TARRING THE TRUST: THE POLITICAL ECONOMY OF STANDARD OIL

MICHAEL REKSLUK*

WILLIAM F. SHUGHART II†

I. INTRODUCTION

It has been well established in the economics literature that the antitrust laws have been used strategically to undermine the competitive market process, whether the alleged abuses were based in fact or not.1 It should, then, come as no surprise that the origins of one of the most famous decisions in antitrust jurisprudence, the 1911 judgment by the Supreme Court against Standard Oil,2 can be traced back to an alliance of rivals that had seen their business interests hurt by John D. Rockefeller, Sr.’s innovative entrepreneurship.3 In fact, the judgment seemed to confirm early fears attributed to “[m]ost economists in the late 19th century . . . [that] the law would impede attainment of superior efficiency promised by new forms of industrial organization.”4 Others concluded later that “the

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* Associate Professor of Economics, College of Business Administration, Georgia Southern University.
† J. Fish Smith Professor in Public Choice, Jon M. Huntsman School of Business, Utah State University.
2. Standard Oil Co. v. United States, 221 U.S. 1 (1911).
enforcement of the Sherman Act over the past 95 years has probably reduced industrial competitiveness.5

On that occasion more than a century ago—an event that has been called “the mother of all monopolization cases”6—the Court decided unanimously (with Justice Harlan concurring in part and dissenting in part7) that the U.S. government had the right to impose “broader and more controlling remedies,” including the dissolution of an entire corporate entity,8 in announcing that they henceforth would apply a “rule of reason” in evaluating alleged antitrust law violations.9 The immediate fallout from the Court’s dissolution order was to disaffiliate no less than thirty-four regional successor companies, many of which would recombine decades later to create some of the most familiar names in the oil industry today, including Chevron, Sinclair, and ExxonMobil, the last of which for many years was the largest multinational corporation on the planet (Apple surpassed it in terms of market capitalization in August 2011 and again in January 2012).10

5. Thomas J. DiLorenzo, The Origins of Antitrust: An Interest-Group Perspective, 5 INT’L REV. L. & ECON. 73, 87 (1985) (“Interestingly, the great majority of economists of the day viewed competition as a dynamic process and thought that mergers (formal or informal) facilitated social coordination. There was no substantial support among economists for the Sherman Act, even from the most severe critics of laissez-faire such as Richard T. Ely. A law to prohibit mergers and combinations was thought to inhibit social coordination and to retard economic development.”).


7. Standard Oil, 221 U.S. at 82. Justice Harlan went on to write: In order that my objections to certain parts of the court’s opinion may distinctly appear, I must state the circumstances under which Congress passed the antitrust act, and trace the course of judicial decisions as to its meaning and scope. This is the more necessary because the court by its decision, when interpreted by the language of its opinion, has not only upset the long-settled interpretation of the act, but has usurped the constitutional functions of the legislative branch of the government. With all due respect for the opinions of others, I feel bound to say that what the court has said may well cause some alarm for the integrity of our institutions.

Id. at 83 (Harlan, J., concurring in part and dissenting in part).


The legislative branch of government responded to this judicial interpretation of the Sherman Act’s reach by passing two other major antitrust laws in 1914, the Clayton Act and the Federal Trade Commission Act, in an attempt to claw back some of the antitrust authority the executive branch apparently had lost in the Court’s refusal to condemn all restraints of trade. The enumeration of business conduct that was declared verboten under the Clayton Act and the establishment of a bureaucratic entity tasked with enforcing antitrust legislation were aimed at reducing the latitude firms might otherwise have enjoyed under the Court’s 1911 ruling.

If the goal of the Standard Oil decision was to diminish the “monopoly” power and the presumably ill-gotten gains from abusing that power, the remedy seemed to have failed miserably. Rockefeller, as the principal owner, tripled his wealth in the years following the dissolution decree. That is just one more indicator that more than the widely discredited “public interest theory of antitrust” was at work. It also agrees with the conclusion by Robert W. Crandall and Clifford Winston, who find “little empirical evidence that past interventions have provided much direct benefit to consumers or significantly deterred anticompetitive behavior.”

