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Antitrust, Microeconomics, and Politics: Reflections on Some Recent Relationships

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Professor Sullivan delivered this address on the occasion of his inauguration to the newly created Earl Warren Chair in Public Law at Boalt Hall School of Law. The establishment of this Chair was the culmination of efforts by friends of the Chief Justice to create a perpetual memorial to one of Boalt's most distinguished alumni.

I am honored and deeply pleased to be appointed to this Chair.

One cannot hope to live up to the name Earl Warren. Anyone who holds this Chair over the years will be fully aware of that. The Chief Justice was a towering figure in the history of the nation and the state. He remains a lively figure in the imagination.

Let me simply express my thanks to those who made the chair possible and assure them that as its first occupant, I shall try to live the scholarly life in a manner consistent both with the warmth and with the dignity of the man whom the Chair honors.

"Philosophy is now become . . . [s]o mechanical . . . that I fear we shall quickly be ashamed of it; they will have the World to be in great, what a watch is in little; which is very regular . . . But pray tell me, . . . had you not formerly a more sublime idea of the Universe?"¹ In a thoughtful book, Basil Willey first quotes these words from Fontenelle. He then insists that the intellectual task of Western civilization has been to account scientifically for matters which had formerly been explained only metaphorically.

Beliefs must be functional to prevail. By beginning with Fontenelle, Willey reminds us that any new view, however well it may serve

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1. B. WILLEY, *THE SEVENTEENTH CENTURY BACKGROUND* 11 (Anchor Books ed. 1953).

present purposes, must replace an older view that itself responded to real if different needs.

The particular explanations that attain orthodoxy are those most in harmony with current beliefs about related phenomena. Any change in prevailing attitudes on any subject of consequence will open some insights but will also close others. Bold indeed would be the scholar who insisted that each successful attack on the citadel of current belief is a boon to mankind.

What has all this to do with antitrust? We seem to be in the midst of a transformation of belief about the purposes of antitrust and about the values it should advance. Antitrust had an organic quality during the Warren years. It is now being made over to be, perhaps, more mechanical and more precise. The significance of this change can better be grasped when seen in context. I'll therefore compare recent antitrust developments with the ascendant political canon about regulatory regimes and with an important academic view about microeconomic issues.

I'll speak about trends and exercise rhetorical license. Where I see a tendency, I may describe an end state. Where I see contrasts, I may describe ideal types to make the contrast vivid.²

I

The Supreme Court is increasingly committed to a conception of competition that emphasizes efficiency as a dominant social value. This tendency is even more noticeable in lower court cases. Efficiency is not the only interest to which antitrust courts respond. But it is the primary one. Preoccupation with efficiency is changing the law.

The current Supreme Court has issued several revisionist decisions. It has expanded the scope of the rule of reason and reduced the reach of per se rules, thus calling for fewer rules and more analysis. At the same time it has narrowed inquiry under the rule of reason. Only competitive effects are relevant. This usually means efficiency effects. "Reason," in antitrust, is becoming blind to other social consequences.

2. With the assistance of a Guggenheim fellowship, I have been studying the political, social, and theoretical components of American and European Economic Community (EEC) competition policies. What is published here is a transcript of a talk on American policy given at Boalt Hall on November 8, 1979. Footnotes have been added only where the editors of the Review insisted. In a more highly elaborated, fully documented, and precisely qualified form, the views expressed here will be included in a paper to be given at a conference, *The Economics of Firm Size, Market Structure, and Social Performance*, to be held in Washington, D.C. on January 17 and 18, 1980, under the auspices of the Bureau of Economics, Federal Trade Commission. The proceedings of that conference will be published. Ultimately, I hope to publish a study which contrasts American and European developments.

For example, free access to markets and dealer independence have been rejected as antitrust goals.

Lower federal courts have gone further. Not only have they made efficiency the sole guide, but also several have accepted shortrun, static analysis as the only way to identify it. They have rejected the seemingly less precise balancing test first used by Kings Bench in 1711,³ and generally applied in common law restraint of trade and antitrust cases ever since.

