ANTITRUST AND BUSINESS HISTORY

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What are the lessons of business history for antitrust policy? In particular, what are the lessons of business history for policies toward firms or practices that Standard Oil has come to symbolize: firms with monopoly power, firms that engage in predatory practices or vertical restraints, or more broadly, firms that just seem too big? There is an interesting and provocative literature that examines the practices and impact that such firms or practices have on consumers and competition. Several of the papers in this volume address the question of whether Standard Oil itself harmed consumers or competition. This discussion is active, after a century, in part because it gets to the underlying question of whether firms ever engage in predatory practices or whether such practices can in fact harm consumers.

The first and most important lesson for policymakers today is that it is a mistake to sequence policies against price fixing and policies against monopolization. Because anti-cartel policies are simpler and easier to adopt and enforce, requiring less capacity on the part of newly formed competition authorities, the International Competition Network and others have encouraged or accepted such a sequencing in the establishment of competition laws. But this sequencing encourages firms to merge rather than to compete, as occurred during the 1890s. The historical research, primarily but certainly not exclusively research by Naomi Lamoreaux, now at Yale, upended claims by Alfred Chandler and others that the merger movement of the 1890s was primarily about creating new, more efficient organizational forms, and not about market control.[1] Those firms were

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1. ALFRED CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977) provides the seminal history emphasizing the essential efficiency gains associated with late nineteenth and early twentieth century consolidation. NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895–1904 (1985) provides the authoritative refutation of Chandler's discussion of the motivation for merger. WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA (1997) analyzes the comparative legal

rationalized after they were created, but they were created in order to control markets.[2] Mergers are arguably more detrimental to competition than price fixing. Competition policy is generally more sympathetic to mergers than to price fixing, since the former have potential efficiency gains not usually associated with the latter. But those potential efficiency gains must be weighed against the efficiency costs of merger, which are often much greater than the proponents and managers expect.[3] Mergers are also more durable than cartels, and they are more likely to affect entry and innovation. The literature on semi-collusion actually suggest that price fixing may encourage more intense competition and investment in nonprice strategic variables, such as capacity, advertising or R&D.[4] Cartels do not, as is sometimes claimed, simply fall apart. My work with Valerie Suslow suggests that many cartels last about five years.[5] Like new firms, many cartels fail quickly, but some endure. And cartels certainly do their best to control entry and sometimes even try to control innovation that would disrupt the cartel.[6] But a merger of existing firms is much less likely to break up, with a natural process restoring competition, and more likely to be successful at restricting the introduction of technological innovations that could destabilize the market.

Business historians used to think, following Chandler—and Adam Smith and Karl Marx and most nineteenth-century thinkers—that larger firms were inevitable, and that bigger was almost always better. One of my favorite moments in reading Herbert Dow's correspondence was when he

foundation for merger across states to support a provocative analysis of this period.

2. See Naomi R. Lamoreaux, *Reframing the Past: Thoughts about Business Leadership and Decision Making Under Uncertainty*, 2 ENTERPRISE & SOC'Y 632 (2001) (presidential address to the Business History Conference) for a discussion of ex post rationalization of business decisionmaking. See DANIEL KAHNEMAN, THINKING, FAST AND SLOW (2011) for a discussion of rationality and economic decisionmaking.

3. There is a large literature evaluating the gains and losses associated with merger. A valuable historical sociological approach to the question can be found in CHARLES PERROW, ORGANIZING AMERICA: WEALTH, POWER, AND THE ORIGINS OF CORPORATE CAPITALISM (2002).

4. Chaim Fershtman & Neil Gandal, *Disadvantageous Semicollusion*, 12 INT'L J. INDUS. ORG. 141 (1994) gives a theoretical presentation of the impact of semicollusion on efficiency. *See also* Frode Steen & Lars Sørgard, *Semicollusion in the Norwegian Cement Market*, 43 EUR. ECON. REV. 1775 (1999); Lars-Hendrik Röller & Frode Steen, *On the Workings of a Cartel: Evidence from the Norwegian Cement Industry*, 96 AM. ECON. REV. 321 (2006).

5. *See* Margaret C. Levenstein & Valerie Y. Suslow, *Breaking Up is Hard to Do: Determinants of Cartel Duration*, 54 J.L. & ECON. 455, 463 tbl.1 (2011).