11. See Michael Reksulak et al., Titan Agonistes: The Wealth Effects of the Standard Oil (N.J.) Case, 21 RES. L. & ECON. 63, 64 (2004) (“At the beginning of 1911, Rockefeller’s net worth was approximately $300 million (in then-current dollars). By the end of 1913, he was worth three times that much, or around $900 million (more than $13 billion in today’s dollars).”); Malcolm R. Burns, The Competitive Effects of Trust-Busting: A Portfolio Analysis, 85 J. POL. ECON. 717 (1977). Plausible reasons for the positive wealth effects, in addition to the well-known defects in the Court’s dissolution order, include rising international tensions prior to the start of WWI, growing demands for diesel fuels and gasoline, and the company’s continuing ruthless search for ways to cut costs, exemplified by U.S. Patent No. 1,049,667, issued to Indiana Standard’s Dr. William M. Burton in early 1913, on the first commercially successful means of cracking relatively low-value gas oil and other middle distillates into the valuable light fractions. Gasoline could now be manufactured, literally, as well as merely recovered . . . .

On March 1, 1913, the Standard Oil Company (Indiana) announced a new “motor spirit.” It was to cost the consumer three cents a gallon, or about one-fifth less than straight-run gasoline.


12. For a history of antitrust policy emphasizing the influence of special interests, see generally WILLIAM F. SHUGHART II, ANTITRUST POLICY AND INTEREST-GROUP POLITICS (1990), and THE CAUSES AND CONSEQUENCES OF ANTITRUST: THE PUBLIC-CHOICE PERSPECTIVE (Fred S. McChesney & William F. Shughart II eds., 1995). For an earlier survey on the then-new literature, see generally Robert D. Tollison, Public Choice and Antitrust, 4 CATO J. 905 (1985).

II. RENT SEEKING BY COMPETITORS

In fact, and often completely ignored in analyses of Standard Oil, desperate competitors early on attempted to slow down the growth of Standard Oil by enlisting public officials in their self-interested drive to win concessions.

Two of the most prominent critics of Rockefeller, Ida Minerva Tarbell and her brother, clearly had personal motives and used the opportunity to tar Standard Oil’s image whenever possible. In doing so, they set the stage for the passing of the Sherman Act (1890) and the subsequent prosecution of Standard Oil for unlawful restraint of trade.

Ida Tarbell was the daughter of an oil man who had seen his fortunes crushed during the rise of the Standard Oil Company. His business was the production of wooden barrels, soon bypassed by technological improvements—many of which were introduced by Rockefeller and Co.—in the transportation and distribution of crude oil. Her brother, William, another relentless opponent and critic of Standard Oil, served as the treasurer of the Pure Oil Company. Ida Tarbell’s lurid serialized muckraking account of the “crimes” committed by Standard Oil was instrumental in the filing of the suit by the Department of Justice on November 18, 1906.

During the investigation by the U.S. Industrial Commission into Standard Oil, one of the leading witnesses against the company was none other than James W. Lee, president of Pure Oil and one of Rockefeller’s most ardent rivals.

Notably, the depiction of the company—by Ida Tarbell and other Standard Oil adversaries—as an all-crushing octopus (eerily similar to Matt Taibbi’s description of Goldman Sachs as a “vampire squid” in his

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14. See, e.g., Klein, supra note 3, which makes no mention of competitors’ attempts to slow Standard Oil’s growth by enlisting public officials.

15. See Elbert Hubbard, The Standard Oil Company 14 (1910) (describing the personal impact of Standard Oil’s inventions on the Tarbell family business: “And that view is from the ditch, where her father’s wheelbarrow was landed by a Standard Oil tank-wagon.”).


17. Standard Oil had been the target of litigation on various grounds at the U.S. state level since the late 1880s, beginning with Ohio, followed by, among others, Texas, Tennessee, Kansas, and Missouri. See Bruce Brinthurst, Antitrust and the Oil Monopoly: The Standard Oil Cases, 1890–1911, at 102 (1979) (“In all, thirty-three separate suits were filed against the combination between 1890 and 1911.”).

