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SOME THOUGHTS ON THE FUTURE COURSE OF AMERICAN ANTITRUST LAW POLICY

David Dale Martin*

Since the very beginnings of capitalism the law in our society has embodied a policy with respect to restraint of trade, monopolization, and unfair competition. Many characteristics of that policy have evolved steadily over time, while others have remained essentially unchanged. In the next ten to fifteen years we may expect further development of the policy implicit in the antitrust law. In a world in which technology as well as political, social, and economic institutions are rapidly changing, it would be surprising if the antitrust policy component of American political and economic institutions remained static.

To forecast in detail the development of the law, however, would require prescience beyond the powers of any student of the subject. The law of antitrust is the net result of the interaction of business behavior, enforcement activity, judicial decision, and Congressional action, all of which are in turn affected by other public policy problems. Therefore, this discussion of the possible, probable, and ideal characteristics of antitrust law and policy ten to fifteen years hence will include some thoughts on the basic nature of antitrust policy, some speculation on other policy areas closely related to antitrust, and some indication of possible courses of development. I make no attempt to avoid normative value judgments since I make no claim to being a "pure" scientist.

I. ON THE NATURE OF FEDERAL ANTITRUST LAW

Public policy concerning the organization and control of economic activity has never been embodied exclusively in the antitrust laws. In the United States from earliest times public policy has sought in many ways to encourage a highly decentralized and flexible pattern of control of resources.¹ Before the emergence of the corporation as the dominant form of business organization the common law doctrines regarding restraint of trade and conspiracy

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¹ See R. ROBERTSON, *HISTORY OF THE AMERICAN ECONOMY* 99-204 (2d ed. 1964).

to monopolize served to inhibit agreements among separate competitors to control markets.² Perhaps a more important deterrent to centralization of control was the state of the general law of property and contract as applied to partnerships. The organization of a very large firm combining the property of many individual owners under central direction requires a management scheme in which decisions are binding on the various participants. The corporate charter not only gave the perpetual life desirable for long-range planning and the limited liability necessary for attraction of property owners into the combination, but also provided a legally enforceable mechanism for centralized decision making. Twentieth-century American antitrust law can be viewed as a federal counterforce to the late nineteenth-century state government legislation, which promoted centralization of control of economic activity through radical changes in certain state incorporation statutes.³

By 1903 it was obvious to Congress that inability of businessmen to work out viable plans of centralized organization could no longer be relied on to prevent unlimited combination of industry through the highly efficient mechanism of the state-chartered but privately controlled business corporation. The people of the United States demonstrated their ability to use the mechanisms of the federal government to slow down the process of centralization. In 1903 the great merger movement ended.⁴ Congress created the Antitrust Division of the United States Department of Justice, enacted the Expediting Act, and established the Bureau of Corporations, which later became the Federal Trade Commission.⁵ In

² See H. THORELLI, *THE FEDERAL ANTITRUST POLICY: ORIGINATION OF AN AMERICAN TRADITION* 36-48 (1955).

³ Between 1886 and 1895 a number of important changes were made in the New Jersey general incorporation statutes. For example, in 1886 the legislature amended the general incorporation statute to allow existing corporations to increase the number of directors and to issue new capital stock to be paid for either by cash or by land and other property with the approval of two-thirds of the existing shareholders. N.J. Laws c. 165 (1886). In 1887 foreign corporations were authorized to acquire and hold property in New Jersey. N.J. Laws c. 124 (1887). In 1888 corporations of New Jersey were allowed to merge and consolidate for limited purposes and in 1893 this privilege was extended to any two corporations engaged in the same or similar kinds of business. N.J. Laws c. 294 (1888) and N.J. Laws c. 67 (1893). In 1893 the legislature also made it lawful for any New Jersey corporation to hold capital stock of any other corporation domestic or foreign and to exercise all the powers natural persons could exercise. N.J. Laws c. 171 (1893).

⁴ Markham, *Survey of the Evidence and Findings on Mergers*, in *BUSINESS CONCENTRATION AND PRICE POLICIES* 146 (1955).

⁵ Thorelli, *supra* note 4, at 535-54.

1904 the Supreme Court decided for the government in *Northern Sec. Co. v. United States*.⁶ From that day to this the basic problem of antitrust law has been the problem of controlling and limiting corporate power to centralize control of economic activity.

How successful the policy has been is difficult to judge. The very existence and enforcement of the antitrust statutes motivates managers of corporations to keep secret many of the basic facts of ownership, control, intercorporate connections, contractual arrangements, and operations without which the economist's industry studies and measures of concentration are of limited value. In my opinion the degree of centralization achieved to date is much greater than meets the eye.⁷ Yet I am also convinced that since *Northern Securities* in 1904, the antitrust law has served to inhibit a far greater level of concentration. The incentives of businessmen and the opportunities afforded by the liberal state incorporation statutes would have resulted by now in a much more highly centralized structure of control of economic activity without federal intervention.