The recent Second Circuit decision in *Berkey Photo, Inc. v. Eastman Kodak Company*⁴ exemplifies the trend. The opinion suggests that a monopolist may lawfully use power in one market to gain advantage in another, whenever doing so yields shortrun efficiencies. It becomes irrelevant whether opportunities for smaller firms or possible entrants are reduced. It becomes irrelevant whether the *goal* of the conduct is preserving market power. It becomes irrelevant whether the shortrun efficiency gains may be offset by longrun losses as rivalry ends.

Recent predatory pricing cases have a similar thrust. The courts specify an objective norm that they think will discriminate between price cutting that hurts allocative efficiency in the short run and price cutting that does not. This norm then becomes the sole legal test. In a vain search for precision, objectivity, and efficiency, courts use simplistic, shortrun, static theory to solve complex, longrun, strategic problems.

The current Supreme Court, although searching for efficiency, still is using more open analysis than the lower courts apply. In recent cartelization cases the high court has spurned narrow per se rules for evaluating strategic conduct. For example, in *National Society of Professional Engineers v. United States*,⁵ the Court acknowledged both the dynamic character of Sherman Act analysis and the need to consider longrun/shortrun tradeoffs. Moreover, in *United States v. U.S. Gypsum*,⁶ the Supreme Court evaluated the competitive significance of market conduct in light of the structural and institutional factors in the particular market.

In sum, antitrust courts today are expositors of applied microeconomic policy. They turn to the economic literature not merely for helpful analytical techniques. They seek to understand evidence in terms of static price theory or dynamic industrial organization theory, or both. There is a discernible tendency in the lower courts to rely on

3. *Mitchel v. Reynolds*, 1 P. Wms. 181, 24 Eng. Rep. 347 (K.B. 1711).

4. 603 F.2d 263 (2d Cir. 1979).

5. 435 U.S. 679 (1978).

6. 438 U.S. 422 (1978).

shortsighted price theory. The Supreme Court, while narrowing its focus to efficiency, still seems ready to consider dynamic consequences.

Antitrust was once different. It was more eclectic. In dealing with horizontal mergers, for example, the Warren Court showed concern about increasing concentration for reasons beyond a perceived need to defend efficiency. In that Court's view, the law sought to preserve an industrial structure composed of large numbers of small competitors as an end in itself. The Court employed analytical techniques sensitive to all potential threats to competition, not just threats to efficiency.

The Court, during the Warren years, did begin to utilize some of the analytical techniques of economists. But it used economics to determine whether competition, as the Court conceived it, continued to thrive, not as a source for determining what competition means. Thus, in merger cases the Court defined markets and considered concentration ratios, but it defined markets in ways responsive to values other than efficiency and it reacted to concentration at levels far lower than those that seriously would threaten output restrictions.

The Warren Court was the custodian of a multivalued antitrust tradition. To that Court, the idea of competition included political and social objectives. Among these were easing market access, protecting dealer independence, promoting good faith in transactions, and correcting extreme disparities in bargaining power. The Warren Court also was interested in assuring, on grounds of equity and fairness, and regardless of supposed impact on resource allocation, that prices be closely related to cost. It sought each of these goals as an end in itself. Competition could foster all of them.

In determining what the law required, antitrust courts once proceeded much as courts have proceeded for decades when dealing with multifaceted issues. Context was important. The interests involved were identified: the strength of values pointing toward one resolution was measured against the strength of those pointing toward another. Present harms or benefits were weighed against predictable future ones. The lack of precise scales was not regarded as disabling.

Precedents were considered, of course, and helpful analogies consulted. After engaging in such conventional judicial exercises, the court would try to reach a sensible resolution and to articulate the result in terms of principle, however fuzzy-edged and emergent.

Why is this eclectic approach receding into the past? Where are the newer conceptions leading? Before attempting to answer, I want to look at political and theoretical developments that run parallel to those in antitrust.

