Antitrust and Trade Regulation

Ernest Gellhorn

MY ASSESSMENT of the Reagan administration's antitrust performance in its first year is probably considerably more encouraging than most of the other evaluations offered here. First, two excellent appointments were made — William Baxter of the Stanford Law School to head the Justice Department's Antitrust Division and James Miller, executive director of the President's Task Force on Regulatory Relief, to chair the Federal Trade Commission (FTC). Both are exceptionally well qualified for their assignments.

Second, the Antitrust Division and the FTC have already taken conspicuous steps to redirect enforcement programs along lines that are more consistent with a consumer welfare standard. Mercifully, ancient monopoly cases have been ended. Merger guidelines that had been used repeatedly to stop desirable, efficiency-enhancing mergers are being revised. Conglomerate mergers are no longer being attacked on fuzzy social grounds. And vertical arrangements that are likely to intensify rather than injure competition have been eliminated from the antitrust hit list.

On the other hand, the past year also has demonstrated that, overall, antitrust is very slow to change direction. Many of the improvements we've seen are in the rhetoric of antitrust enforcement rather than in concrete action. Indeed, Baxter and Miller have sometimes appeared too hesitant, perhaps even timid, in following through on their convictions. One consequence is that the Baxter-Miller message has seemed unclear and occasionally has been misunderstood.

Before getting into specifics, let me explain briefly the consumer welfare standard I am using to assess the Reagan team's antitrust efforts (and which that team accepts). It has been stated most persuasively by Robert Bork [*The Antitrust Paradox*]. Antitrust, he argues, should be used to intervene in the marketplace only when private action impedes competition, blocks entry, or otherwise misuses market power to restrain output. In all other circumstances, private forces operating in the market can be relied upon to coerce, through competition, efficient results. Applying this principle to the four traditional areas of antitrust—monopoly, merger, price fixing, and vertical restraint—Bork states four rules:

- "Antitrust should not interfere with any firm size created by internal growth." Dominant firms should be allowed to compete aggressively. Firms with monopoly power should be prosecuted not for their size, but only when their actions are clearly exclusionary.
- With respect to mergers, "[t]he law should interfere only where the merger would create a market share that raises the likelihood of a significant restriction of output." Conglomerate and vertical mergers merely substitute one owner for another and so should generally be ignored by antitrust. Only large horizontal mergers leading to monopoly warrant close antitrust scrutiny.
- "The per se rule against naked price fixing and similar agreements not to compete is the oldest and clearest of antitrust doctrines" and should be applied vigorously. Agreements between the dominant firms in a market to fix prices, divvy up customers, boycott outsiders, and so forth should be punished severely.
- "[E]very vertical restraint should be completely lawful." That is, agreements between a manufacturer and its dealers to assign territories, establish supply and delivery terms, or even to fix prices are designed to achieve distributional efficiencies. Antitrust should not interfere with them.

Now, measured by the four rules, how does the administration's record in antitrust stack up? Overall, I think quite well, although there are some major deficiencies.

Taking monopoly enforcement first, it is notable that in 1981 four massive cases still crowded the government's calendar and consumed most of its enforcement resources. To get the full flavor of this, remember that these very same cases crowded the calendar when the Carter administration took office. One cannot help but be impressed, then, that the FTC moved in 1981 to end both its shared monopoly prosecution of the ready-to-eat cereal companies and its eight-year quest of six oil company "monopolists." As for the other two cases, little happened at the Antitrust Division until, shortly before the administration's first anniversary, two momentous announcements were made on one day: first, the government was dismissing its action against IBM (having discovered after thirteen years that it was "without merit"); and second, it would settle the AT&T case. Under the pending AT&T settlement, the twenty-two local operating companies will be separated from the Bell System and the slimmed-down AT&T will be free to enter the telecommunications and related computer markets.

Several points about these actions deserve emphasis. First, the FTC dismissals suggest that novel theories relying on inferences of conduct from market structure will no longer be sufficient to support antitrust prosecutions. In fact, both agencies have now indicated by word and deed that antimonopoly actions must be based on substantial evidence showing either actual abuse of a monopoly position by an individual company or some agreement among dominant firms in an industry. Monopoly cases, in other words, are being returned to first principles, namely, whether the firm with monopoly power has maintained its position by abusive or other exclusionary tactics.