6. Margaret C. Levenstein & Valerie Y. Suslow, *What Determines Cartel Success*, 44 J. ECON. LITERATURE 43, 74–75 (2006); Margaret C. Levenstein & Valerie Y. Suslow, *Contemporary International Cartels and Developing Countries: Economic Effects and Implications for Competition Policy*, 71 ANTITRUST L.J. 801, 821–24, 834 (2004) [hereinafter Levenstein & Suslow, *Contemporary International Cartels*].

wrote to Henry Osborn, a member of the then-recently formed Dow Chemical Company's Board of Directors, in 1903, that the age of the small firm had passed.

> The day of small manufacturing business in every line has either gone by or will soon be a thing of the past. A man can accomplish so much more when working at one thing all the while than he can when changing around from one job to another so that it gives a big concern where men do not change their jobs a big advantage. I think, however, the handling of things in a big way has more of an advantage from some other points than it has from the above mentioned, for example, one man can handle the blowing out apparatus and analyze the Bromin brine if our Bromin plant was ten times as big as any we have ever had. Again, the well man that is working all the while on well repair jobs gets so familiar with the different kinds of accidents that occur that he knows how to take care of them with facility, and he has all the tools on hand that are necessary for this work. Looking at it from another stand point, if a little concern makes money they are bound to have an unlimited amount of competition sooner or later as there are lots of people in the country who could command enough money for a little business, and would take chances of litigation with a small concern who would not dare antagonize a large concern. For my own part I am very well satisfied that this Company is going to make a lot of money out of Bleaching Powder and allied things, but the present fight on Bleaching Powder, which is world wide, has prevented any of the Bleaching Powder makers from making very much money.[7]

Dow's description of the gains from size sound remarkably like those of Adam Smith's pin factory and reflect the widespread presumption that there are efficiency gains associated with size. But his assertion that "if a little concern makes money they are bound to have an unlimited amount of competition sooner or later" reflects the experience of his own small firm trying to enter a market controlled by large, incumbent, dominant firms with longstanding agreements to divide the market and restrain competition.[8] It was the restrictions on market access created by large firms that motivated Dow's insistence that his firm would have to achieve similar size. That is, the imperative for size is not simply about efficiency gains. It is about access to markets and the ability to prevent predation.

7. Letter from H.H. Dow, Founder, Dow Chem. Co., to J.H. Osborn, Member, Dow Chem. Co. Bd. of Dirs. (Nov. 3, 1903) (on file with Post Street Archives, Herbert Dow Papers, File #030030).

8. See Margaret Levenstein, *Mass Production Conquers the Pool: Firm Organization and the Nature of Competition in the Nineteenth Century*, 55 J. ECON. HIST. 575 (1995) for more details on competition and collusion in the bleach industry and its impact on the early years of the Dow Chemical Company.

The notion that there is little downside risk associated with increasing size is widely accepted in both economics and antitrust policy. In modeling the firm, we show that a large firm can always replicate any efficiency of small firms by permitting decentralization among the component parts of the firm. But small firms cannot achieve the coordination or economies available to large firms. This presumption that large firms can always do what small firms could do, but not vice versa, resembles the assumption built into virtually all economic models that more choice is better than less choice: we can always ignore choices we do not prefer. But it turns out that this assumption is false once one looks at real human beings for whom making decisions requires real resources.

A new generation of post-Chandlerian business historians has discovered small firms—networks of firms.[9] These firms did not just disappear as technological change created economies of scale. In different regions of the United States and the world, firms that are not gargantuan have been showed to be viable and innovative, able to lead in the creation of new industries, new products, jobs and productivity growth. But state policy and regulation often favor large firms, sometimes unintentionally. Sometimes this is the result of straight-up regulatory capture, in which firms lobby to protect themselves from competition—as has been the case, for example, in an ongoing battle over building a new bridge between Detroit and Canada. The monopoly private owner has lavished donations on state legislators to protect his monopoly, not only distorting transport costs, and increasing export and tourism costs, but also distorting the political process.[10] When we regulate, that regulation is often written by large firms, even when those large firms have created the problems that regulation is being asked to solve. This was true of the late-2000s banking crisis.[11] This was true of the regulation of the stock market after the Great

9. *See* Charles Sabel & Jonathan Zeitlin, *Historical Alternatives to Mass Production: Politics, Markets and Technology in Nineteenth-Century Industrialization*, 1 PAST AND PRESENT 108 (1985); SABEL & ZEITLIN, WORLD OF POSSIBILITIES: FLEXIBILITY AND MASS PRODUCTION IN WESTERN INDUSTRIALIZATION (1997); PHILIP SCRANTON, ENDLESS NOVELTY: SPECIALTY PRODUCTION AND AMERICAN MANUFACTURING, 1865–1925 (2000); Naomi R. Lamoreaux, Margaret Levenstein, & Kenneth L. Sokoloff, *Financing Invention during the Second Industrial Revolution: Cleveland, Ohio, 1870–1920*, *in* FINANCING INNOVATION IN THE UNITED STATES 1870 TO THE PRESENT 39, 40–41, 69 (Naomi R. Lamoreaux and Kenneth L. Sokoloff, eds., 2007).

