The Case Against Antitrust

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With the Justice Department hammering away at Microsoft and suing to block the proposed merger between Lockheed Martin and Northrop Grumman, the perennial debate about antitrust policy has taken on a new urgency. Economists and others argue that antitrust laws are necessary because companies might otherwise collude to keep prices high or merge with potential rivals to reduce competition. But study the past effects of antitrust enforcement, and you get a very different picture: It often hurts competition or prevents mergers that would reduce costs and prices.

The recently aborted merger between Staples and Office Depot is one instance where antitrust probably hurt consumers. The Federal Trade Commission blocked the merger, insisting that the two companies combined would have had too large a share of the office-superstore market. The FTC's narrow definition of the market ignored the fact that many people buy office supplies over the phone, on the Web, and at discount superstores such as Price Costco. The likely result was that the FTC prevented economies of scale from being realized, and customers were 'saved' only from paying lower prices.

Antitrust zeal can also backfire when it causes U.S. companies to shun productive and efficient activities for fear of an antitrust suit. University of California economist Carl Shapiro, who was recently the chief economist in the Justice Department's antitrust division, writes of a 'sad case' in which modem manufacturers got together to set standards so that the modems could 'talk' to one another. The firms had proposed a limit on the fees that holders of the relevant patents would charge one another to use them. This agreement would have kept prices low on the new modems--yet it never materialized because, Shapiro writes, 'at least one company was concerned it might be attacked as price-fixing.' Today the new modem standard is in place, but holders of the key patents are seeking higher royalties, which could well mean higher modem prices. Fear of antitrust dealt consumers a significant defeat.

That there is a downside to antitrust enforcement isn't surprising. After all, Congress' intent in passing the Sherman Antitrust Act of 1890 wasn't to protect consumers--but to protect small business. Start with the fact that the law was called the Sherman Antitrust Act, not the Sherman Antimonopoly Act. Monopolies restrict output and increase prices, but when industries organize into trusts (a legal device to allow a certain amount of coordination among rivals), the typical result is that output expands faster than the economy's overall output, and prices fall. Take petroleum refining, where John D. Rockefeller produced 90% of the industry's output. According to University of Chicago economist Lester Telser, between 1880 and 1890, output of the petroleum-refining industry rose by 393%, and prices fell by 61%. 'The oil trust did not charge high prices because it had 90% of the market,' Telser concludes. 'It got 90% of the market by charging low prices.'

But didn't Rockefeller raise prices after he eliminated rivals? No. In fact, few clear-cut cases of 'predatory pricing' have ever been found. And as surprising as that sounds, it makes sense: If a company cut prices below its own costs to drive its rivals out, once it raised prices to reap the benefits of monopoly, new rivals would emerge.

The oil industry is hardly the only example of consumers benefiting from trusts. Thomas DiLorenzo, an economist at Loyola University in Baltimore, found that between 1880 and 1890, real GNP in the U.S. rose by 24%. But in the allegedly monopolized industries for which DiLorenzo could get real data, output rose by an average of 175%. If that's monopoly, this consumer wants more of it.

Who, then, could oppose trusts? The main opponents, says DiLorenzo, were small, inefficient firms that could not compete against them (and whose owners represented a sizable number of votes). One antitrust advocate at the time, Rep. William Mason, admitted that 'trusts have made products cheaper' but argued that the trusts 'have destroyed legitimate competition and driven honest men from legitimate business enterprises.' (Translation: the competitors couldn't cut it.) Sen. John Sherman, after whom the antitrust law was named, was also a proponent of tariffs, another measure that reduces competition, keeps prices high, and gives inefficient companies a break.

The scariest lesson from history is what antitrust can do to the stock market.

George Bittlingmayer of the University of California at Davis notes that many major market declines were preceded by announcements of stepped-up antitrust enforcement. On Friday, Oct. 25, 1929, to take the most notorious example, the Justice Department declared it would deal 'vigorously with every violation of the antitrust law.' By the closing bell on Oct. 29, 1929, the Dow had fallen 23%.