Second, the four cases demonstrate that monopoly actions are harder to stop than start, and that market-oriented antitrust enforcers

are as confined by political realities as their more populist counterparts. Why did it take a year to end a groundless case? Why were both actions announced the same day? To borrow a line from the Arkansas creationist trial, Baxter's explanation that it was "sheer serendipity" is about as credible as the likelihood that a tornado sweeping through a junkyard will create a Boeing 707. Politics and little else explains the simultaneous announcements; that this tactic obscured their individual effect was not unintended. While public attention has focused on the Bell System divestiture, I suspect that Baxter was more worried about adverse reaction to his total dismissal of the IBM case (especially after the sharp bipartisan criticism he had been getting on Capitol Hill for his visible and more lenient stance on mergers).

Third, there are troubling aspects of the AT&T agreement that reflect, in my view, an undesirable reliance on executive instead of legislative authority. In short, the issues are so large that they demanded congressional resolution. The case against Bell focused on an abuse of monopoly theory—that AT&T had misused its position to exclude long distance competitors and to cross-subsidize unprotected services unfairly. But instead of enjoining such conduct and ensuring equal access to the local telephone system—which is all that the theory or the evidence in the case warranted—the consent arrangement adopts the draconian measure of total divestiture. To be sure, this relief pursues through institutional arrangements what an injunction would also provide. The trouble, however, is that divestiture does lots more, including possibly throwing out the baby with the bath. Simply put, divestiture will eliminate the benefits that vertical integration of the Bell System achieved. While we may not know why, we do know that the Bell System is the most efficient telephone service in the world. This may not seem substantial to most people, but as a resident of a community served by a non-Bell telephone company — where reaching out and touching someone often requires patience and perseverance—I worry about this potentially high cost of the settlement to consumers, especially if it wasn't necessary.

What bothers me even more is that the Baxter-imposed decree obviously relied on the threat of endless litigation, follow-on private treble damage actions, and possibly less favorable legislation to coerce AT&T into accepting this settlement if Bell was to enter the telecommunications field. It is probably too early to tell if the terms of the AT&T agreement are wise or if my doubts about it are correct. What is clear, it seems to me, is that the issues decided by the AT&T settlement about the proper structure of the telephone and telecommunications industry and their regulation should have been made by Congress.

Fourth, the total irrelevance of antitrust law as a cure for the problems of corporate size and market concentration is amply demonstrated by each of these cases. The FTC's novel theory of shared monopoly seems bizarre when fully explained. The other cases concentrated on the irrelevant legal question of motive and intent. As a matter of policy, what matters is whether consumers are already well served—or would be better served by an alternative industry structure. Since this question has not been delegated to the Antitrust Division under the antimonopoly provisions of the Sherman Act, it should first be addressed by Congress. Insofar as the principles of the AT&T settlement are relied upon in other structural monopoly cases, an unwise rule will be reinforced.

Moving to the Reagan team's merger policy, which is probably more important to consumer welfare than its monopoly actions, a similarly mixed picture emerges. Recent administrations have in general followed the basic policies of the Justice Department's 1968 merger guidelines, despite increasing evidence that mergers are seldom harmful. Thus, as Yale Brozen's forthcoming study observes, we should adopt a restrictive merger policy only if "we wish to remain frozen in a tradition-bound state with all the old familiar places, businesses, and occupations forever with us and progress abolished" [*A Perspective on Mergers*]. As Brozen explains, mergers often are desirable because they facilitate necessary reallocations of resources and help firms adapt their size or market structure to meet changes in demand, technology, and competition. Thus, Mr. Baxter's announcement that he will rewrite the guidelines in 1982 and adopt a more tolerant merger standard is particularly welcome. (As for the FTC, it has not been wholly silent or submissive, but until the Marathon Oil takeover, still being played out, it did not take a leading role in remaking merger policy.)

Unfortunately, the signals we've heard from the Antitrust Division since Baxter's initial statements have been much less encouraging. There's obviously policy confusion down in the trenches where the daily decisions are made. As cases in point, take two horizontal merger decisions in 1981. In the first, the division dismissed a Carter administration challenge to a merger between two leading brick makers because subsequent evidence showed that market concentration figures had overstated the effect of the merger. This dismissal suggested that a merger between firms with 6 and 14 percent of the market would no longer be automatically condemned. However, the narrowness of this wedge into the 1968 guidelines is shown by the division's challenge to the proposed merger of the Schlitz and Heileman breweries. Even though the resulting firm would have been no larger than Schlitz was five years earlier, the merger did not satisfy Baxter's unannounced standard because the industry had become more concentrated in those five years. What the division did not note, and should have, is that concentration in brewing has risen steadily (in the entire world) for over forty years despite very strict antimerger enforcement in the United States. The irony, as the FTC economic staff reported in 1979, is that this policy has probably promoted higher national concentration: by barring mergers, it has forced national brewers to ex-

pand internally and has probably weakened the competitive position of the smaller brewers. Nonetheless, even modest relaxation in the rigidities of past horizontal merger policies is welcome and worth praise.