II

Many policymakers today see markets as primary mechanisms for solving social problems. There is a growing consensus that public regulation of private activity is likely to do more harm than good. This perception shows itself in a wide variety of recent political events, from California's Proposition 13, through legislation proposing a congressional veto over administrative decisions, to the deregulation movement. For years, deregulation was a topic for theoreticians alone. Congress has now deregulated airlines, and the political momentum for deregulation of trucking, telecommunications, and railroads increases rapidly.

In its genesis, the movement called for an end to entry and price regulation of industries with basically competitive structures. That goal still commands support across the entire political spectrum. Also widely supported are calls for the design of the least disruptive ways of correcting market failures. But much of the political energy first generated by those consensus goals is now being harnessed in support of fundamentally different proposals. "Deregulation" is becoming a political euphemism for halting governmental responses to environmental, health and safety, and consumer protection problems that markets cannot handle. Indeed, many of the current "deregulators" would stifle antitrust as well. A Washington headline recently said: "Move Over EPA. Move Over OSHA. The FTC is Now First on the Deregulation Hit List."

The movement to which I refer has several elements. First, most proposals are based on a cohesive, theoretical conception about how pure markets work. Since we have lived for decades in a mixed economy, such proposals call for substantial changes from the status quo. The theory behind them sees individuals as utility maximizers, firms as profit maximizers, and everybody's everyday conduct as both hedonistic and rational. Behind the theorizing, a political ideology can often be identified. When the individual thrives, society thrives. Individuals, motivated by self-interest, are the best judges of what is good for them. These are basic tenets. The antecedent political philosophy is eighteenth century liberalism. But today most Americans who hold these views call themselves conservative.

The political tradition that gave rise to American regulatory institutions was very different. Regulation was the product of what since the 1930's has been called liberalism. Liberals, like conservatives, value individual opportunity, initiative, and productive energy. They, too, see economic activity as a medium for self-expression as well as material acquisition. But adherents to the liberal tradition are as suspicious of discretionary economic power as they are of discretionary po-

htical power. They are skeptical that markets adequately control economic power. Liberals do not accept as given the existing distribution of wealth. They insist that minimum levels of welfare be provided for all.

The liberal tradition, moreover, is strongly pragmatic. Liberals engage with a certain zest in interest group politics. Their policies are seldom doctrinaire; they are built upon coalitions and compromise. They embody a certain skepticism about human capacity to predict the consequences of present action. It was a liberal, no doubt, who said: "An economist is someone who has predicted eleven out of the last two depressions."

Yet liberals remain optimistic doers. As Benjamin Ward recently put it, they start "from the status quo, try to make things a bit better here and there, concentrating attention on those areas where effort . . . [seems most likely to be productive]."⁷ In this fashion, our present mixed economy was constructed.

III

Changes in antitrust law and regulatory politics are related to the intellectual history of microeconomic theory.

During the second half of the nineteenth century, this country underwent a rapid social, political, and economic transformation. Railroads altered time and geography. New technology prompted ventures on a scale never before seen. Local markets became regional, regional markets national. It was a time of immense energy, entrepreneurial imagination, and ambition.

During most of this period, the government's role was to foster and abet industry. Nobody in Washington was thinking about industrial structure; nevertheless, as markets and investment both expanded, competition thrived. But vigorous competition can be painful—especially for investors in capital intensive industries. Periods of cutthroat competition sometimes led to bankruptcies and even abandonments. More often, competition ended in consolidation. The great trusts resulted.