In considering the possible characteristics that antitrust policy and law will have ten to fifteen years hence we should not rule out the abandonment of the fight to hold the line on the degree of centralization. The Supreme Court, however, recently has given real teeth to the application of Section Seven of the Clayton Act to horizontal and vertical mergers and acquisitions, and in *United States v. First Nat'l Bank & Trust Co.*,⁸ it has also revived the pre-1920 interpretations of the Sherman Act. Nevertheless, the Court is but one force affecting the development of antitrust policy, and antitrust law is but one part of policy affecting the organization and control of economic activity in the United States and the world. We should therefore consider some of the other policy developments of recent years, their possible courses in the years ahead, and their impacts on antitrust policy.

⁶ 193 U.S. 197 (1904).

⁷ The concentration statistics compiled by the Census Bureau, for example, throw no light on the degree of community of interest among separate corporations achieved through inter-corporate stockholding of less than fifty percent, interlocking of officers and directorates, or ownership of stock by individuals and trustees in several corporations. See R. NELSON, CONCENTRATION IN THE MANUFACTURING INDUSTRIES OF THE UNITED STATES, A MIDCENTURY REPORT 7-9 (1963).

⁸ 376 U.S. 665 (1964). The economic implications of the recent Supreme Court decisions in this and other merger cases have been discussed at some length by this author in *Hearings on S. Res. 56 before the Subcomm. on Antitrust and Monopoly of the Comm. on the Judiciary*, 89th Cong., 1st Sess., pt. 2, at 687-711 (1965).

II. THE UNEMPLOYMENT-INFLATION DILEMMA

The role of the federal government in the regulation of economic activity has been important from the very beginning of the Union. But the nature of that role has changed. Throughout the nineteenth century the federal government was the promoter of economic growth and geographical expansion. In response to state actions the federal government became the limiter of centralization of control at the turn of the century; it also began the specific regulation of certain sectors of the economy such as transportation, banking, the securities markets, and broadcasting. But the Great Depression left the federal government with quite another type of regulatory function—the role of balancing aggregate demand against economic capacity that was formally recognized by Congress with the Employment Act of 1946.⁹ It was not until the 1964 tax cut, however, that fiscal policy was actually used by Congress with the purpose as well as the effect of controlling aggregate demand. Although contemporary fiscal policy is still on tenuous ground, it seems safe to predict that the President and his economic advisers, working through the Congress, will regulate total spending so as to stabilize economic activity. So momentous a change in economic policy is likely to have an effect on antitrust policy. What is this effect likely to be? To answer this question we must consider the nature of the economic stabilization problem and the policy instruments for dealing with it.

Throughout the history of America, but particularly since the great merger movement at the turn of the century, the aggregate demand for currently produced goods and services has been too small or too large. If we have actually achieved the ability to tread the fine line between too little and too much total spending, then in the years ahead we will be faced with a new set of problems—those associated with sustained periods of economic stability. The major problem likely to plague economic policymakers during the next decade is that of inflationary pressure. I do not foresee that prices will, in fact, rise rapidly over time and thereby constitute a problem. Quite the contrary, the problem lies in the consequences, or side effects, of measures that may be taken to halt inflation. The general price level can be stabilized rather easily by monetary and fiscal policies designed to hold down aggregate demand. The problem lies in the apparent facts that maintenance of a level of aggregate spending consistent with price stability will result in a chronic level of unemployment of four to five percent and a slower rate of growth of industrial capacity than would be ex-

⁹ 15 U.S.C. § 1021 (1946).

perienced if full employment were maintained.¹⁰

In terms of other important public policy goals such as the assimilation of the Negro minority into the mainstream of American life, the elimination of poverty, the improvement of education, the reduction of crime, and the building of urban public facilities, the difference between a policy of maintaining aggregate demand sufficient to reduce the employment rate to, say, two percent and a policy of tolerating five percent unemployment is very great indeed. Unemployment is likely to be concentrated in the population groups where these social problems exist, and the loss of real output of goods not produced constitutes a high price for avoiding inflation. Yet the political pressure on any administration to avoid inflation is likely to be strong, so strong that the chief economic issues in future elections may be related to the way in which prices are held in check. Policymakers will probably continue to search for ways to stabilize the price level without having to hold aggregate demand below the full-employment level. The search for ways to deal with the deflation and unemployment problems of the early thirties led, at least temporarily, to a policy of promoting through National Recovery Administration codes the very sort of anti-competitive behavior that antitrust policy attempts to prevent. Stabilization measures of the forthcoming decade may also have an impact on antitrust. Two alternative solutions to the inflation-unemployment dilemma are (1) the "price stability with unemployment" approach that was tried from 1957 through 1961 and (2) the "guidelines" approach tried since 1961.

