

Inside the history of Antitrust: special interests unleashed

"The world of antitrust is reminiscent of Alice's Wonderland: everything seemingly is, yet apparently isn't, simultaneously. It is a world in which competition is lauded as the basic axiom and guiding principle, yet "too much" competition is condemned as "cutthroat." It is a world in which actions designed to limit competition are branded as criminal when taken by businessmen, yet praised as "enlightened" when initiated by the government. It is a world in which the law is so vague that businessmen have no way of knowing whether specific actions will be declared illegal until they hear the judge's verdict - after the fact.

In view of the confusion, contradictions, and legalistic hairsplitting, which characterize the realm of antitrust, I submit that the entire antitrust system must be opened for review. It is necessary to ascertain and to estimate: (a) the historical roots of the antitrust laws, and (b) the economic theories upon which these laws were based."¹

Much of the controversy about the true nature of the European Union's policy and legislation stems from a clear contradiction between the terms used and their real meaning. "Free competition" might be a good example of how the draft Treaty Establishing a Constitution for Europe obscures language. In Article I-3, second paragraph, one can read, "the Union shall offer its citizens [...] an internal market where competition is free and undistorted." What does undistorted add to free? It actually makes room for the alleged necessity of state intervention in the market through antitrust policy and legislation.

Nowadays it is widely believed (and even supposed to be common knowledge) that antitrust policies protect individuals against powerful business and interest groups. Most consumers would probably identify this kind of interventionist policy as their shield, defending their sovereignty against the power of large corporations and trusts. However, at the end of the nineteenth century, all economists agreed that state intervention in the free market was no way to defend consumers' interests. A number of myths have since been created to convince people that anti-trust policy works to their benefit.

Apart from the economic justifications of antitrust, some of which have already been discussed in "The shaky foundations of antitrust policy,"² the idea that antitrust laws and policy were



John Sherman

produced by benevolent politicians to defend the consumer, is another widespread myth surrounding competition and monopoly. Therefore, a review of the history of antitrust laws is of the greatest importance to show that politicians were and are mainly defending inefficient producers against other producers who served consumers best.

The origin of antitrust legislation and policy is to be found at the end of the nineteenth century. Between the 1870's and the 1880's a spectacular advance in the application of new technologies to a large number of economic sectors in the US took place. That kind of process is typical of what one can observe today in industries related to communication and information, namely a stunning increase of productivity during the last three decades resulting in lower prices. For instance, in 1990 the standard computer was sold for 6250 euros with a 16MHz Intel processor, a 2 Mo memory and a 80 Mo hard drive. In 2002, the standard PC with a 1,4 GHz processor, a 40 Go hard drive and 256 Mo memory plus DVD player, sound and video card, was sold for 904 euros, namely a price reduction of 85% in 12 years, disregarding the differences in quality.

In the nineteenth century, the beef industry underwent a series of changes increasing productivity of related sectors such as butchering, cattle farming or meatpacking thus reducing prices of the final product. The owners of four large companies in these related economic activities (Swift, Armour, Morris and Hammond) decided to vertically integrate their businesses. This was their bid to take

¹ Alan Greenspan, "Antitrust", in Ayn Rand, 1967, *Capitalism: The Unknown Ideal*.

² Published by the Molinari Economic Institute and available on www.institutmolinari.org

advantage of the technological innovation applied to beef production. In this way they centralized the butchering and meatpacking process making use of assembly line methods and fostering economies of scale as well as taking advantage of the new refrigeration technology. These production improvements allowed the beef trust to ship their final product to every point of the US from their centralized facilities in Chicago.

As a result, the price of beef fell fabulously during the 1880's. Many butchers and cattlemen were negatively affected by the falling prices for their activities. The successful formula of the big four had increased productivity and reduced prices and if their competitors wanted to stay in the market they had to win over the consumer. In states like Missouri butchers and cattlemen protested against what they considered a "conspiracy" designed to reduce the price of beef. They soon established a lobby whose core goal was to pass the legislation needed to prevent prices from falling.³ Two were the main arguments the lobby tried to spread. First, there were the supposed dangers of the "land concentrating in the hands of capitalists". The second argument was that "the cost of the beef to the consumer ha[d] not decreased in proportion" to the fall of the price of beef paid to the cattle raiser, an argument that implicitly recognized that the trusts activity was being quite benign to the American consumer.