18. Reksulak & Shughart, supra note 3, at 274.

2010 *Rolling Stone* article\(^{20}\) was not shared by other contemporaneous observers who had studied the enterprise. Elbert Hubbard pointedly described the benefits that Standard Oil had created for its workers and consumers. Moreover, he emphatically claimed that the enterprise had played by the then-prevailing rules—and won:

The position of The Standard Oil Company in the commercial world is the result of competition. It is the natural result of a commercial struggle for existence. It is the survival of the fittest. People who hate a monopoly should reverence the Standard Oil Company. For the men who manage The Standard Oil Company went into a free-for-all field, and won their way to fortune *with exactly the same tools and weapons that all of their competitors had*. In this fight for business there was no favor asked nor given. And the battle was fought *according to the established rules of the game*.

They have done to their competitors what their competitors were trying to do to them.\(^{21}\)

III. THE SOUTH IMPROVEMENT COMPANY ENIGMA

It is largely undisputed that Standard Oil’s business practices with respect to taking advantage of railway rebates were both quite common and not illegal at the time. Klein takes pains to point out that, even if legal then, such business practices would violate current antitrust law.\(^{22}\) So what? Discriminatory railway rates had long been a way for railroads to guarantee regular traffic, a necessary lifeline for high fixed-cost entities that saw themselves as being continuously threatened by the ruinous effects of frequent “railway wars.” What, too, must be emphasized is that Standard Oil had become a leading refiner before accepting its first rebate.

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21. HUBBARD, supra note 15, at 9–10 (emphasis added). For assessments of Standard Oil that are much more balanced than those of the axe-grinding Ida Tarbell, see generally RALPH W. HIDY & MURIEL E. HIDY, PIONEERING IN BIG BUSINESS, 1882–1911 (1955), and GIBB & KNOWLTON, supra note 11. Sadly now out of print, these are the first two of the three-volume *THE HISTORY OF THE STANDARD OIL COMPANY* (NEW JERSEY), prepared under the auspices of the Business History Foundation, Inc., and published by Harper & Row in 1955.

22. See Klein, supra note 3, at 495 (emphasis added). It is easy, if not quite fully honest intellectually, to view the antitrust matters of the past through the lens of modern economic analysis and judicial procedure. As Bringhurst observes,

[T]he Standard Oil cases . . . were not determined by court decisions based upon the pertinent economic facts at issue. Hence readers familiar with contemporary antitrust litigation probably will be surprised at the relatively minor emphasis placed on economic analysis. The evolution of the suits against Standard Oil between 1890 and 1911 were primarily dependent on legal technicality, political maneuver, and press manipulation.

BRINGHURST, supra note 17, at 8.
Much ink has been spilled in crediting the creation of the South Improvement Company in the fall of 1871 as a turning point that launched Standard Oil’s rise to domination of the markets for crude oil and kerosene, the latter being the petroleum industry’s principal product up to the trust’s dissolution. Yet, the only (albeit intuitive) evidence is one of correspondence on the timeline of events. The acquisition of refineries by Standard Oil accelerated during that time period. However, one major drawback to the conclusion that the establishment of the South Improvement Company had to be responsible for the continuing growth of Standard Oil is the awkward detail that it never went into effect.

It is, in fact, highly doubtful that the mere threat that the company would secure advantageous transportation rates—as proposed by Klein—was the overwhelming reason for the willingness of independent refiners in Cleveland to sell out to Standard Oil. Contemporaneous accounts and later testimony by competitors of Standard Oil tell a different and much more convincing story.

According to newspaper reports during the period in question, the “independent” refiners, rather than being trembling bait in front of a Standard Oil giant ready to strike, immediately mustered their own muscular response. Forming a cartel of their own, these independent refiners utilized the same negotiating tactics and successfully struck agreements with railroads that were similar to the practices now advanced to accuse and convict Standard Oil of anticompetitive behavior under economic analyses of the antitrust law as now understood. It makes absolutely no sense in this context to dismiss out of hand, as Klein does, as mentioned, the firms that Rockefeller bought out were distressed because of market conditions discussed previously. Also, some of the refineries that sold out to Standard Oil were fly-by-night operations set up for the sole purpose of having Standard Oil purchase them. See CHERNOW, supra note 16, at 205 (“Aware that Standard would buy ramshackle plants to shut them down, many blackmailers entered the business in