A. THE PRICE STABILITY WITH UNEMPLOYMENT APPROACH

The "price stability with unemployment" approach was adopted after the 1955-1957 period of inflationary pressures. Monetary and fiscal policies adopted for whatever reasons had the effect of holding aggregate spending for newly produced goods and services at a level low enough to stabilize the price level. The result was a seasonally adjusted rate of unemployment that fluctuated from a low of 3.9 percent of the labor force in April 1957 to a high of 7.5 percent in July and August 1958 and was 6.7 percent in January 1961 when the Kennedy Administration took office.¹¹ Such a policy resolves the dilemma only if we accept as an acceptable full employment level whatever happens to be consistent with price stability. When such a policy was tried, investment in new plant capacity was discouraged by both "tight money" and the relatively

¹⁰ See Perry, *The Determinants of Wage Rate Changes and the Inflation-Unemployment Trade-off in the United States*, 31 REV. OF ECON. STUDIES 287-308 (1964).

¹¹ U.S. DEP'T OF COMMERCE, BUSINESS STATISTICS, 1959, 1961, and 1963.

poor outlook for the growth in demand for consumer goods. Not only was the recovery from the 1957 recession aborted and the 1960-1961 recession produced, but the policy also resulted in imbalance between the stock of capital goods (plant capacity) and the labor force of the economy. The impact of this imbalance was felt primarily by the less able, less skilled, less educated members of our society. This fact has tended to obscure the relationship between general economic policy and such apparently sociological phenomena as racial strife, urban blight, and crime in the streets.

The differential impact of an inadequate demand for labor has also tended to support the contention that the problem lies on the supply rather than on the demand side of the labor market. Unemployment is thus said to be "structural." It is undoubtedly structural in the sense that the composition of the supply of labor does not match up with the composition of the demand for labor. Yet the best solution to the unemployment problem still may be the maintenance of a higher level of aggregate demand. Why? Simply because the most important part of the vocational education of almost all workers in our society is on-the-job-training. This fact is at least as true of lawyers and doctors as it is of factory workers. In a market economy when demand for newly produced goods and services goes up, demand for specific labor services goes up. The empty positions that call for highly skilled or professionally educated and experienced workers are filled with the best available persons. Such persons are most likely already employed in less demanding jobs. Their promotion creates lower level vacancies that are filled with slightly less experienced, less able, or less educated persons who learn on the new job and generally rise to the occasion; the railroad hires a new office boy when the president retires. When demand increases for highly trained, experienced workers the result is much like that of battlefield promotions in a combat force. Jobs are created at the bottom of the ladder. Such jobs can be and are in times of high demand filled by persons previously considered unemployable, many of the women hired in World War I and World War II being examples. Experience teaches, and the structure of the labor force tends to be brought into line with the composition of demand.

B. THE GUIDELINES APPROACH

If the stabilization policymakers generally come to agree with these conclusions, we may expect strong forces to act against the readoption of the price stability with unemployment approach to the inflation-unemployment dilemma. The second alternative—the "guidelines" approach—has prevailed since 1961. The Kennedy-

Johnson Administration adopted reduction of the unemployment rate to four percent as a tentative goal, one not achieved until January 1966. Unemployment as a seasonally adjusted percentage of the civilian labor force has fluctuated between 3.5 and 3.9 during the January 1966-March 1967 period. During that period the Bureau of Labor Statistics' retail price index rose from 111.0 to 115.0 percent of the 1957-1959 base.¹²

Such a performance of the economy was, of course, excellent judged by historical standards. Recession was avoided for at least five years, and unemployment was pushed down to the lowest levels since 1956. The price level was contained, if not stabilized, the American experience being superior to that of any other country in the world.

Yet the incompatibility of full employment with price stability observed in the 1955-1957 period has again been confirmed. To stabilize prices to the extent of holding annual changes in the BLS retail index to one or two percent, we must apparently tolerate at least four percent unemployment or find some new policy measures to deal with the problem. The "guidelines" approach has not proved adequate and will be even less effective if aggregate demand is allowed to rise to a level high enough to get unemployment down still more. That further reduction in unemployment is desirable can be seen from an examination of some of the components of the labor force. In the second quarter of 1966 the seasonally adjusted unemployment rate averaged 3.9 percent of the civilian labor force. The rate for white males twenty years of age or over was only 2.2 percent. For non-white males twenty years old or over the rate was more than double at 4.8 percent. Of all whites, disregarding age, 3.5 percent were unemployed, while 7.5 percent of all non-whites were unemployed. For the fourteen through nineteen year age bracket unemployment was much higher with 11.1 percent of the young white persons in the labor force unable to find jobs and 26.7 percent of the young non-whites out of work.¹³

A basis clearly exists for political pressure to maintain a higher level of aggregate demand and a level of unemployment well below four percent. If monetary and fiscal policies are so adopted, however, inflation will result unless some change is made in the structure of control of the economy. One possibility would be the extension of the guidelines approach to include some sort of newly created governmental control mechanism. Wartime-type price and

¹² JOINT ECONOMIC COMMITTEE (U.S. Congress) ECON. INDICATORS, April 1967.