Through much of this period theoretical economics was quiescent. In the 1870's neoclassicism was born. Economists developed concepts like marginal utility and elaborated the theoretical conditions of competitive equilibrium. Industrial concentration brought political reactions in the form of antitrust and regulatory legislation. But while the tide of consolidations was a flood, economists were bringing moral zeal to the defense of laissez-faire. Francis Walker typified the attitudes

7. B. WARD, *THE IDEAL WORLDS OF ECONOMICS* 9 (1979).

prevailing at the turn of the century. He saw the unfettered market as "the order of the economic universe, as truly as gravity is the order of the physical universe, and . . . not less harmonious and beneficent in operation."⁸

There were, of course, some divergent economists. Richard Ely, for example, thought the benign involvement of the state to be essential to the human program. He and others who founded the American Economic Association were exponents of empiricism and inductive theory building.

While neoclassicism continued to thrive, an alternative approach grew stronger during the 1920's. Scholars like Ernest Freund, John Commons, and others focused on governmental and other institutional factors which affected industry.

After the Great Depression, several empirical and realistic approaches, too varied in style and emphasis to be called a school, became prominent. Adolf Berle and Gardiner Means wrote about the divergence of corporate ownership and control and about the divergence between actual pricing conduct and that which neoclassical models predict. Edwin Chamberlain and Joan Robinson presented "analytics," as rigorous as those of the neoclassicists, to explain price and output decisions in oligopolistic and product differentiated markets.

This ferment readied economics for the postwar development of a school that focused attention not on the individual or the firm but on the industry. Under the leadership of Edward Mason and Joe Bain, analytically sophisticated, institutionally informed studies were done of structure, conduct, and performance in significant industries.

By the mid-sixties there were two well-developed styles of competition theory. One, neoclassical price theory, was based on hedonistic, utility-maximizing assumptions and given to rigorous, static, equilibrium models. The other, industrial organization economics, made fewer limiting assumptions and was, therefore, more tentative, more open, and less sure of itself. There was an ongoing dialectic between its models and empirical reality.

Adherents of each school tended to develop characteristic biases. Neoclassicists prized efficiency above all values. They thought existing markets worked well except when government aided cartelization or limited entry. They often attributed high concentration and market power to scale economies. They disapproved of cartelization, but thought it no great concern because cartels were inevitably unstable. In their minds, horizontal mergers created no competitive problem unless

8. Quoted in H. COMMAGER, *THE AMERICAN MIND* 230 (1950).

massive market shares were achieved. They regarded vertical mergers and other vertical restraints as efficiency-enhancing.

Industrial organization theorists spoke with less certitude. They believed that concentration, and the mergers that increased it, were troublesome. They were skeptical of the reassurance that neoclassicists provided about the industrial status quo. They were aware that particular markets, like other human institutions, changed over time. They doubted that any rigorous set of presuppositions would adequately explain any particular market.

IV

The affinities between Warren Era antitrust policies, liberal regulatory politics, and empirically based, dynamically oriented industrial organization economics should now be obvious.

I have also tried to highlight affinities between today's antitrust policies, deregulation politics, and neoclassical price theory. All take efficiency as the goal and see markets as engines moving toward that goal. They approve public intervention only when market failures can be explicitly diagnosed and efficiently corrected.

Antitrust courts today worry greatly about efficiency. But they also think still about institutional competence, the separation of legislative and judicial power, the proper role for administrative discretion, and the demands of federalism. The Supreme Court, moreover, though eager to learn economists' ways, is not rushing pell-mell toward short-run static price theory. This may reflect that Court's hesitancy to adopt the values with which price theory comes laden and, in doing so, to abandon the humanistic view that informed antitrust policies during the Warren Court years.

Yet static price theory is gaining ground. Why?

The broadest explanation is highly tinged with ideology. Reliance on government is said to weaken civic fiber. If one sees the modern age in these bleak terms, then both deregulation and a tame antitrust policy will seem healthy reactions. I do not agree that the current changes in antitrust and regulatory politics result from the barrenness of liberal institutions. Benjamin Ward and others make a credible case that liberalism has been remarkably successful.

Where liberalism has prevailed, political freedom, social stability, and material welfare have all been valued and expanded. Disparities of both political and economic power are narrower in liberal societies than elsewhere. Liberal institutions have been, at once, stable enough to provide security and flexible enough to accommodate change.

