Economics and Antitrust Enforcement: Transition Years

BY OLIVER E. WILLIAMSON

WITH THE BENEFIT OF hindsight, the field of industrial organization and the enforcement of antitrust were in crisis in the 1960s. Price-theoretic reasoning, with emphasis on monopoly and the real and imagined consequences of barriers to entry, carried the day.[1] To be sure, price-theoretic reasoning is very powerful and ought to inform antitrust enforcement. But there can also be too much of a good thing. Because of the ready, even uncritical, access to monopoly explanations for nonstandard and unfamiliar contractual practices and organizational structures, no one was asking the question, What is going on out there?

Things began to change during the 1960s when Donald F. Turner was the Assistant Attorney General for Antitrust. Whereas economists within the Antitrust Division had come to be viewed as support staff for the lawyers, Turner viewed the role differently. The object was not merely to bring and win cases—which had become increasingly easy to do, as witness Justice Potter Stewart's dissent in *Von's Grocery*: the "sole consistency that I can find is that in [merger] litigation under Section 7, the Government always wins"[2]—but to distinguish between good and bad cases (and good and bad arguments) within the winnable set.

An accurate record of the progressive introduction of economics into antitrust should make prominent provision for the "early years" from 1965–1968, when Turner was the Assistant Attorney General for Antitrust. Initiatives taken during the Turner Administration not only had immediate consequences for changing antitrust enforcement as we had come to know it, but they also provided a foundation upon which successor administrations built.

Pre-Turner Antitrust Enforcement

Industrial Organization. Legislation from the New Deal Era[3] and hearings held under the auspices of the Temporary National Economic Committee set a populist tone for antitrust enforcement in the immediate post-World War II era. Arguably the most important developments in the field of industrial organization in the 1950s were Joe Bain's books, *Barriers to New Competition*[4] and *Industrial Organization*,[5] and *Antitrust Policy* by Carl Kaysen and Donald Turner.[6] This body of work ushered in the structure, conduct, performance (SCP) approach to industrial organization, with special emphasis on barriers to entry. Franco Modigliani's survey in 1958 of "New Developments on the Oligopoly Front"[7] gave added weight to entry barrier arguments. Entry barriers took many forms, some real and some imaginary. Entry barrier arguments were quickly adopted by, and gave impetus, even legitimacy, to populist antitrust.

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To be sure, there were other views. Aaron Director and his students and colleagues at the University of Chicago were grave skeptics of "the new SCP learning." Be that as it may, both the Harvard and Chicago approaches were based on price-theoretic constructions.[8] Both schools, for example, described the firm as a production function (a technological construction) for antitrust enforcement purposes. Also, although Chicago gave prominence to the allocative efficiency benefits that purportedly resulted from vertical market restrictions, monopoly reasoning was ubiquitous. As Ronald Coase pithily observed:

> One important result of this preoccupation with the monopoly problem is that if an economist finds something—a business practice of one sort or other—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a monopoly explanation, frequent.[9]

Enforcement.[10] The possibility that non-standard practices sometimes had economizing purpose and effect was ignored or, worse, efficiency was regarded as the source of an unfair competitive advantage. Thus, the Federal Trade Com-

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ission held in *Foremost Dairies* that the necessary proof of violation of Section 7 "consists of types of evidence showing that the acquiring firm possesses significant power in some markets *or that its over-all organization gives it a decisive advantage in efficiency over its smaller rivals.*"[11] Turner, among others, was quick to label that holding as bad law and bad economics, in that it protects competitors rather than promoting the welfare benefits of competition.[12] But the Commission carried its reasoning forward in challenging Proctor & Gamble's proposed acquisition of Clorox, linking it with barriers to entry in the following way:

> In stressing as we have the importance of advantages of scale as a factor heightening the barriers to new entry into the liquid bleach industry, and so impairing competitive conditions in the industry, we reject, as specious in law and unfounded in fact, the argument that the Commission ought not, for the sake of protecting the "inefficient" small firms in the industry, proscribe a merger so productive of "efficiencies." The short answer to this argument is that, in a proceeding under Section 7, economic efficiency, or any other social benefit resulting from a merger is pertinent only insofar as it may tend to promote or retard the vigor of competition.[13]

The Supreme Court's decision in that case echoes the FTC's emphasis on entry barriers and the low regard accorded to economic efficiency. Thus, the Court observed that Proctor's acquisition of Clorox might tend to raise barriers to new entry:

> The major competitive weapon in the successful marketing of bleach is advertising. Clorox was limited in this area by its relatively small budget and its inability to obtain substantial discounts. By contrast, Proctor's budget was much larger; and although it would not devote its entire budget to advertising Clorox, it could divert a large portion to meet the short-term threat of a new entrant. Proctor would be able to use its volume discounts to advantage in advertising Clorox. Thus, a new entrant would be much more reluctant to face the giant Proctor than it would have been to face the smaller Clorox. . . . Possible economies cannot be used as a defense to illegality.[14]

The low opinion and perverse regard for economies went so far that the beleaguered respondents disclaimed efficiency gains.[15]

Such was the state of antitrust enforcement when Turner became the Assistant Attorney General for Antitrust. This upside-down assessment of economies was bound to change, and it did.