¹³ U.S. DEP'T OF LABOR, MONTHLY LABOR REV. 1180 (1966).

wage controls might be adopted when the problem becomes particularly acute. But such controls are not likely, however, unless aggregate demand is suddenly increased relatively more than events in Viet Nam have required. Even a sudden escalation of defense spending does not have to result in very great increases in inflationary pressure.

A prospect more likely than direct wartime controls is the development of some sort of "N.R.A.-type" program in which business firms are encouraged to cooperate in holding down wages and prices. The advocates of such a policy might propose that the public interest be protected by having some government agency or the President oversee and approve wage and price policies. If stabilization policy should move in the latter direction, I would expect to see the development of more and more formal governmental mechanisms for planning and coordinating private business decisions, not only on wage and price policies but on investment as well. The role of traditional antitrust policy would, of course, steadily diminish. The government might, in effect, trade off antitrust enforcement for business cooperation in the planning effort.

I would not anticipate much opposition from businessmen to such a policy evolution. On the contrary, the leaders of the business establishment in the coming decade may very well take the lead in mobilizing public opinion and political support for such a policy. We would then move closer to the Western European approach to problems of economic organization as they move toward ours. We might even see by 1980 an Atlantic Community in which economic activity is organized and controlled by a handful of huge international corporations cooperating with national and supranational governments.

If general economic policy should develop along these lines, I would not expect antitrust policy to be completely abandoned. The statutes would not likely be repealed. We might even have a great increase in the amount of legislation to deal with specific practices that arise in the new environment. A natural concomitant of such a policy evolution would be the gradual abandonment of *per se* rules and the substitution of "rule-of-reason" type criteria of illegality. The reasonableness of business practices would then be evaluated more and more by administrative agencies in the light of short-run stabilization goals rather than by judicial bodies using the traditional criterion of effect on competition in particular markets.

Once the competitive market mechanism is abandoned as the primary protector of the individual citizen from private centers of

economic power and government agencies are instead given the function of overseer, the foremost argument against bigness and concentration of control is greatly weakened. In fact, direct government regulation of business decision making probably can be carried on more efficiently if firms are bigger and fewer in number. The "guidelines" policy may lead therefore to the abandonment of the fight to limit economic concentration. The enforcement effort could be greatly lessened without changes in the law by Congress or the Supreme Court. It is a rare merger that cannot be interpreted as being conglomerate enough to have no effect on any line of commerce. If the executive branch of the government should find it consistent with its general economic policies to acquiesce in the evolution of a more concentrated structure of control of American (or international) business, it could easily do so.

III. ANTITRUST LAW AS A STABILIZATION POLICY INSTRUMENT

What are the alternatives to these two approaches to the inflation-unemployment dilemma? Aside from the unlikely possibility of public acceptance of a rather high and steady rate of price-level increase each year, this writer has thought of no alternative other than a deliberate decision on the part of the President to use the antitrust law as a policy instrument to change the structure of the economy sufficiently to make full employment compatible with price stability. This is not to say that the many efforts to improve the quality and mobility of the labor force are undesirable, but that their effectiveness will be increased greatly by the maintenance of a high level of aggregate employment and competitive markets.¹⁴ Let us now turn to the questions of why the inflation-unemployment dilemma persists and whether antitrust law can be used effectively to resolve it without the government's having to undertake antitrust actions so drastic as to be politically unfeasible.

A. THE REASONS FOR THE INFLATION PROBLEM

The inflation-unemployment dilemma results from structural characteristics in the economy that are frequently assumed away in the construction of theoretical models. One eminent British economic theorist, R. F. Harrod, recently acknowledged such a limitation in his own well-known economic growth model, saying:

¹⁴ Some proposals to limit labor union power, particularly restrictions on entry into crafts or vocations, would contribute to economic use of resources, but in my opinion union power is not the root of the problem. The power of unions in most instances stems from their power to bargain for a larger slice of a pie made large by monopoly in markets other than those for labor services.

I had to admit in the face of Professor Alexander's criticism, that, if the representative entrepreneur would not be minded, if all turned out satisfactorily, to increase orders in the same proportion at t_0 as he had done on the last round, my equation would not define a steadily sustainable warranted growth rate. But I argued that, once the representative entrepreneur's behavioral parameter was defined, there must be *some* sustainable warranted rate of growth, given that the determining forces remained unchanged. . . .

