Of Price And Men

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Sentiment against trusts evolved partly because people feared their size. One of the largest was John D. Rockefeller's petroleum-refining enterprise. Rockefeller started at a disadvantage: his firm's headquarters were in Cleveland, 150 miles from Pennsylvania's oil-producing regions, and 600 miles from New York and other Eastern markets. Rockefeller built a vertically integrated operation, complete with pipelines. But a key to offsetting the distance disadvantage was the low freight rates charged by railroads. The quality of Rockefeller's main product, kerosene, was also important. If not produced to a very tight specification, the stuff had a tendency to explode and kill customers. Rockefeller wanted buyers to know that his product was safe because it met a stringent production standard. Thus his company's name: Standard Oil. Between 1870 and 1879 Standard Oil's U.S. market share of total refined output soared from 4 to 88 percent.

STANDARD ISSUE

The rapidly growing size of Standard Oil and other trusts made many nervous -- and envious. Smaller competitors complained that Rockefeller was getting railroad rate rebates unavailable to them. But the rebates were based on sound economic factors. Standard had a good competitive alternative, its pipelines, which it used to bargain the railroads down. Also, Standard provided loading facilities, discharge facilities, and fire insurance at its own cost. And, perhaps most important, Standard furnished a heavy volume of rail traffic at predictable periods, an advantage that was crucial for railroads with their high fixed costs and low variable costs. The rebates made business sense, but the legislators behind the Sherman Act were politicians, not economists.

Even the antitrust critic Richard Posner, in his 1976 book, Antitrust Law: An Economic Perspective, expressed the conventional belief that "the Sherman Act was passed in 1890 against a background of rampant cartelization and monopolization of the American economy." But the research of some economists in the '80s cast new light on the trusts of 100 years earlier. If the trusts' main impact had been to monopolize industries to the detriment of consumers, then a study of those industries should find that prices were growing more quickly and output more slowly than in industries where the trusts were not taking over. The economist Thomas DiLorenzo, who is now at Loyola University in Baltimore, did such a study in 1985. In his article, "The Origins of Antitrust: An Interest-Group Perspective," published in the International Review of Law and Economics, Mr. DiLorenzo found that between 1880 and 1890, while real gross domestic product rose 24 percent, real output in the allegedly monopolized industries for which data were available rose 175 percent, seven times the economy's growth rate. Meanwhile, prices in these industries were falling. Although the consumer price index fell 7 percent in that decade, the price of steel fell 53 percent, refined sugar 22 percent, lead 12 percent, and zinc 20 percent. The only price that fell less than 7 percent in the allegedly monopolized industries was that of coal, which stayed constant.

In his 1987 book, A Theory of Efficient Cooperation and Competition, Lester Telser, a University of Chicago economist, reinforced Mr. DiLorenzo's theme, pointing out that between 1880 and 1890 the output of petroleum products rose 393 percent and the price fell 61 percent. These findings turn the conventional wisdom on its head. Writes Mr. Telser: "The oil trust did not charge high prices because it had 90 percent of the market. It got 90 percent of the refined oil market by charging low prices."

TRUST EXERCISES

Mr. DiLorenzo's findings on who promoted antitrust laws were also telling. Many supporters were farmers upset about the low prices they got for their crops, others were small businesspeople who couldn't compete. Many trustbusters in Congress recognized that the low prices that came about because of the trusts enhanced the consumers' well-being -- and that was the problem. Congressman William Mason stated clearly the case for small business: "trusts have made products cheaper, have reduced prices; but if the price of oil, for instance, were reduced to one cent a barrel, it would not right the wrong done to the people of this country by the 'trusts' which have destroyed legitimate competition and driven honest men from legitimate business enterprises."

Mason and his colleagues favored antitrust laws because the low prices of bigger companies were driving out the smaller, less-efficient competitors. That makes political sense -- whatever violence it does to economic theory. Why on earth would any small businessman in his right mind advocate a law that he thinks would create more competition? For a small firm, the ideal market is one in which the large firms are keeping prices high.