The Turner Regime

Donald Turner was the first Ph.D. economist to head the Antitrust Division. After receiving his Ph.D. from Harvard in 1947, he went directly to Yale, where he received his law degree in 1950. Turner then clerked at the Supreme Court and was an associate at Cox, Langford, Stoddard & Cutler before joining the Harvard Law School faculty in 1954, where he specialized in antitrust.

As described in the Foreword (and elaborated in the Preface by Edward S. Mason) to *Antitrust Policy*, Harvard was in the vanguard of reshaping the field of industrial organization in the 1950s. Moreover, the SCP approach to industrial organization took shape with applications to antitrust enforcement foremost in mind. Kaysen and Turner, for example, took the "limitation of market power,"[16] rather than consumer benefits, to be the chief public policy purpose of antitrust.

Activist antitrust enforcement thrived on such ideas. With the help of concepts like "potential competition," it was easy to find problematic structures and practices lurking under nearly every rock. One of Turner's concerns was that good but delimited arguments were being taken to extremes. One of his objectives as Assistant Attorney General for Antitrust in 1965 was to restore perspectives.

To my knowledge, Turner never announced the objective of putting antitrust enforcement on sounder economic foundations. But this objective nevertheless can be inferred from a series of steps taken during the Turner Administration. Modest though each of these steps may now appear, they set in motion substantial changes that had lasting effects. The Turner-Zimmerman era (Turner was immediately succeeded as Assistant Attorney General by Edwin Zimmerman) was the beginning of what would turn out to be a vast reorientation of antitrust, in which more and better economic reasoning made progressive headway—a process that continues even to this day.

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That the initial changes were subtle and modest was partly because this was the only practical way to proceed. Forcing a change was not only unrealistic, but could have been counterproductive. Not only would the career staff be there long after Turner had left, but every administration depends on the career staff to initiate new cases and manage ongoing cases. Lest this be done in a perfunctory manner, change had to be implemented in a way that the career legal staff could buy into and ascribe merit. Also, activist antitrust enforcement had its supporters in both Congress, where the Celler-Kefauver Amendment to the Clayton Act had just been passed in 1950, and the Court, which celebrated the populist rhetoric from the legislative history of that Amendment. Additionally, the Economics Section in the Antitrust Division had come to understand its function to be that of litigation support. Changing that mindset would likewise take time.

Management and Proselytizing. Turner accordingly changed the direction of the ship of state gradually. Problematic cases that were already in progress were rarely dismissed but were reshaped to replace incorrect or vague arguments with more careful and nuanced arguments. New cases that could be brought and won under current law, as inferred by recent decisions, were not approved if they relied on mistaken or contrived economic thinking.

Turner's reliance on economic reasoning was evident, moreover, in his weekly conference with section heads, where the discussion of cases-in-progress was extended to include a case's economic merits, or lack thereof. The economic merits of a case were also featured in meetings with outside counsel. Turner made a point of updating the antitrust bar on his antitrust thinking in his frequent speeches, and he was actively involved in the preparation of briefs for the government that were headed for the Supreme Court.

Supporting Staff. Turner could not do it all. Key figures in his administration who played important roles in transforming antitrust enforcement included Edwin Zimmerman (whose title before succeeding Turner was that of First Assistant), Lionel Kestenbaum (who headed up the Evaluation Section), Robert Hammond (as head of Policy and Planning), now Justice Stephen Breyer (who was then Turner's Special Assistant), and Richard Posner (who was then in the Solicitor General's office and specialized in briefing and arguing antitrust cases before the Supreme Court). Turner also staffed the Evaluation Section with an exceptional group of recent law school graduates, many being his and Zimmerman's students from the Harvard and Stanford Law Schools. And he created the new position of Special Economic Assistant, which reported directly to him.

