The Economic Roots of Antitrust

An Outline by Thomas B. Leary

[*] Commissioner, Federal Trade Commission. This outline was prepared for a pesentation at the International Seminar on Antitrust Law and Economic Development, held at the Chinese Academy of Social Sciences Institute of Law in Beijing, China, on July 1, 2004. The outline represents my individual views, which are not necessarily the views of any other Commissioner or of the United States Government.

- In later years, additional competition laws were passed. The idea was to add some specificity to the Sherman Act's very general language and to deal with some practices at an early stage, before they had caused significant competitive harm. Thus, mergers were first specifically addressed in the 1914 Clayton Act. In the same year, the Federal Trade Commission (FTC) was created to provide administrative guidance on what was and what was not acceptable business conduct.

  - Standards of illegality, however, continued to be expressed in general terms. The Clayton Act's test for a merger was whether the deal would "substantially . . . lessen competition, or . . . tend to create a monopoly," without further elaboration (Section 7).

  - Similarly, the Federal Trade Commission Act prohibited "[u]nfair methods of competition," without further elaboration (Section 5).

  - General standards of this kind have the advantage of flexibility, and they have allowed the law to evolve with advances in the understanding of the commercial world.

  - General language, however, has also permitted application of competition law in ways that we now believe were profoundly mistaken.

- The interpretation of U.S. competition law as recently as thirty years ago was characterized, first and foremost, by a substantial concern over the sheer size of some business enterprises. Size and substantial resources alone were considered troublesome because - -

  - They would allow a company to "subsidize" some operations with profits from other operations, and thereby permit below-cost pricing and other aggressive tactics to drive targeted competitors out of business.
  - They would allow a company to invest in state-of-the-art facilities, or engage in research to develop better products or production methods - - in short, to become more efficient. This efficiency would confer a "competitive advantage" that could make it harder for smaller companies to survive.[1]

  - They would allow a company to shape consumer demand by extensive advertising and promotion, and even to affect the political environment, to the detriment of small enterprises and of society as a whole.

[1] Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

- Other antitrust principles were based ultimately on a suspicion of size and special concern for small businesses.

  - It was assumed that so-called “concentrated” industries, dominated by a few large competitors, would inevitably be less competitive - - with excessive profits and less innovation.

  - All so-called “vertical” restraints that limited a dealer’s choices in the resale of products were assumed to be anti-competitive.

  - Intellectual property laws, which can confer some market power, were narrowly construed as contrary to basic antitrust principles.

- Beginning in the late 1970s, there was a dramatic change in the applications of competition law in the U.S. There were various contributing factors, but two are worth special mention:

  - Certain basic U.S. industries - - like steel, autos and consumer electronics- - were dramatically affected by efficient foreign competition. It became apparent that the U.S. could not continue a domestic competition policy that was fundamentally hostile to efficiency.

  - Policymakers became aware of emerging economic theories - - the socalled “new learning” - - which reflected a deeper understanding of the ways that industries operate. These theories demonstrated that certain business strategies, previously considered harmful, were in fact beneficial or benign. (Exclusive dealing or vertical restraints, for example, could be pro-consumer in many circumstances.)

  - At the same time, further economic research suggested that the higher profitability of large companies in concentrated industries was explained by their superior efficiency.

- In 1977, this “new learning” was embraced by the U.S. Supreme Court in the landmark Sylvania decision.[1] The narrow question before the Court involved the legality of territorial restrictions on dealer sales but the Court took the opportunity

Consumer welfare is defined primarily to mean competitive prices and freedom of choice, not more nebulous social and political concerns.

- This does not mean that other social or political objectives - - like employment, balance of payments, health and safety, or environmental protection - - are unimportant. It does mean that these matters are not relevant when interpreting competition laws.

- It is also appropriate for the competition law agencies openly to advocate that other government agencies, which do have direct responsibility for these social and political matters, consider regulation that relies to the greatest possible extent on private incentives rather than detailed controls. We call this "competition advocacy."

• Efficiency is good and efforts to preserve efficiency should be encouraged, not condemned.

  - Sheer size can be beneficial because it may enable companies to achieve economics of scale and scope.

  - We want companies to grow and to earn higher profits that flow from superior efficiency.

  - On the other hand, a large enterprise that is shielded from competition - - either as a result of its own predatory behavior or, perhaps, a government-granted monopoly - - is likely to become progressively more inefficient over time.
  - If any company - - even a monopolist - - has achieved its market position by superior efficiency or by innovation, it is free to charge whatever prices it wants.

• Consumer welfare depends on the health of the competitive process overall, not the survival of an individual competitor or group of competitors.

  - The competitive struggle means that there are "winners" and "losers."

  - The important thing is to preserve competitive opportunities for efficient enterprises, not to preserve competitors that have fallen behind.

• Competition laws focus on effects within the United States and make no distinctions based on the nationality of enterprises.

  - Foreign companies which do business in the U.S. are subject to the same rules as purely domestic concerns.

  - We do not regulate the competitive conduct of U.S. firms abroad, unless

[2] This quotation is from a speech by William Baxter, the head of the DOJ's antitrust Division in the early 1980s.

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- Mergers are of less concern in industries that are easy for competitors to enter, for obvious reasons. There has, however, been an evolution that

[11]See statistics set out in the Leary article, supra n.3.

the consideration of actual cases with an international dimension.

- We hope to lay the groundwork for similar interchanges with China.
- We believe that it is desirable to seek convergence in the application of