10. *See* Dawson Bell, *Ambassador Bridge Owners Spent Nearly $5M in Ads in Attacks on Proposed Span*, DETROIT FREE PRESS, Sept. 19, 2011; Dawson Bell & Tom Walsh, *New Bridge in Canada Will Be Built, Governor Says*, DETROIT FREE PRESS, Nov. 3, 2011.

11. *See* James B. Stewart, *Volcker Rule, Once Simple, Now Boggles*, N.Y. TIMES, Oct. 21, 2011, at B1 ("Wall Street firms have spent countless millions of dollars trying to water down the original Volcker proposal and have succeeded in inserting numerous exemptions. Now they're claiming it's too complex to understand and too costly to adopt.").

Depression, which favored the New York Stock Exchange and therefore firms with connections to New York City, to the detriment of local and regional stock markets that had sprung up across the country in the late nineteenth and early twentieth centuries. These local capital markets were created by local boosters, businessmen and bankers working together to build their businesses and their region.[12] In a country where employment and economic activity are increasingly concentrated in the coasts, it's important to remember that this was also not inevitable.[13] There are externalities, so that as the size of some firms grows, there is an incentive for upstream suppliers to increase in size. For example, we have seen consolidation cascade through the automobile industry, as supplier firms attempt to achieve the size necessary to contract and bargain with original equipment manufacturers. This bias emerges when there are underfunded health and safety regulators, who rely on industry expertise to write regulations and industry capacity to self-regulate.[14] When we believe that the increasing size of firms is inevitable, we write laws and regulations that implicitly favor the large over the small, because we believe that's progress.

In the one hundred years since the United States had the audacity to break up Standard Oil, we have lost that confidence that we can shape our own economic society, to make it serve the human beings (or the environment) that should be the goal. Not just consumers, but humans, who consume and produce and live in communities and dream and hope and despair.

Research on contemporary international cartels suggests that they consist of firms that are not lacking in audacity.[15] They don't do so in random industries. They do so in industries that are highly concentrated, so much that "The cartels in our sample occur predominantly in very highly concentrated industries. The mean industry four-firm concentration ratio ("C4") is 75 percent: two-thirds of the cartels were in industries with C4 of

12. CHARLES A. COLE, REGIONAL STOCK EXCHANGES: HISTORICAL DATA (1994) (report prepared for the U.S. Securities and Exchange Commission).

13. According to the most recent estimates from the U.S. Census Bureau's American Community Survey, of the fourteen states in the Census's coastal divisions (New England, Middle Atlantic, and Pacific) all but two (Pennsylvania and Maine) had household incomes above the national median. U.S. CENSUS BUREAU, STATE MEDIUM INCOME, http://www.census.gov/hhes/www/income/data/statemedian/ (last updated Nov. 1, 2011).

14. *See, e.g.*, Mary Olson, *Managing Delegation in the FDA: Reducing Delay in New-Drug Review*, 29 J. HEALTH POL. POL'Y & L. 397 (2004).

15. *See* Levenstein & Suslow, *Contemporary International Cartels*, *supra* note 6.

75 percent or over."[16] We tell our students that concentration is not the same as collusion and that it is not a proxy for the intensity of competition. And it's true; they aren't the same thing. But a C4 of 75 percent in the global economy seems unlikely to be required to meet minimum efficient scale. It is not consistent with efficiency, and perhaps more importantly it is not consistent with democracy. Should we equate, logically, market power with market share? Of course not. But we can set informed and reasonable limits. Policymakers can make one kind of error by preventing mergers or firm growth and losing the efficiencies that size may bring; this happens when we undermine organizations because we are overzealous in our protection of competition or market access. But there is another kind of error when there is a presumption that anything goes, unless it's proven beyond a shadow of a doubt to be detrimental to competition. We need adopt a precautionary principle to protect our markets from abuse. Young firms are very important to both employment and productivity growth, so ongoing entry is critical to maintaining a dynamic economy.[17] Entry is critical to maintaining a dynamic economy.