As noted above , the Economics Section in the Antitrust Division up to then was used mainly for litigation support. The creation of a Special Economic Assistant who reported directly to Turner signaled that economic analysis would now be featured more prominently in the decision to bring cases and in the manner in which the cases were argued. William Comanor was the first Special Economic Assistant. I was his successor.

Lou Marcus, who headed the Economics Section, retired in 1973, at which time Thomas Kauper was the Assistant Attorney General for Antitrust and George Hay was the Special Economic Assistant. Kauper and Hay took the process to its "natural" completion. The position of Special Economic Assistant was abolished, the Economics Section was transformed into the Economic Policy Office (which put it on a parity with the Office of Operations, at least on the organizational chart), George Hay was appointed Director of the Economic Policy Office, and the active recruiting of Ph.D. economists ensued (four were recruited that first year). These changes served to ratify the upgrading of economic analysis in the enforcement of antitrust that had been begun by Turner.

Taken together, the creation of the position of Special Economic Assistant and the decision to staff the Evaluation Section with young lawyers who bought into the idea that economic reasoning should be featured more prominently in antitrust enforcement were important "organizational innovations." For those who were a part of this transition, these were exciting times.

Some Particulars. The 1982 revision of the Merger Guidelines (and the 1984 Guidelines that followed) signaled a new and important era in which economic analysis and economic criteria have played more important roles in antitrust enforcement. Public policy is much the better for it. But note that I refer to a revision in the Merger Guidelines. The idea for merger guidelines goes back at least to Kaysen's and Turner's early sketch of such guidelines in their 1959 book.[17] The first Department of Justice Merger Guidelines were issued on Turner's last day (May 30, 1968) as Assistant Attorney General.

The 1968 Guidelines are more stringent than both the earlier Kaysen and Turner "benchmarks" and the later 1982 Guidelines. In large measure, the 1968 Guidelines adopted market share limits that could be inferred from recent merger decisions by the courts.

The first draft of the 1968 Guidelines was written by Turner and was circulated and discussed in the Spring of 1967. The general response among the career staff was one of caution, sometimes disfavor.

One of the consequences of issuing enforcement guidelines is that firms considering merger would face less antitrust enforcement uncertainty. Inasmuch, however, as such uncertainty served mainly to deter mergers, many of the career staff viewed uncertainty as an "advantage." Of greater concern was that the issuance of guidelines would serve to introduce a floor, below which the burden of bringing a case would have to be borne by the Division. The previous practice of progressively ratcheting down admissible market shares would be brought to a halt. That the 1968 Guidelines were stringent can thus be thought of as a compromise. To propose more permissive market shares would, in effect, concede error—by the antitrust enforcement agencies and the courts—in earlier cases. Not only did Turner and Zimmerman need the continuing cooperation of the staff, but they did not need a squabble on Capitol Hill.

But the 1968 Guidelines also reflect the intellectual heritage that came out of the SCP school, of which Turner was a part. Thus, the 1968 Guidelines are preoccupied with real or imaginary entry barriers, to which detrimental effects purportedly accrue by reason of (1) product differentiation and promotional expenses; (2) price or supply "squeezes"; and (3) reciprocal buying from which competitors are excluded. More generally, the theory of the firm on which the 1968 Guidelines are based is that of the firm as production function—the requisite background for which was relative prices and technology, or "economics and industrial engineering," but *not* organization theory.[18] Albeit broadly in accord with the prevailing price theory, viewing the firm as a production function is also self-limiting.

For some purposes, of which antitrust is one, firms are more than a black box for transforming inputs into outputs according to the laws of technology. Firms have internal structure, which structure is not adventitious.[19] Viewing the firm as a governance structure (which is an organizational, rather than a technological construction), to be compared with simple and complex modes of contracting, has turned out to be instructive. For one thing, the opening of a new window on firm and market organization—the lens of comparative contractual analysis—invites a more detailed and nuanced examination of the activities to be organized and of the properties of alternative modes of governance. Second, and related, the presumption that nonstandard and unfamiliar contracting practices and organizational structures have monopoly purpose and effect is revealed to be simplistic. If organization (to include the design of complex contracts) has efficiency consequences, then antitrust thinking needs to be expanded to take that into account. The narrowness with which economic efficiencies are viewed in the 1968 Guidelines is partly a byproduct of the prevailing technological (production function) conception of the firm.

Changes were nonetheless brewing, which I illustrate with two cases that are chosen, not because they are representative, but because they illustrate the need for new thinking about the uses and misuses of economics in antitrust. The first of these is the *Schwinn* case,[20] which illustrates the benefits of going "outside the [neoclassical black] box." The second involved the proposed merger of two daily newspapers in a small community, where the benefits of economic reasoning accrue from working within an orthodox applied welfare economics setup.