In this rejoinder I did not raise the question whether, if, owing to his behavioral parameter, the representative entrepreneur always had to be kept a little short of desired inventories and capacity, in order to make him stay on his steady growth rate, he would be thereby tempted to put up prices. If it is right to think that he would be so tempted, we have another paradox. The more *conservative* the representative entrepreneur is, the more inflation we have to have, if the economy is to be kept moving forward . . . ¹⁵

Harrod thus points up the crucial importance of an aspect of the behavior of business decision makers that is obviously related to antitrust policy, although he made no attempt in the article cited to relate the theoretical problem of inflation to the structure of control of particular markets. The question is: Can monetary and fiscal policies be used to maintain aggregate demand just sufficient to maintain a steady growth rate with full employment without inflation? Harrod's answer is "No," if business decision makers are tempted to put up prices rather than to expand capacity and increase output as aggregate demand rises. The degree of temptation to raise prices under such circumstances is restrained in the United States by Presidential guidelines and admonition. The temptation is also restrained by the degree to which one fears loss of future markets resulting from expansion of capacity and increased output by competitors. Despite the importance of this question, however, the economic literature contains scant treatment of the effect of alternative structures of industrial control on the pattern of investment in new capacity through time.

The existence of the inflation-unemployment dilemma may stimulate economists in the next few years to attempt an explanation of the consequences of alternative institutional structures and practices that affect investment in new capacity. More generally, what is the effect of alternative structures on prices and the vertical flow of productive services and materials from the underlying extractive industries up through intermediate stages to final product markets? As one extreme, such alternative institutional structures and practices include vertical integration achieved through owner-

¹⁵ Harrod, *Are Monetary and Fiscal Policies Enough?*, 74 THE ECON. J. 903, 904-05 (1964).

ship by a single corporation of land and capital at all stages of production of a line of product. At the other extreme is the decentralization of ownership among a large number of separate firms that order vertical relationships among themselves through well-organized competitive spot auction markets. In reality a large set of alternative structures exists between these two extremes. Only a few of these alternative structures have been thoroughly treated in the theoretical economic literature, *e.g.*, the special case of bilateral monopoly. It is common in economic theory—particularly in macro-theory—to assume explicitly or implicitly that all production takes place in vertically integrated firms, or that firms at various stages of production relate to each other through perfectly competitive auction markets.

In reality, firms relate vertically to each other through a large variety of complex ownership and contractual arrangements. These real-world complications, about which economists have had so little to say, are the aspects of the real world that give rise to most of the antitrust cases. Except for a few horizontal and conglomerate merger cases and price-fixing, antitrust enforcement deals primarily with the many and varied facets of vertical arrangements among firms. If such arrangements have something to do with the unemployment-inflation dilemma, then antitrust law may prove to be a crucial instrument of economic policy in the years ahead.

We need to ask what are the effects of alternative vertical arrangements on the manner in which increases in aggregate demand in a growing, fully employed, economy are passed down from final product markets to the markets for basic resources. We must also inquire into the manner in which quantities supplied and prices respond to particular demand changes. Why does a level of aggregate demand less than enough to provide full employment of labor result in increases in prices rather than greater increase in outputs of particular final products? Does it make any difference whether the structure of control includes partially owned subsidiaries; joint ventures in which firms competing at one stage of production obtain supplies of components or materials from subsidiary corporations owned jointly; long-term supply contracts in which the flow of inputs to a firm is more or less fixed by contract for a long time period; tying contracts that tie transfers of one good or service to transfers of another; leasing arrangements that transfer control of property without changing actual ownership; or franchising and agency practices? Various combinations of these and other arrangements result in markets unlike those implicitly assumed to exist in most of the economic literature.

The problem of analysis of the relationship between antitrust

policy and the inflation problem is complicated by the fact that the normal functioning of a market economy requires that particular product prices change through time. Relative price changes are necessary and useful quite apart from their effects on stabilization goals. In order to encourage the reallocation of resources to correspond to changes in relative demands for particular goods and to changes in relative scarcities of particular resources, particular prices must be free to fluctuate up and down. We cannot, therefore, in our concern about inflation jump to the conclusion that all price increases are inflationary and therefore bad, nor should we forget that prices that fail to go down enough when real costs or demand declines are contributing to inflation. The price stabilization goal requires only that some sort of average of thousands of particular prices be stabilized. Since some prices in the average need to rise over time, it follows that some must fall. The "guide-lines" policy emphasizes the prevention of unnecessary price increases, but it does little to bring about necessary decreases. The ideal antitrust policy should facilitate the resource allocative role of prices in a market system while simultaneously securing stability of the average of all prices.

As the economy grows and aggregate spending increases, we can expect differential effects in particular final product markets. Furthermore, the effect on the market demand curve (that is, the relationship between prices and quantity demanded) for a particular product will vary with the nature of the increase in aggregate spending. Increases in either real or money income of individual buyers result in an upward shift in their demand curves; that is, buyers become willing to pay a higher price for any given quantity of each good. As a result the market demand curve would also shift upward and to the right. If aggregate demand grows through time merely as a result of population growth, then the market demand for a particular produce increases not because individuals are willing to pay more but simply because more individuals exist. Such growth would result in the counterclockwise rotation of product demand curves. In reality both forces are at work so that particular product demand curves tend to shift up and also to rotate through time. We can expect the changes to vary considerably from market to market.

