in part because with low tariffs, larger domestic firm size would be consistent with competitive markets (1934 [1948], pp. 69–70), and in part because the possibility of obtaining tariff protection was an incentive for rent-seeking.

# Chicago II Aaron Director

- Aaron Director ran the Free-Market Study at the University of Chicago from 1946-1952, and its successor the Antitrust Project from 1952-1956.
- In 1947, Director's views were very much in line with those of Henry Simons (Van Horn, 2009, p. 212):

The unlimited power of corporations must be removed. Excessive size can be challenged through the prohibition of corporate ownership of other corporations, through the elimination of interlocking directorates, through a limitation of the scope of activity of corporations, through increased control of enterprise by property owners and perhaps too through a direct limitation of the size of corporate enterprise.

## Chicago II Aaron Director

Aaron Director's views on antitrust changed, by fits and starts.

- In 1951, he wrote favorably of antitrust, and critically of patent rights and tariff protection.
- But as early as 1950 he expressed views that anticipate the position that antitrust policy is not necessary, that market processes erode market power (1950)
  - (p. 165): "Enterprise monopoly is evidently held in check by entry of new firms;"
  - (p. 166): "the effective tendency of the market system to destroy all types of monopoly," and
  - (p. 166): "So far in the absence of government aid and encouragement the competitive tendencies have triumphed over the exclusive or restrictive tendencies."

# Chicago II Aaron Director

- In 1951, on the one hand his views on the relative merits of regulation and government ownership, where called for, were still very much those of Henry Simons (1951b, p. 21).
- But he thought that takeover threats in the market for financial capital nullified the possibility of the separation of corporate ownership and control.

#### Aaron Director: empirical support?

- Nutter (1951), a Chicago Ph.D. dissertation (with Director and Milton Friedman on the committee) concludes that seller concentration in manufacturing showed no persistent tendency to increase over time.
- Weston (1953), following up on a research suggestion from Director, found that there was some contribution of mergers to the growth of large firms, but that this influence was largely felt before 1903 (around the end of the first great U.S. merger wave), and that by 1948, mergers accounted for about one-quarter of the growth of large firms. Weston's economic conclusions were appropriately cautious; his policy advice was skeptical toward the need for intervention (1953, p. 105).
- This may be empirical evidence that suggested less of a need for interventionist antitrust policy than had hitherto been thought.
- But Weston's work was far from compelling; it was sharply criticized by Stigler, who found that Weston's results implied (1956, p. 40)
   "merger has been the basic method by which individual firms have acquired high shares in major industries in the United States."

Aaron Director: empirical support — or not?

Posner describes Director's fundamental insight as (1979, p. 928, footnotes omitted, not set off as a list in the original)

[F]irms cannot in general obtain or enhance monopoly power by unilateral action—unless, of course, they are irrationally willing to trade profits for position. Consequently, the focus of the antitrust laws should not be on unilateral action; it should instead be on:

- (1) cartels and
- (2) horizontal mergers large enough either to create monopoly directly, as in the classic trust cases, or to facilitate cartelization by drastically reducing the number of significant sellers in the market.

Aaron Director: empirical support — or not?

• Posner (1979, p. 931):

[Director] explained tie-ins, resale price maintenance, and other business behavior described in antitrust cases not by studying the practices but by looking for an explanation for them that squared with basic economic theory.

• Posner (1979, p. 931, footnote 13):

It is a curiosity, and a source of regret, that to this day very few of Director's ideas have been subjected to systematic empirical examination.

#### Aaron Director: influence

- Director published little; his students published a great deal, and often credited him as the source of their inspirations (see Bork (1954), Bowman (1957), McGee (1958), Telser (1960), and others).
- For Priest, Director came to hold two views that became central to Chicago II (2010, p. 7):
  - (1) that markets are superior to any form of governmental, including judicial, intervention; and
  - (2) that judicial interventions generally have no coherent analytical basis . . .
- If Priest is correct, research on the Chicago I-Chicago II change in views should look at examinations of landmark antitrust decisions by the Free-Market Study and the Antitrust Project.

#### Aaron Director: influence

• To further these views, according to Priest, Director as founding editor of the *Journal of Law and Economics*, and his successor, published a series of papers the intension of which was to discredit antitrust policy. Commenting on McGee's (1958) examination of the trial record in Standard Oil, Priest writes (2010, p. 4, footnotes giving citations omitted):

McGee's point, surely encouraged by Director, was to demonstrate that the justification given by the Court and accepted in popular opinion for governmental interference in this famous case was basically nonsense.