Schwinn. Turner asked me to take a look at *Schwinn* soon after I arrived in September 1966, and I received a draft of the brief from Richard Posner shortly thereafter. Both Turner and Posner regarded *Schwinn* as an important opportunity to bring the "then prevailing thinking of the economics profession [to bear] on restricted distribution."[21]

Alas, what Turner and Posner took to be the then prevailing thinking of the economics profession was deeply confused. As I have discussed in other writings,[22] the prevailing thinking was self-limiting in three respects: (1) there was little appreciation for the possibility that product differentiation (as opposed to homogeneous product market exchange) might be the source of economic benefits; (2) there was even less appreciation for the possibility that the integrity of a distribution system could be compromised by subgoal pursuit among the parts (in this case, the individual franchisees); and (3) there was a preference for internal organization (hierarchy) over market organization (interfirm contract) if vertical restrictions, for whatever reason, were to be applied.

Such misconceptions were the product of combining a view of the firm as production function with the SCP school of thinking. Thus, Turner viewed "customer and territorial relations not hospitably, in the common law tradition, but inhospitably in the tradition of antitrust."[23] Unsurprisingly, the government's brief argued that the restrictions attacked in *Schwinn* were per se unlawful, and that is effectively what the Court decided.

To be sure, and to their credit, both Turner and Posner revised their views ten years later, when *GTE-Sylvania* came before the Court.[24] As of 1966, however, my efforts to place a more favorable construction on *Schwinn*'s restrictions and to reshape *Schwinn* got precisely nowhere. The difference is that, whereas I viewed contract and organization from a combined economics and organizational perspective, which was a byproduct of my (unorthodox) training at Carnegie, Turner and Posner were confident that the combination of orthodoxy and SCP reasoning on which they relied for authority was entirely sufficient.

That has changed, and many of us like to believe that those years are behind us forever. Even if they are, however, new issues of complex contracting and economic organization will arise for which new analytical tools will sometimes be needed. Interestingly, the current head of the Federal Trade Commission, Timothy Muris, seems to agree. As Stephen Stockum puts it:

> Muris describes his economic approach as neither Chicago School nor Post-Chicago, but rather "New Institutional Economics," which combines "theory with a study of real world institutions . . . [and is] heavily empirical" . . . . [This promises to] be a welcome relief for many to move away from what Muris refers to as the "very stale" Chicago/Post-Chicago debate over economic ideology toward more practical discussions of how economic analysis can contribute to rational enforcement of the antitrust laws.[25]

The Economics Model. The second case was the proposed merger of two daily newspapers in a small community. Given the clear prospect of increased market power, this was an easy case: Disallow the merger.

But there was a further complication. That was that the merger might also yield economies. The question was, how should a merger that would simultaneously yield both efficiencies and market power be evaluated? I discovered to my surprise that the allocative efficiency consequences of such a merger had never been worked out. The prevailing intuition, however, was that any increase in market power, however small, would trump the benefits of any cost saving. Was that intuition correct?

What I have referred to as the "naïve model"[26] revealed that, over a wide range of demand elasticities, the allocative efficiency benefits of a small reduction in average costs could be offset only by a large increase in prices—easily on the order of 10:1. That result surprised me, and it also surprised Turner.

To be sure, such a simple model should not, and did not, carry the day—in that an efficiencies defense did not immediately become available to respondents in merger cases. But demonstrating the error of the earlier intuition—that any shred of monopoly power, however small, was decisive on reaching informed decisions on the merits—had an immediate and salutary effect by delegitimizing the animus against efficiencies. Thus, although the 1968 Merger Guidelines scarcely invite an economies defense, the Guidelines nevertheless viewed economies favorably (which is also the way that economies are treated throughout by Kaysen and Turner).

The 1982 Merger Guidelines can be viewed as being more deferential to efficiencies, in that market share criteria for challenging a merger are increased. The 1982 Guidelines are nevertheless cautious about admitting an actual efficiency defense, except in close cases,[27] mainly because the magnitudes would be "extremely difficult to determine."[28] The 1984 Guidelines, by contrast, introduce the discussion of efficiencies with the following statement: "The primary benefit of mergers to the economy is their efficiency-enhancing potential, which can increase the competitiveness of firms and result in lower prices to consumers."[29] Thus, although the 1984 Guidelines "are designed to proscribe only mergers that present a significant danger to competition," the Department will nevertheless consider "clear and convincing evidence . . . [of] efficiencies . . . in deciding whether to challenge [a] merger."[30] As since discussed by William Kolasky and Andrew Dick, the merits of economies, both in general and in merger enforcement, eventually prevailed.[31]