As the demand curve for a particular final product shifts, the suppliers of it will react with price or output changes or both. If the demand shift were accurately forecast, if output could be increased with no effect on unit costs of production, and if suppliers were perfectly competitive, profit-maximizing firms, then price would stay the same as before and output would go up enough to

clear the market. The price might rise merely because the upward shift in demand was not accurately forecast. If so, given time and the existence of the other two conditions, we could expect the price to return eventually to the lower level. If the only reason for particular prices to rise were inaccurate forecasts, the price level would rise to a higher plateau as full employment were approached, but maintenance of steady growth in aggregate demand at the full employment level would result in a stable price level with price decreases offsetting price increases through time.

The shift in demand for each particular product and the subsequent increase in its production gives rise to shifts in derived demand curves for component parts, capital equipment, labor, land, and materials used in the production of the final product. (Whether a final product producing firm responds with a proportional increase in its purchases of such inputs, or is instead tempted to put up its output price is the question raised by Professor Harrod in the article cited above.) These secondary shifts in demand in turn give rise to shifts down the line. It seems likely that the nature of these induced changes will be affected by the nature of the vertical arrangements. Arrangements that tend to result in unnecessary and permanent price increases rather than output responses somewhere along the line can be thought of as "inherently anticompetitive" to use the phrase of the Supreme Court in *Tampa Elec. Co. v. Nashville Coal Co.*¹⁶

This is not to say, however, that price responses to particular demand increases are always undesirable. The quantity of underlying resources may be naturally limited to such an extent that even in the long run the quantity offered for sale cannot be increased as rapidly as the quantity demanded at the previous price. In such cases, prices will rise for the unexpandable resource, and the increase will be passed vertically forward. The owners or controllers of the resource will receive increased economic rent. The higher price will serve the function of rationing the limited supply and stimulating the substitution of alternative resources. Such economic rent and consequent higher prices would also encourage technological development and exploration for untapped sources of supply. Exploration might take the form of search for new mineral deposits or, in the case of labor scarcity, the search for persons who might be taught to perform a new labor service. The latter phenomenon would then give rise to the battlefield promotion effect discussed above.

If it is normal that some particular prices should rise through time, and if the goal of monetary and fiscal policy is to achieve full

¹⁶ 365 U.S. 320 (1961).

employment without average prices rising, then it is obvious that some prices must fall. What force is at work to bring about a reduction in any prices as growth takes place? Even though the demand for each particular final product is rising over time, the derived demands for inputs of component parts, materials, capital equipment, land, and labor might fall through time if technological innovation is taking place. If, for example, technical changes in the production processes, embodied in changes in labor skills, changes in the form of capital, and changes in the nature of component parts and materials, result in an average three percent per year increase in productivity, then it should be possible to achieve full employment with a secularly declining price level. Prices could drop by an average percentage equal to the productivity increase. It would, of course, be possible to stabilize prices under such circumstances and allow the full increase in per capita real income to be taken out as wage, salary, or other income increases rather than price reductions. The guidelines policy is based on the idea that wage increases on the average can be held equal to average productivity gains and that price increases can be held to an average of zero, or at least to a politically tolerable rate of increase. If the policy succeeded, economic rents would rise to reflect real resource scarcities. Other income increases would just offset productivity gains.

Two circumstances might thwart the achievement of full-employment growth with stable prices. One would be the failure of productivity to increase as population growth pressed against resource supplies. So far we appear to have experienced sufficient technological change and resource discovery to more than offset population changes, and the United States, if not the world, is likely to continue to do so in the next ten to fifteen years. The other circumstance that might exist, and I think does exist, is a structure of control of production that makes possible artificial restriction of the expansion of resources through time. The quantity of underlying resources may be capable of expansion at a rate equal to the increase in the quantity demanded at the previous price for a particular product, and yet the controllers of the supply may be able to restrict the rate of expansion and thereby obtain economic rents for which there would be no need if the structure of control were inherently more competitive.

I am suggesting that rents arise for two reasons: natural scarcity and contrived scarcity. The contrived scarcity case may be very difficult to recognize and distinguish from the natural scarcity case. The economic power that gives rise to the restriction of production and the accompanying unwarranted rent may be at

any level from basic resource control through the intermediate productive stages to the final product stage. The guidelines policy is based on the explicit recognition that such power exists to contrive scarcity and administer prices. The guidelines approach seeks to encourage socially responsible use of such power rather than its dissipation. Its weakness is twofold: It brings Presidential admonition to bear on pricing decisions rather than the capacity and output decisions that underlie unwarrantedly high prices, and it tends to result in government-business cooperation to stabilize industrial sectors, thereby eroding the competition that antitrust policy seeks to promote. The best argument for the guidelines approach is that only very drastic antitrust enforcement would result in a significant contribution to the solution of the dilemma. Careful consideration of the specific role that antitrust enforcement might play therefore seems warranted.

