The Economic Roots of Antitrust

An Outline by Thomas B. Leary*

I. Introduction

- I am pleased to join Hew Pate on this first high-level visit by U.S. Antitrust officials to China, following a number of staff visits in the last year and a half. We understand that China will soon adopt a national competition law. Our goal in the meetings here is to start a more formal dialogue with key agencies and officials here.

- The United States is a young country - - particularly, when compared to China. Competition law is one of the very few areas where we have had a longer experience than most, so it is not surprising that we are proud of it and like to talk about it. We hope that other countries will benefit from a discussion of our experience, including a candid admission of some mistakes that we have made.

- With that objective in mind, I would like to provide a brief overview of how competition law principles have evolved in the United States, from early populist concerns to the present emphasis on economics.

II. A Summary History of Competition Law in the United States.

- U.S. competition law is based on the Sherman Act, which was passed in 1890. The statute, which is still the bedrock of our law, broadly prohibited contracts "in restraint of trade" (Section 1) and actions to "monopolize" (Section 2).

  The language of the statute is general enough, and the legislative history is vague enough, to support varied interpretations in the intervening 114 years.

  - It is noteworthy that in 1890, 65% of the people in the U.S. lived in rural areas. (The figure is under 25% today.) These people had limited experience with large business institutions and were suspicious of them.

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*Commissioner, Federal Trade Commission. This outline was prepared for a presentation 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.

- The U.S. was then a huge and thinly populated country, relatively isolated by distance from the rest of the world. It is therefore not surprising that early interpretations of the law reflected these insular attitudes.

• 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

- 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.

• 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:

  - Cert- -on:

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

- 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 there are some spillover effect in the U.S., and expect that these firms will be governed by the competition laws of the countries in which they do business.

• Improvements in consumer welfare are ultimately dependent on innovation and innovation itself ultimately depends both on aggressive competition and the protection of intellectual property.

  - U.S. competition law accommodates the protection of intellectual property - - even though there may be some immediate cost to consumers - - because it will encourage innovation over the long run.

  - Laws that protect intellectual property are no longer regarded as anticompetitive anomalies and they are no longer interpreted narrowly.

• Consumer welfare economics also explains the link between what we think of as “competition” laws and those that deal with “consumer protection.”

  - The FTC shares jurisdiction with the Department of Justice (DOJ) in -0.0006 Tw[(be goverL)1r to the tt8.7((“unfair rovem)8.6(e)-anddrov(x8l.7(ofS)]Tfnt of J

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IV. An Illustrative Case: The Evolution of Merger Policy

- The developments in competition law, generally outlined above, apply

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[3]For a more detailed account of merger law evolution, see Thomas Leary, The Essential Stability of Merger Policy in the United States, 69 Antitrust L.J. 105 (2002).

[4]Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

[5]Stanley Works v. FTC, 469 F.2d 498, 504-05 (2d Cir. 1972).

[6]U.S. v. Von's Grocery Co., 384 U.S. 270 (1966).

[7]U.S. v. Pabst Brewing Co., 384 U.S. 546, 552-53 (1966).

[8]Brown Shoe v. United States, supra n.4.

[9]Foremost Dairies, Inc., 60 F.T.C. 944, 1059, 1080-81 (1962).

- In the post-Sylvania environment that has prevailed for the last twenty-five years, merger policy has been based on entirely different assumptions. The principles

[10] This language appears in all versions of the Guidelines, including the most current. More extensive quotations and full citations to these Guidelines are contained in the Leary article, supra n.3. In addition, excerpts from the 1989, 1992 and 1997 Guidelines are contained in ABA Section of Antitrust Law, Antitrust Developments (5th ed. 2002).

requires more rigorous proof that entry is likely. This evolution makes it harder to defend a merger.

- Although recent merger enforcement has focused on so-called “horizontal” mergers between actual or potential competitors, there have been some isolated examples of attacks on “vertical” mergers between suppliers and customers. The principal concern with vertical transactions is the possibility that outsiders will be denied significant access to suppliers and customers. Examples are limited, however, because most vertical mergers simply result in a realignment of supplier/customer relationships, rather than outright foreclosure.

- Some process issues should be mentioned. All mergers above certain size

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

- We maintain an active dialogue with our counterparts in other countries, not only in general meetings like those we will engage in here but also in 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 merger law (or competition law generally), consistent with the needs and objectives of individual sovereign nations. An active and ongoing interchange will be helpful in achieving this objective.

• This is not to say that we are entirely satisfied with our current efforts or that we believe further changes are unnecessary. As mentioned above, merger enforcement before the fact always involves predictions of the future - - a process that we must always seek to improve but can never perfect.

Conclusion

I hope that this overview of competition policy generally, and merger policy in particular, has been of some interest to you and now I look forward to your questions and comments.