More impressive was the Antitrust Division's steadfastness in overseeing the Conoco takeover war between DuPont and Mobil. Not only did the division handle a tense case with care and dispatch, but it also held firm against intense political pressures growing out of the supposed danger of conglomeration. Despite fears of "merger mania" for which Mr. Baxter is unfairly taxed, overall business concentration in fact has remained unchanged for decades. In fact, the number of mergers today is still far below the level reached in the late 1960s, and the mergers of that time have had no traceable adverse effects on the economy. It is useful to remind ourselves that large mergers as well as small ones can be beneficial, sometimes spectacularly so: recall, for example, that after Shell purchased Belridge Oil, the latter's production rose 70 percent. Not all mergers are so desirable or successful, to be sure. But sound policy should attack only those that seriously threaten competition.

Finally, I have just a few comments on horizontal and vertical arrangements, not because they are relatively unimportant, but because there isn't much to say other than that the Justice Department and FTC generally have followed the Bork prescription. In particular, the Antitrust Division continued the Carter administration's vigorous pursuit of highway bid-rigging and said it will press for criminal penalties. I hope, however, that it will also pay attention to one of the probable causes of the exceptional number of hard-core antitrust violations in government bidding—the sealed bid process, which almost invites price fixing. This deserves priority now that government purchases loom so large in the economy.

On vertical arrangements, both Baxter and Miller have stated that they will apply the reasoning of the Supreme Court's 1977 decision in *Sylvania*, and that they will not repeat the contrary actions taken by their agencies in 1980 (the indictment of Cuisinart for vertical price fixing and the FTC challenge to Russell Stover for announcing suggested resale prices). Small businesses that for years have used the FTC to protect themselves from aggressive competition may be disappointed, but consumer welfare should be improved.

ALL IN ALL, THEN, the Reagan administration did fairly well its first year. Antitrust enforcers increasingly adopted a more rational course. Probably more actions helped than hurt. And, as they say, "That's close enough for government work." ■

Telecommunications

Henry Geller

FROM THE VIEWPOINT of a regulatory reformer, the Reagan administration's record in telecommunications ranges all the way from excellent to poor.

The AT&T Case Settled at Last. The blockbuster event in the first year was, of course, the welcome and historic settlement of the AT&T antitrust suit. When Theodore Vail put together the AT&T combine at the turn of the century, he made a pact with government: AT&T got a monopoly position in exchange for providing regulated, universal end-to-end service. But after World War II, what Vail wrought became obsolete as dynamic technology blurred the lines between industrial sectors and made competition inevitable. AT&T then tried for years to gain from Congress the right to enter the new information markets on an unregulated basis. And for years Congress sputtered and came forth with increasingly complex bills heavy with regulation. Finally AT&T elected to cut the Gordian knot.

Under the settlement reached with the Justice Department, the Bell System is split in two: One part, AT&T, retains Bell's competitive communications businesses—long-distance services, terminal (or customer premises) equipment, Western Electric, and Bell Laboratories—and will be free to expand into data processing, enhanced communications services, or anything else. The other part will consist of Bell's twenty-two telephone companies, organized into one company or many and restricted to monopoly local distribution services.

The settlement is a good one. It recognizes the need to allow AT&T to respond quickly to changing technology and markets by offering new services and equipment. It wipes out the 1956 consent decree, which had largely kept AT&T out of unregulated businesses and had resulted in long, stultifying proceedings that sought to determine whether a proposed AT&T offering was more a telephone, and thus subject to regulation, or a computer.

But the settlement presents difficulties too. First, implementation will not be easy. There will be serious problems in properly valuing the assets to be split up and in arranging the timetable for shifting all consumer premises equipment to AT&T. And there may be clashes between the communications policy enunciated by the FCC and that embodied in the settlement. Transitions are always messy, of course, and one this huge will be grossly messy. But problems of this sort, however difficult, will be worked out.

A more fundamental issue involves the future status of the twenty-two operating companies. Unlike the new AT&T—or, for that matter, GTE, Continental, United, and the smaller independent telephone companies—the twenty-two Bell companies will be barred from entering the new information services, even through a fully separated subsidi-