B. THE POTENTIAL USEFULNESS OF ANTITRUST LAW

Power to contrive scarcity can result from a large variety of ownership and contractual arrangements. The law has long embodied the principle that power to enhance the price and exclude entry of competitors is unlawful.¹⁷ This legal concept of monopoly power is quite consistent with the economic concept. Both in law and in economics, however, much disagreement exists on just what observable or measurable attributes of an actual structure or set of practices constitute adequate evidence to conclude that such power exists.

Horizontal combinations that centralize control of most of the supply of a particular well defined product in a well defined market are generally recognized by the courts, the antitrust bar, and the economics profession to be unlawful and undesirable. Much controversy, and indeed much litigation centers around the definition of the product and market.¹⁸ The manner in which such a horizontal combination is brought about has also had much to do with judgments about its legality. At least since *United States v. Addyson Pipe & Steel Co.*,¹⁹ the law has presumed that agreements among separate competing suppliers to control a market are made for the purpose of monopolizing or restraining trade and will have that effect. Yet when the same suppliers have negotiated a complete centralization or control of their whole operations through merger, the law has vacillated on the question.

¹⁷ *United States v. Aluminum Co. of America*, 148 F.2d 416 (1945).

¹⁸ See Jones and Martin, *The Brown Shoe Case and the New Antimerger Policy: Comment and Reply*, 54 AM. ECON. REV. 407 (1964).

¹⁹ 85 F. 271 (6th Cir. 1898).

At the present time the Supreme Court's policy on both loose-knit and close-knit horizontal combinations is quite clear. The actual structure of control, however, is another matter. The electrical equipment cases demonstrated that loose-knit price-fixing and other horizontal market control agreements may exist for many years even though plainly illegal. Congressional and Presidential support for vigorous enforcement of this part of the law is never openly opposed by anyone, but improvement could undoubtedly be made in the effectiveness of the enforcement program if political support for it were stronger. Two measures might be taken. First, the general appropriations to the Antitrust Division and the Federal Trade Commission could be substantially increased. Secondly, both the Congress and the President could support much more collection of data from business firms about their operations. Vested interests too weak to get the law changed can often inhibit its effectiveness through parsimony and secrecy.

On close-knit combinations the Supreme Court has recently given strong teeth to the law not only in its interpretations of the Celler-Kefauver Act but also in reviving the Sherman Act's role in preventing mergers.²⁰ With Congressional tolerance and Presidential support the Antitrust Division now has a legal basis for attacking many of those close-knit combinations achieved around the turn of the century after the New Jersey incorporation statutes were liberalized but before the Sherman Act had been brought to bear on the problem in the *Northern Securities* case.²¹ Within the near future a president might resume the program of decentralizing control of manufacturing began under Theodore Roosevelt's Administration but brought to a halt by *United States v. United States Steel Corp.*²² It is just this sort of "trustbusting" activity that most present-day economists consider to be too drastic and too unlikely to have significant results to be justified. Although I disagree with that conclusion, acceptance of it still does not rule out an effective role for antitrust law in making full employment compatible with price level stability.

The effects of alternative vertical arrangements on the power of suppliers to enhance price and exclude entry is much less obvious than are the effects of horizontal combinations. The range of disagreement is much greater as well. Professor Stigler has argued that vertical integration cannot do more than transfer monopoly power from one stage to another so that the elimination of horizontal combinations at all levels is sufficient to insure perfect

²⁰ *Hearings on S. Res. 56, supra* note 8.

²¹ 193 U.S. 197 (1904).

²² 251 U.S. 417 (1919).

competition.²³ In my opinion the problem of vertical arrangements cannot be so simply disposed of, if for no other reason than because horizontal decentralization is not likely to be achieved and the effect on the degree of contrived scarcity may well be influenced by vertical arrangements under the sorts of circumstances that actually exist.

Fortunately, the Supreme Court had adopted an economically meaningful criterion for judging the legality of vertical arrangements. In *Tampa Electric*²⁴ the Court clarified the "quantitative substantiality" test of *Standard Oil Co. v. United States*,²⁵ earlier applied in judging the legality of a tying contract under Section Three of the Clayton Act. In upholding the Tampa Electric Company's coal supply contract with Nashville Coal Company the Court held that vertical contractual arrangements are to be judged not only on the basis of the *relative* quantity of commerce foreclosed to competitors by the contract, but also on the basis of the relative strength of the parties and whether the exclusive arrangement might be justified on economic grounds. The Court recognized a requirements contract, unlike a tying arrangement, to be economically advantageous to the buyer as well as the seller. In the discussion of the vertical part of *Brown Shoe Co. v. United States*,²⁶ the Supreme Court developed its new approach to vertical arrangements still further and generalized it to include ownership as well as contractual arrangements. Now, in any vertical arrangement case the trial court must measure the relative market share foreclosed and the degree to which the arrangement is *inherently anticompetitive*. An arrangement that is by its very nature monopolistic is prohibited even if the amount of commerce affected is small relative to the total market.