Let me try a less sweeping explanation for the increasing success of

static price theory. People with a problem want to solve it. They may try any new technology offered for the purpose. This is true of analytical technologies as well as of production technologies. Moreover, the market for decisionmaking technologies among judges and regulators is far from perfect. Some new analytical techniques will come to the attention of this audience. Others will not. Some theoretical ideas will be understood by this audience. Others will not. In part, then, the adoption by judges or policymakers of any analytical technique to deal with antitrust or regulatory issues will depend upon how effectively the new technique is presented to them.

As Arthur Leff reminds us, courts turned to economics only after legal realists had demolished the illusion that ultimate solutions could be found within the legal system itself.⁹ Chicago School theory has a particular appeal to decisionmakers because it is presented as a closed system, capable of providing rational answers to almost any issue. It insists that intractable problems can be solved without making value judgments.

Moreover, static price theory has been presented directly to judges and policymakers in ways that most of them can easily understand. In contrast, most economists who would refute that style of analysis speak only to each other, and in a language that most judges and lawyers do not understand. At a symposium, I once heard an economist explaining an arcane theory to a judge. After a few sentences, the economist said, "Do you follow me?" and the judge answered, "Yes." The economist went a little further and asked, "Do you follow me?"; the judge answered, "Yes." A few sentences later: "Do you follow me?" The judge said: "Yes, I follow you. That's why I'm lost!"

Professors Posner and Bork are preeminent among Chicago School advocates who speak clearly to the legal community.¹⁰ They have presented a manageable and, as they claim, completed system. Not just the foundation, but the entire edifice has been built. And judges and policymakers are beginning to occupy the edifice with them.

Indeed, Posner and Bork have also influenced scholars who for a time were contributing to an alternative view of antitrust. Recently, shortrun price theory has been proposed as an adequate basis for examining predation by Donald Turner who, in his early career, contributed significantly to industrial organization theory. Noting this and other differences between views expressed in the recent Areeda-Turner antitrust treatise and those found in the earlier Kaysen-Turner antitrust

9. Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451 (1974).

10. See, e.g., R. BORK, *THE ANTITRUST PARADOX* (1978); R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* (1976).

book, Professor Posner asserts that Chicago analysis at last has been adopted by those who once championed its major alternative.¹¹ As he sees it, competition among styles of economic thinking in antitrust theory is ending as views converge around Chicago ideology; courts will now be able to follow the Chicago lead free from disturbing distractions.

My own expectation is different. Antitrust courts will surely use economics more and more. But the economics they use is bound to evolve. Microeconomic theorizing is a process in which old views are screened, altered, and sometimes discarded. There are significant deficiencies in Chicago theory. Any claim that Chicago analysts hold the butterfly of truth secure in the net is sheer hubris. Some current economic theory emphasizes the defects in Chicago analysis and exposes its ideological component. As the legal audience becomes more sophisticated about economics, it, too, will look beyond static price theory. Moreover, the courts may discover that economic theory is not sensitive to all of the values to which the law should be responsive.

Some of the theoretical sources from which changes in legal thinking may spring are visible even now. In microtheory three sources of intellectual ferment can be identified.

First, economic analysis is beginning to take fuller account of the dynamics of market behavior. Sophisticated theorists recognize that firms do not simply solve problems with determinate solutions. They make choices and often act strategically. Oliver Williamson—one sophisticated economist who does talk to lawyers and judges—is currently writing about opportunistic behavior. Eventually, judges will see that employing even crude methods of dealing with dynamic issues is better than ignoring these issues. Then, courts may use the newer economics to refine judicial analysis.

Dynamic analysis bears on efficiency in yet another way. Static price theory recognizes allocative and productive inefficiencies. It ignores slack in the economy as a source of inefficiency. More recent theory suggests that rivalry in a market may squeeze out slack even when firms are already using advanced technology and earning no excessive returns. In real markets cost functions go up or down over time. Rivalry tends to force them down.