Conclusion

As herein interpreted, the vast upgrading of the role of economics within the Division—from litigation support in the pre-Turner years to analysis of the merits of proposed antitrust actions and active participation in shaping antitrust arguments today—can be traced to conceptual and organizational changes that were made by Turner. Specifically, the staff that now reports to the Deputy Assistant Attorney General-Economics is very much a consequence of two organizational initiatives taken by the Turner administration: creation of the position of Special Economic Assistant and staffing of the Evaluation Section with young lawyers who shared the Turner-Zimmerman vision of what antitrust enforcement was all about. "Tall oaks from little acorns grow." The seeds planted during the Turner administration warrant more than a passing nod. ■

1 As Ronald Coase put it, the two leading industrial organization texts "consider the subject of industrial organization as applied price-theory." Ronald H. Coase, *Industrial Organization: A Proposal for Research, in* Policy Issues and Research Issues in Industrial Organization 62 (Nat'l Bureau of Econ. Research, Victor Fuchs ed., 1972) (referring to Joe S. Bain, Industrial Organization (1959) and George Stigler, The Organization of Industry (1968)).

2 United States v. Von's Grocery Co., 384 U.S. 270, 301 (1966) (Stewart, J., dissenting).

3 *See* Lawrence J. White, *Are Giant Companies Taking over the US Economy?*, 4 Milken Inst. Rev. 60–62 (2002).

4 Joe S. Bain, Barriers to New Competition: Their Character and Consequences in Manufacturing Industries (1956).

5 Bain, *supra* note 1.

6 Carl Kaysen & Donald F. Turner, Antitrust Policy (1959).

7 Franco Modigliani, *New Developments on the Oligopoly Front*, 66 J. Pol. Econ. 215 (1958).

8 Coase, *supra* note 1.

9 *Id.* at 67.

10 This subsection is based on Oliver E. Williamson, The Economic Institutions of Capitalism 366–67 (1985).

11 Foremost Dairies, Inc., 60 F.T.C. 944, 1084 (1962) (emphasis added).

12 Donald F. Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313 (1965).

13 Proctor & Gamble Co., 63 F.T.C. 1465, 1580 (1963).

14 FTC v. Proctor & Gamble Co., 386 U.S. 568, 579–80 (1967).

15 Thus, in its brief, Proctor and Gamble insisted that its acquisition of Clorox was unobjectionable because the government was unable to definitively establish that any efficiencies would result:

> [The government is unable to prove] any advantages in the procurement or price of raw materials or in the acquisition or use of needed manufacturing facilities or in the purchase of bottles or in freight costs. . . . [T]here is no proof of any savings in any aspect of manufacturing. There is no proof that any additional manufacturing facilities would be usable for the production of Clorox. There is no proof that any combination of manufacturing facilities would effect any savings, even if such combination were feasible.

Brief for Proctor & Gamble, *quoted in* Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 Cal. L. Rev. 1582 n.5 (1983).

16 Kaysen & Turner, *supra* note 6, at 82.

17 *See id.* at 132–36.

18 *Id.* at 119.

19 Kenneth Arrow, *Foreword*, Firms, Markets, and Hierarchies vii (Glenn Carroll & David Teece eds., 1999).

20 United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

21 Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the* Sylvania *Decision*, 45 U. Chi. L. Rev. 3 (1977).

22 *See* Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 59 Am. Econ. Rev. 18 (1968); Oliver E. Williamson, *Assessing Vertical Market Restrictions*, 127 U. Pa. L. Rev. 953 (1979); Oliver E. Williamson, The Economic Institutions of Capitalism (1985).

23 The quotation is attributed to Turner by Stanley Robinson, Address at the New York State Bar Association Antitrust Symposium 29 (1968).

24 Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). Both Turner and Posner participated in amicus briefs that helped defeat the per se rule in *Schwinn*.

25 Stephen Stockum, *An Economist's Margin Notes: The Antitrust Writings of Timothy Muris*, Antitrust, Spring 2002, at 60.

26 *See* Williamson, *Economies as an Antitrust Defense*, *supra* note 22.

27 *See* U.S. Dep't of Justice, Merger Guidelines § IV.A. n.53 (1982).

28 *Id.*

29 *See* U.S. Dep't of Justice, Merger Guidelines § 3.5 (1984).

30 *Id.*

31 William J. Kolasky & Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers* (2002), *available at* http://www.usdoj.gov/atr/hmerger/11254.pdf.