In the last twenty years, the component organizations of Standard Oil have recombined. The component organizations of ATT have recombined. Our most important monopoly cases, Microsoft and Intel, eschewed structural remedies.[18] Our famously fragmented banking industry has seen dramatic increases in the last decade, so that the C4 of the U.S. banking increased from 34 percent to 53 percent between 2000 and 2010; the HHI increased from 497 to 877.[19] We know that in many specialized financial services there were just a few firms operating, and they engaged in the most explicit and unacceptable behavior, such as paying their competitors to exit a market. This pattern in banking is partly the result of regulatory capture: only the industry has the expertise to regulate itself, and the industry's ability to offer employment opportunities to former regulators is unsurpassed. Recent legislation creates a new statistical agency, an Office of Financial Research,[20] but the U.S. government cannot pay anyone who

16. *See* Levenstein & Suslow, *supra* note 5, at 470.

17. John Haltiwanger, Ron S. Jarmin & Javier Miranda, *Who Creates Jobs? Small vs. Large vs. Young* (Ctr. for Econ. Studies Working Paper CES-WP-10-17, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1666157.

18. Daniel L. Rubinfeld, *Maintenance of Monopoly: U.S. vs. Microsoft*, *in* THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION, AND POLICY 530, 535, 554–56 (Kohn E. Kwoka, Jr. and Lawrence J. White, eds., 5th ed. 2009).

19. *See Deposit Market Share—Pro Forma HHI Report Selection*, FED. DEPOSIT INS. CORP., http://www2.fdic.gov/SOD/sodMarketBank.asp?barItem=2 (last visited Apr. 18, 2012).

20. *See Office of Financial Research Created Under the Dodd-Frank Wall Street Reform and Consumer Protection Act: Frequently Asked Questions*, U.S. DEP'T OF THE TREASURY,

has the expertise to run such an agency a salary that will compete with employment in the private sector. Large businesses require a large state, a state capacity that we are not willing to create. But there is an alternative, and that is effective antitrust policy which is empowered to promote competitive markets.[21]

http://www.treasury.gov/initiatives/Documents/OFR_FAQ-11242010-FINAL.PDF (last visited Mar. 20, 2012), for a summary of the relevant provisions of the legislation and the plans to create the Office of Financial Research.

21. For an analysis of the implications of antitrust on business, see Benjamin Klein, *The "Hub-and-Spoke" Conspiracy that Created the Standard Oil Monopoly*, 85 S. CAL. L. REV. 459 (2012); George L. Priest, *Rethinking the Economic Basis of the Standard Oil Refining Monopoly: Dominance Against Competing Cartels*, 85 S. CAL. L. REV. 499 (2012); Daniel A. Crane, *Were Standard Oil's Rebates and Drawbacks Cost Justified?*, 85 S. CAL. L. REV. 559 (2012); Christopher R. Leslie, *Revisiting the Revisionist History of* Standard Oil, 85 S. CAL. L. REV. 573 (2012); Barak Orbach & Grace Campbell Rebling, *The Antitrust Curse of Bigness*, 85 S. CAL. L. REV. 605 (2012); William H. Page, Standard Oil *and* U.S. Steel*: Predation and Collusion in the Law of Monopolization and Mergers*, 85 S. CAL. L. REV. 657 (2012); D. Daniel Sokol, *The Strategic Use of Public and Private Litigation in Antitrust as Business Strategy*, 85 S. CAL. L. REV. 689 (2012); Andrew I. Gavil, *Moving Beyond Caricature and Characterization: The Modern Rule of Reason in Practice*, 85 S. CAL. L. REV. 733 (2012); Alan J. Meese, Standard Oil *as* Lochner*'s Trojan Horse*, 85 S. CAL. L. REV. 783 (2012); Peter C. Carstensen, *Remedies for Monopolization from* Standard Oil *to* Microsoft *and* Intel*: The Changing Nature of Monopoly Law from Elimination of Market Power to Regulation of Its Use*, 85 S. CAL. L. REV. 815 (2012); Timothy J. Muris & Bilal K. Sayyed, *The Long Shadow of* Standard Oil*: Policy, Petroleum, and Politics at the Federal Trade Commission*, 85 S. CAL. L. REV. 843 (2012).