This was the political environment when in May 1889 an antitrust law was passed by the state of Missouri. Among other restrictions to freedom of contract and free enterprise, Missouri's antitrust law prohibited cooperative actions fixing the amount or quantity of any article, commodity, or merchandise to be manufactured, mined, or sold in the state. Furthermore, the law prohibited actions oriented toward "limiting or fixing the price of outputs", a proposal elaborated a few months earlier at the St. Louis beef-trust conference supported by Missouri's Governor. In the ensuing months several states would pass other antitrust laws by virtue of which entrepreneurial actions aimed at cutting prices would be considered illegal.

³ See Boudreaux and DiLorenzo, 1993, "The Protectionist Roots of Antitrust", especially pp. 83-89.

As has been explained, 1880-1890 was a period when business concentration, technical innovation and the use of the new systems of transportation helped many US industries boost their productivity. The result of these market changes was an average reduction in consumer prices of 7%.

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Despite this beneficial state of affairs for consumers, the first federal antitrust law was introduced in July 1890. Its author and most zealous defender was Senator John Sherman, an outspoken detractor of the new trusts; in particular of Standard Oil. Sherman never tired of repeating that trusts artificially reduced production, seriously hurting the American consumer. Without doubt, this was the key argument for moving the first federal Anti-Trust law forward, a law that would carry his name.



Innovation in the butchering process

However, Sherman's justification for proposing the law does not even pass the most cursory test of statistics. Even if it was not clear for the consumer at that time, today it is well documented that between 1880 and 1890 production grew in every sector in which a major trust appeared at an average of 175% while gross national product in real terms increased by 24%.⁴ This huge expansion in production contradicts the Republican Senator's main argument. Business concentration such as the one in the beef sector characterized by a constant fall in prices can hardly be considered as an aggression damaging the consumer.⁵ The situation is similar today in the software marketplace. The entrance of Microsoft in new markets has always brought about a dramatic fall in prices. From 1988 to 1995, Microsoft produced a product in 10 of the 15 major categories of consumer software as defined by Dataquest. The average price variation in these categories where Microsoft was present was a dazzling fall of 65%. These beneficial consequences for the consumer were less important where Microsoft was not present. In fact, in the other 5 markets, prices only fell by an average of 15%.⁶ Some 100 years after the birth of antitrust laws, it remains hard to understand why the prosecution of companies that use their alleged - and freely gained- "dominant power" to innovate,

⁴ Thomas J. DiLorenzo, "The Origins of Antitrust: Rhetoric vs. Reality" in *Regulation*, The Cato Review of Business & Government.

⁵ Ibid.

⁶ See J. Liebowitz and Stephen E. Margolis, 1999, *Winners, Losers and Microsoft: Competition in High Technology*.

increase production and strongly reduce prices, should be considered protective to the consumer.

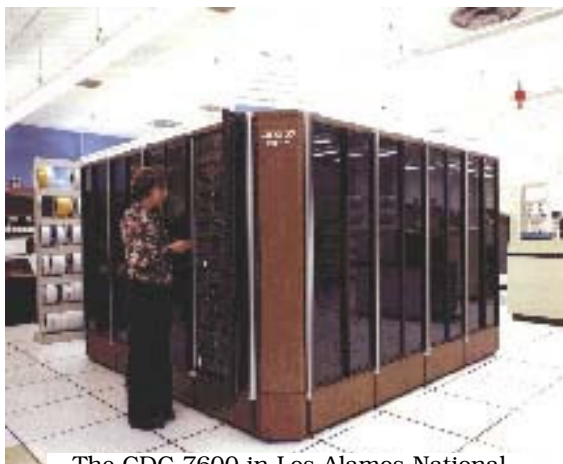
A study of John Sherman's letters has determined that while the Senator never received any petitions for consumers asking him to defend the passing of antitrust legislation, he did receive a great number of letters from small businesses worried about the new trusts and requesting a law to regulate competition.⁷ Modern cases against communication and software companies follow the same feature. Although these antitrust cases are carried on in the name of the consumer, no consumer can usually be found behind the suing

but competing companies. Both the International Business Machines Corp (IBM) and the ongoing Microsoft cases have been characterized by the involvement of companies willing to avoid free-market competition. IBM was sued under antitrust laws by companies like Greyhound, Telex, Cal Comp., and Memorex. In Europe, the Commission has been helped to prosecute Microsoft Corp. by many rivals including, Oracle Corp., Nokia Corp., Red Hat Inc., RealNetworks Inc. and, ironically enough, IBM.