The dynamic amendments just noted are all within the neoclassical tradition. Some current theorists have gone further. Nelson, Winter, and others propose an alternative behavioral theory. They view firms as selecting performance norms and experimenting to find behavioral patterns which satisfy those norms. An antitrust policy responsive

11. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 946-48 (1979).

to this theoretical view would make rules about what performance norms and conduct patterns were permissible.

A second theoretical movement likely in time to influence courts involves efforts to analyze market failures more seriously. Even scholars within the neoclassical tradition are cutting themselves loose from the simplifying assumption that firms know all relevant cost and demand functions or that profit maximization is a matter of calculation rather than judgment. Information costs money; when decisions must be reached, uncertainty about some factors inevitably remains. Further, firms need not try to optimize anything; many seem content so long as profits are adequate and market shares stable.

Additionally, industrial arrangements may affect the quality of life in ways the market ignores. Some people may prefer a world in which they could elect to walk to a local grocer to a world in which they must always drive to a supermarket. But the supermarket is more efficient in producing things that the market measures, and we do not have very precise ways of determining what portion of the public would be ready to incur what cost to preserve alternatives. Because of this, static price theorists would regard as wrong-headed any public intervention aimed at preserving the local market. A more eclectic approach would allow the possibility that political action preserving local units, even at some cost, might result in a net increase in welfare.

A third impetus for evolution in economic thought is recognition of both the discretion and the inertia that are inherent in highly concentrated markets.

The existence of firms of great size and high levels of concentration make the presence of discretionary power inevitable. On countless questions involving product design, investment in research and development, plant location, levels and styles of advertising, and choice of legal and lobbying strategies, the profit maximizing solution will hardly ever be clear in an oligopolistic industry. The individual firm will have discretion about these and related matters. Its decisions will be market tested only if other firms in its oligopolistic market adopt different strategies. Even then, it may be tested only over such a long period, and in connection with so many conjunctive decisions, that no clear market assessment of any one decision—say, product design—may appear.

The auto industry is a useful example. The price of a car fell significantly during the period when the industry was following Henry Ford's strategy of mass producing a simplified, standardized, functional product. Later, when the industry was following the General Motors strategy of developing ornate, differentiated, price-graded, multiple product lines, the price increased significantly. The different effects of these strategies on public welfare was enormous. The market

did not dictate the latter. It was a deliberate choice by a management exercising great discretionary power.

Heterodox economists, including some of the towering theoretical figures of the post-war generation, have inquired into the inner workings of organizations such as large firms. Herbert Simon, Kenneth Arrow, and Kenneth Boulding have studied administrative behavior within firms. Others will follow this lead.

Related insights can be gleaned from research on decisionmaking in government agencies. For example, some conclude that these agencies, lacking the discipline imposed by the market, develop internal standards of performance that bear weak relationships to the public purposes for which the agencies were created. To the extent that large firms escape market discipline, they too have the kind of power deregulators deplore.

CONCLUSION

The process of change and development in economic theory continues apace. Old schools fragment. New groupings appear. Surely courts will not remain strangers to these developments.

"How would a sensible antitrust policy respond to all of this?" The answer brings me back to the eclectic attitude of the Warren Court. Any judicial dream of gaining certainty through contemporary economics will inevitably be shattered because economics itself evolves. As courts realize this, they may realize too that economic theories are not simply means for analyzing problems. Each theory comes linked to a particular view of the world, to a set of convictions about what is important. In choosing among theories, courts are not selecting tools from a kit, but making important social judgments that should be made with full awareness. Courts should refuse to surrender to any group of theorists the basic value judgments that should be made by Congress and, with deliberation, by the courts themselves.

Courts, then, should inform themselves as widely as they can, utilize economics knowingly where they usefully can, and make the best judgments they can, even though these may, at times, be troubled and tentative. This task is a difficult one. But I take comfort that neither law nor economics ultimately succeeds in making the world over to be "like a watch . . . very regular."