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23. See Klein, supra note 3, at 470–71.
25. See The Oil War, N.Y. TIMES, Mar. 9, 1872, available at query.nytimes.com/mem/archive-free/pdf?res=9A01E3DB1739EF34BC4153DFB566839669FDE (“The producers . . . have found [a remedy] in pledging themselves not to sell, either directly or indirectly, a gallon of crude petroleum to the Southern Improvement Company, and to decrease the daily production of oil, in order to prevent forced sales for want of storage.”); CHERNOW, supra note 16, at 444 (“Far from being free-marketers, [the opponents of the South Improvement Company] repeatedly tried to form their own cartel to restrict output and boost prices. And, as Rockefeller pointed out, they happily took rebates whenever they could.”).
26. See Klein, supra note 3, at 470 (“Although the South Improvement Company arrangement did not go into effect, in the three-month period between when the South Improvement Company was established in late December 1871 and the demise of the Company in late March 1872, Standard Oil acquired essentially all the refineries in Cleveland, many of them at distress prices.”). As mentioned, the firms that Rockefeller bought out were distressed because of market conditions discussed previously. Also, some of the refineries that sold out to Standard Oil were fly-by-night operations set up for the sole purpose of having Standard Oil purchase them. See CHERNOW, supra note 16, at 205 (“Aware that Standard would buy ramshackle plants to shut them down, many blackmailers entered the business in
the reality that the South Improvement Company agreement never went into effect, was attacked immediately in the media and by legislators,27 and, moreover, that the overwhelmingly negative reaction to news of its proposed creation strengthened the hands of the alliance of refiners opposed to its most efficient competitor, Standard Oil.28

The other inconvenient fact in this line of thought is that even before Chief Justice White handed down the Court’s decision, new oil discoveries elsewhere already were eroding Standard Oil’s putative monopoly. Transcripts of the investigation into Standard Oil’s practices by the U.S. Industrial Commission29 present evidence, even by witnesses hostile to the Standard Oil, that this development influenced the strategic calculations by refiners. The witnesses mention “panic years” and new discoveries of “large and prolific fields” as other reasons for price declines.30 The difficulties this posed to existing small refiners because “the price was very low” was reason enough for many to contemplate selling their business interests in light of, perhaps, dwindling profits.31

In this light, subsequent attacks, through pamphlets and lawsuits against the market power of Standard Oil, can be described as yet another instance of antitrust as wealth transfer. Having lost the battle for consumers and being unable to keep pace with the constant technological innovations introduced by Standard Oil, the vanquished business interests turned to the courts and legislatures to reverse their business misfortunes.

order to sell out.

27. See The Oil War, supra note 24 (“It is announced that the Legislature will be asked to make an investigation in this particular instance . . . . The fight, to say the least, is a lively one . . . .”).
28. See The Petroleum Difficulty, N.Y. TIMES, Mar. 15, 1872, available at query.nytimes.com/mem/archive-free/pdf?res=9A04E7D7143EE43BBC4052DFB56683869FDE (“The people of the oil regions will make themselves heard on this question. There will be a party formed here which will be a nucleus to gather round those whose war-cry will be, ‘no more monopolies’ . . . .”); Gibert Holland Montague, The Rise and Supremacy of the Standard Oil Company, 16 Q.J. ECON. 265, 276 (1902) (“On January 18 the contract was signed; and, on February 27, the day after the contract went into effect, an excited mass meeting was held at Titusville and an organization to oppose the new company hastily effected. At once a complete embargo was placed on the sale of oil to the South Improvement Company. Committees were hurriedly dispatched to the railway officials, to Harrisburg, and to Washington. On March 15 a resolution was introduced into the House of Representatives at Washington to investigate the South Improvement Company. On March 25, in an agreement signed by the independent refiners, the railroads publicly abrogated their contract with the company . . . .”).
30. Id. at 107.
31. Id. GIBB & KNOWLTON, supra note 11, at 3, variously describe the oil industry of the late nineteenth century as “boisterous,” marked by “chaos and indiscriminate warfare,” and “recklessly competitive.”
VI. ANTITRUST AS WEALTH TRANSFER

To be clear, there may be cases in which antitrust law enforcement action might be advisable on the basis of economic analysis. In reality, however, interest group politics and the instrumentalization of antitrust litigation as competition by other (“uncompetitive”) means to transfer wealth make the case for the antitrust laws much less straightforward. As Justice Breyer perceptively asked in a recent major antitrust case before the Court while questioning whether the analytical tools of economics and evidentiary rules of the law will be sufficient to ascertain the facts and to fashion the proper and effective remedies, how is one to “separate the beneficial sheep from the antitrust goats”?