Thus the new policy is coexistent with the *Standard Oil* decision if one views the tying of exclusive sale of the supplier's line of auto accessories to the continued supply of gasoline to be such an inherently anticompetitive device. Incidentally, such an arrangement illustrates the way in which monopoly power in one product can be extended to other products by means of a vertical arrangement. The Court has said in effect that such an arrangement is reachable with the law even though the degree of horizontal centralization of control is the underlying cause of the problem.

²³ Stigler, *The Division of Labor is Limited by the Extent of the Market*, 59 J. OF POL. ECON. 185 (1951).

²⁴ 365 U.S. 320 (1961).

²⁵ 337 U.S. 293 (1949).

²⁶ 370 U.S. 294 (1962).

For economic activity to take place some sort of vertical arrangement must exist. Even if all firms were completely vertically integrated through ownership, the problem of controlling the scheduling of productive activities at the various stages would still have to be solved. Whether it be a problem of business policy i.e., of management of the firm—or of public policy, some basis for evaluating vertical coordination and control arrangements is needed. The Supreme Court has offered a very general, yet quite specific public policy criterion. Vertical foreclosure is bad, in principle, since it injures potential or actual competitors who are thereby foreclosed from selling a portion of the forward-stage market. But their interests must be weighed against the interest of those firms that gain from the arrangement and also against the interests of the public generally. The weighing of the conflicting interests is to be achieved by using a variable share of the market foreclosed as a standard. The magnitude of market share that may legally be foreclosed is a function of the inherent anticompetitiveness of the arrangement. The legal notion of anticompetitiveness used by the Court in these cases seems to be quite consistent with the need to reduce contrived scarcity that gives rise to unwarranted economic rents and higher than necessary prices of final products.

Although the legal principle is precise and clearly stated in the law, much work remains to be done before the principle can be applied generally to vertical arrangements in the American economy. Herein lies both the challenge and the opportunity. The executive branch, with the concurrence of Congress, could make use of this body of law and the existing enforcement arrangements to accomplish what might well turn out to be a significant reduction in the rate of price level increase associated with full employment of the labor force. Specific programs of inquiry into vertical arrangements in several crucial industries such as metals and chemicals, for example, would probably pay off with the discovery of a number of arrangements that cannot meet the Supreme Court's test. To what extent is the power to administer prices in the steel industry, for example, based not on the horizontal oligopoly structure in the final product markets, but on the long-term ore supply contracts between basic steel producers and ore companies that are jointly owned subsidiaries of the ore-buying firms? To what extent are crucial inputs of materials or processes controlled by a firm that appears to compete with later stage firms that are really dependent on it? To what extent do existing contractual arrangements slow down the rate of change in capacity as demand increases?

Economic theory teaches that a change in the demand for a product will tend to result temporarily in a price reaction with very little output reaction. In the long run the price movement will tend to be reversed as output responds, given time for firms to step up or down their rates of inputs of productive services. If demand for a particular product continues to increase, the price response may dominate unless rates of inputs of productive services are responsive to product price rises. To put it another way, whether growth in demand results in a short-run or long-run type of price-output response depends on the responsiveness of inputs. The ease with which inputs of productive services, including components, materials, and capital equipment, respond to product demand changes in either direction will certainly depend on the nature of the contractual and ownership arrangements that relate producers at the various stages from the extractive industries to the final products. Response to scarcity reducing developments such as mineral deposit discoveries or technological improvements will also be related to the vertical structure of control.

In judging the degree of inherent anticompetitiveness of vertical arrangements the courts, therefore, should examine the facts of each case with a view to ascertaining whether the arrangement will facilitate (1) the reflection of demand changes for final products in output changes rather than unjustified prices all up and down the line, and (2) the reflection of resource discoveries and technological improvements in appropriate output increases and price reductions all the way up to the final product level.

IV. CONCLUSION

Such a policy is completely consistent with the time-honored one of prohibiting power to enhance the price and exclude entry. I am suggesting that the ideal antitrust policy in the years ahead should include on the part of the executive branch, with the support of the Congress, a concerted effort to find the sources of such power and dissipate it. In my judgment, if we do not soon recognize the importance to other economic and social goals of the development and maintenance of more competitive markets, the probability is high that a comprehensive planning mechanism will replace the market system in the years ahead.