 McGee's reading of the Standard Oil case record has been called into question; see Dalton and Esposito (2007).

Aaron Director: influence

#### Priest continues:

Most of the other articles criticizing antitrust law solicited or encouraged by Director and Coase were of that nature: [not set off as a list in the original]

- Telser's study of resale price maintenance, criticizing the Supreme Court's General Electric opinion;
- Ward Bowman's and, later, Ken Dam's work on tying arrangements;
- Stigler's article on the U.S. Steel case;
- John Peterman's studies of International Salt and, later, Brown Shoe.

Although these articles generated substantial new learning concerning industrial practices, the underlying aim of the antitrust program was only partially scientific advance; more centrally, it was to ridicule the grounds upon which courts interfered with the marketplace.

#### The Mont Pelerin Society

In preparation.

- For the first one-third of his career, George Stigler's antitrust views were much like those of Henry Simons.
- In a 1952 article in Fortune magazine,
  - he criticized the market power exercised by large firms and by unions,
  - advocating breaking up "giant companies," a policy the referred to as
  - "the minimum program, and ... essentially a conservative program.
- He was critical of Harberger's (1954) estimates of the deadweight welfare loss from the exercise of market power in U.S. manufacturing,
- asserting that market power remaining a proper subject of policy concern (1956a, p. 35);
- He expressed confidence in the ability of courts to intervene in market processes on a coherent analytical basis (1956b, pp. 506-507).

- In 1958, the year he moved from Columbia University to Chicago, Stigler gave the first Henry Simons Lecture at the Chicago Law School.
- Here he identified "The supreme goal of the Western world" as "the creation for the individual of a maximum area of personal freedom,"
- and in pursuit of this goal regretted declining support for promotion of competition, one sign of which was that

Since the war our antitrust policy has drifted into a spiritless action against the more blatant forms of conspiracy and monopolization. While the federal government has been opening up these back lots to individual freedom, it has quietly been erecting barriers to individual action throughout the prairies of economic life, with its paternalistic small-business programs and the regulation of competitive industries such as agriculture, motor trucking, and housing.

 These views are not those of an economist who has come around to the position that a spirited antitrust policy is inconsistent with personal freedom.

• In 1959, Stigler claimed that training in economics tended to make the professional economist conservative in the sense of

a person who wishes most economic activity to be conducted by private enterprise, and who believes that abuses of private power will usually be checked, and incitements to efficiency and progress usually provided, by the forces of competition.

 He characterized support for antitrust policy as a conservative position (1959, p. 525)

[Economists] have been campfollowers, when not critics, in the area of egalitarian policies, in the areas of state intervention in competitive markets, including agriculture, labor, and housing. In fact they have been leaders only in the areas of freer trade policy and antitrust policy, two traditional elements of the conservative position, and in the fields of monetary and fiscal policy, where the paramount role of the state has always been acknowledged although the script for that role has been much debated.

- Stigler came to repudiate these Chicago I views
- in favor of the Chicago credo that (1988, p. 93) "people act efficiently in their own interests,"
- a credo that (1988, p. 94) he attributed to Chicago because that is where he learned it.
- It seems likely that he learned this credo after his 1958 move from Columbia to the Graduate School of Business at the University of Chicago.
- Timing alone makes it difficult to attribute the difference between Stigler's early and later view to the Free Market Study and the Antitrust Project; the relation to his association with the Mont Pèlerin Society remains unclear.

#### What happened?

- U.S. antitrust, *circa* 1950, was the object of a program designed to narrow its scope
  - from a policy that sought to maintain effective competition as a means of preserving "the game of representative government"
  - to a policy that assumes actions of individual firms are efficient in a Kaldor-Hicks welfare sense, and as part and parcel of that assumptions, denies that it is possible to limit rent-seeking by any means other than the limitation of government presence in the economy.
- This program came out of the 1946–1956 Free Market Study and Antitrust Project at the University of Chicago, both organized by Aaron Director.

#### What happened?

- There was little if any empirical support for the influential Chicago II "theorem" that firms cannot acquire or maintain market power by unilateral action.
- The hypothesis that the views of Chicago economists were influenced by the views of corporate funders remains to be demonstrated.
- The role of the Mont Pèlerin Society in the change in Chicago views in general, and in the views of George Stigler, remains unclear, as does the continuing influence of Chicago II views on U.S. courts.