Of course, the assumption underlying this statement is the ability of antitrust bureaucrats and judges (and even economists) to analyze, adjudicate, and enforce antitrust legislation free of extraneous influences. However, the idea that antitrust enforcement agencies are immune to political influence by interest groups has by now been thoroughly dismissed in the literature. Equally untenable in light of empirical research is the assumption that judges “who interpret and give effect to the vague language of the antitrust statutes” are invulnerable to political influence. One study reports evidence that judges who are in line for promotion to higher courts are more likely to hand out harsher penalties in antitrust cases. Robert K. Fleck and F. Andrew Hanssen state that “judges are not as immune from external influence as many commentators suppose.”

Such patterns of influence bolster the hypothesis that major antitrust legislation was either passed or used, or both, as a wealth transfer tool over the last century. Robert B. Ekelund, Michael J. McDonald, and Robert D.

35. Id. at 449.
Tollison describe the Clayton Act of 1914 as private-interest legislation. Carlos D. Ramírez and Christian Eigen-Zucchi present statistical evidence regarding the passing of the Clayton Act and find that Senate votes on the bill can be explained to a large extent by parochial economic interests. Many other studies have questioned the claim that antitrust enforcement improves consumer welfare.

The evidence is clear and overwhelming. Antitrust legislation is both used and introduced at the behest of competitors who want to wield its blunt force and significant threat of harmful remedies to fend off successful competition. Although there are certainly instances where a complaint has merit, there are many examples where this is not the case.

The question, then, is an empirical one: Does the rate of failure in correctly adjudicating such complaints outweigh the benefits of successful enforcement of antitrust legislation to consumers? There is significant indication that this may not always be the case and that antitrust remedies serve only as a regulatory wealth transfer from successful to unsuccessful companies.

"Standard Oil" was but one instance of a case in which interest-group influence led to a significant antitrust remedy where the value in terms of any consumer welfare concept has been questionable. Given the importance that has been ascribed to the Supreme Court’s decision in the case and the continuing influence it has had over subsequent discussion regarding the dissolution of large firms, however, it is imperative that the mercantilist (rent-seeking, protectionist, and wealth-transfer) aspects of this blockbuster case not be forgotten.

Even one hundred years later, leading experts on the economics of the Standard Oil legislation are unable to agree (as this Symposium amply demonstrates)—with the benefit of a century of advances in judicial interpretation and economic analysis—what model would best describe (under current law) the illegal acquisition of market power by Rockefeller and Co. One wonders, then, how the Court in 1911 was supposed to have


gotten it “right.”

Output in the trust-dominated industries was expanding rapidly—more rapidly than it was in the economy as a whole—and the prices of those products were falling faster than the general level of prices in the deflationary period of the 1890s. But, animated by populist sentiments against the aggregation of economic power, the mindset of the antitrust establishment then, as now, can be illustrated no better than in a passage taken from the opinion of Judge Thaddeus A. Minshall, who wrote for a unanimous Ohio Supreme Court in a decision handed down on March 2, 1892:

It may be true that [Standard Oil] has improved the quality and cheapened the cost of petroleum and its products to the consumer. But such is not one of the usual or general results of a monopoly; and it is the policy of the law to regard, not what may, but what usually, happens. . . . A society in which a few men are the employers and a great body are merely employees or servants is not the most desirable in a republic; and it should be as much the policy of the laws to multiply the numbers engaged in independent pursuits or in the profits of production as to cheapen the price to the consumer.

In that light and given the propensity of antitrust enforcement to be battered by competing interests, one hundred years of Standard Oil should teach us one lesson before all others: it is prudent to be cautious whenever antitrust concerns are raised by competitors who are losing the race for innovation.

42. DiLorenzo, supra note 5, at 80.
43. State ex rel. Att’y Gen. v. Standard Oil Co. of Ohio, 49 Ohio St. 137, 186–87 (1892). See also Bringhurst, supra note 17, at 16.