In the nineteenth-century, the main companies applying the heaviest pressure to encourage Sherman in his interventionist crusade were small oil and petrol refining companies. Specifically, these companies complained that their competitor's success was based on the use of tank cars instead of the traditional oil barrels. Analysis of the letters sent to Sherman regarding the anti-trust debate reveals, "Sherman focused his energies on satisfying the demands of small oil refiners."⁸ This led the author of the study to conclude, "Senator Sherman intended to protect small and inefficient firms from their larger competitors, regardless of the effect on consumer welfare."

More than hundred years later, European

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The CDC 7600 in Los Alamos National Laboratory

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Union politicians and regulators do not seem to have changed that protectionist approach to competition and monopoly. Under Microsoft's rivals complain, the EU Commission has forced Microsoft in March 2004 to sell Windows without its Media Player, so that the sanction correct the 'unfair' advantage Microsoft is supposed to have over its competitors at the detriment of the consumers. However, in the last months, some doubts have been raised concerning the Commission's intentions. While ordering the production of two different versions of windows (one with media player and one without), the Commission has also spent considerable energy in order

to minimize the differences between the two versions of windows⁹. But, according to the Commission's views, the consumer is supposed to be better served and the market shares to be redistributed only if for him, the two versions perform differently. If the consumer considers the performance of the two Windows versions to be identical, the existence of a version without Media Player cannot enhance his welfare. In that case, the 'benefit of the consumer' cannot justify Microsoft's harassment by the Commission concerning the name of the new version.

Back to the nineteenth century, it is worthwhile to notice that not every anti-trust law supporter shared Senator Sherman's views. Many admitted that the consumer was the main beneficiary of the establishment of trusts, which took advantage of economies of scale, new modes of transportation and multiple advancements in various scientific fields to increase productivity and lower prices. But the defense of anti-trust laws had little to do with defending the consumer and everything to do with defending uncompetitive companies.

For example, representative William Mason declared that "trusts have made products cheaper,

⁷ See Werner Troesken, 2002, "The Letters of John Sherman and the Origins of Antitrust", unpublished manuscript.

⁸ Troesken, 2002, "The Letters of John Sherman and the Origins of Antitrust", unpublished manuscript, p. 3.

⁹ On March 28 2005, an agreement was found between Microsoft and the Commission concerning the name of the operating system. Microsoft has been ordered to sell without its own audiovisual software. Instead of 'Windows reduced media edition', it has become 'Windows XP N' for Not with media player.

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".¹⁰ Thus, the fact that consumers bought their beef from the trusts instead of the traditional businesses did not matter, even though the former would offer lower prices.



Since the end of the nineteenth century in the USA and the mid 1960's in Europe, state interventionism on behalf of antitrust legislation and mandates has grown astonishingly. On both sides of the Atlantic Ocean, departments in charge of antitrust policies in the EU and the USA have argued that they undertake this interventionist race to protect and benefit the consumer.

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In the case of the European Competition Directorate General, its mission is defined as "enforcing the competition rules of Community Treaties in order to ensure that competition in the EU market is not distorted, thereby contributing to the welfare of consumers and the competitiveness of the European economy."¹¹ Along the same lines, the US Department of Justice explains that "when competing firms get together to fix prices, to limit output, to divide business between them, or to make other anticompetitive arrangements that provide no benefits to consumers, the government will act promptly to protect the interest of American consumers and taxpayers."¹²

This is the official rhetoric: defense of the consumer, market and liberty. The reality is very different. Antitrust gives privileges to a reduced number of well-established entrepreneurs while impoverishing consumers and other entrepreneurs. From its very origin until today, antitrust legislation has been used either by governments or inefficient producers as a protectionist tool hampering innovative companies and consumers. This is not an undesired and unfortunate consequence of well-intended plans for consumers' protection. It is the basic idea behind antitrust policy and, as we have seen in the present note, the deliberate goal lying at the heart and origin of antitrust legislation.

European authorities have copied from the US this damaging legislation in the name of consumers demanding protection. However, it should be clear that the antitrust legislation has nothing to do with the defense of the consumer. It is a special-interests legislation. Paradoxically as it may seem, the real defense of competitive markets and consumer's rights might require the complete abolition of antitrust legislation.

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¹⁰ DiLorenzo, "The Origins of Antitrust: Rhetoric vs. Reality", p. 7.

¹¹ <http://europa.eu.int/comm/dgs/competition/mission/>

¹² http://www.usdoj.gov/atr/public/div_stats/1638.htm