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Controversy: Are Antitrust Laws Immoral? A Response to Jeffrey Tucker

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Antitrust As Protection Against Cartels

Perform with me a *gedanken* experiment. Imagine, if you would, three product markets, each supplied by several firms, who are vying with one another for customer patronage. In the first market, the firms tire of competing against each other. So they divide up the market geographically, each firm agreeing not to poach on customers outside one another's designated territory. In the second market, sellers become unhappy with prevailing prices. So they agree to a floor price below which sales will not be made. The floor price represents an increase over past prices. To underscore their agreement, each firm deposits a sum of money payable to others in the price-fixing ring if that firm is ever observed cutting prices. In the third market, prices are determined by competitive bidding. Sellers can restrain their enthusiasm for prevailing price levels so they meet in advance in order to escalate the bid price. At each meeting they determine which firm among them will win a particular bid. The other sellers submit fictitiously high prices with the understanding that they will receive a side-payment from the successful bidder or that they will be permitted to bid without genuine opposition on future bid solicitations.

Economists recognize each of these collective strategies as a variation of cartel behavior. Antitrust lawyers recognize each as being illegal *per se* under federal antitrust laws. Notwithstanding the legal prohibition on cartels in the United States, Jeffrey Tucker claims that the "moral burden of proof is on the side of those who advocate antitrust policies, and that burden has yet to be born."

To begin bearing the burden, let me suggest the Bible's ninth command-

ment. When a company holds itself out to its customers as an independent center of initiative in the marketplace, yet buyers are never informed that the market has been parceled out, or that a floor price has been set, or that the bidding is phony, the firms in the cartel have born false witness. Antitrust laws that deter cartels are deterring the bearing of false witness. Participants in a cartel bear false witness whether the cartel raises prices and restricts output by large amounts or small; participants in a cartel bear false witness notwithstanding centrifugal incentives for cartels to come undone by members cheating on the agreement.

Jeffrey Tucker's critique of antitrust never specifically discusses antitrust's prohibition of cartels, but since he endorses no element of federal antitrust policy, I take his condemnation of antitrust to be a blanket one. That Tucker never discusses cartels is peculiar. The meat and potatoes of antitrust enforcement in the United States is ferreting out cartels. Presumably, Tucker would abandon this kind of antitrust enforcement. In so doing, there would be several consequences for consumers.

First, without antitrust deterrence, there will be more cartels. Deciding to form a cartel involves the calculation of prospective costs and benefits. *Sans* antitrust, the primary cost to cartelization will be the coordination costs (since there will be no financial penalties to pay, or incarceration to endure, if caught). The major economic hindrances to cartelization will be the free rider problem, cheating by members, and fending off prospective new entrants. Second, without antitrust deterrence of cartels, consumers who perceive themselves as aggrieved by the absence of competition would turn to politicians who might respond with burdensome government regulations on business. Antitrust, in principle, sets the rules of the game, but not the outcome. Absent antitrust enforcement, the regulations politicians substitute might directly involve the government in price and output determination that would be more obstructive than antitrust's more limited restrictions upon freedom of contracting. Tucker never mentions the economic advantages consumers now enjoy because of deregulation that came about because antitrust was offered as a substitute for direct government regulation of price and entry.

To be sure, deterring cartel agreements involves a limitation on voluntary contract. Because of the presumptive benefits of voluntary transactions, one treads cautiously in enlisting the power of the government to inhibit voluntary exchange, but not all agreements are equally voluntary and not all things done voluntarily are moral. If done properly, at least with regard to cartelization, antitrust can become a rejection of laissez-faire in the in-

terests of laissez-faire. For this reason, antitrust's prohibition of horizontal price fixing should appeal to free market proponents.

Antitrust As Protection Against Anticompetitive Mergers

If cartels are the meat and potatoes of antitrust enforcement, mergers are the bread and butter, and maybe the salad course too. Yet Tucker's critique of antitrust is silent with regard to antimerger enforcement, as it was with regard to cartel prevention. Imagine the following story in the *Wall Street Journal*: "The investment banking firm of Goldman Sachs announced today that it had orchestrated the merger of every paper manufacturer in the United States." I suspect that Jeffrey Tucker would not rejoice over the news that there was a horizontal merger of all paper companies in the United States. The Ludwig von Mises Institute buys a lot of paper to communicate its economic insights. Presumably, one could count on an economist like Tucker to understand, better than most consumers, that by ratcheting up the price of paper, in the long run, new entrants would be attracted to the industry; indeed the director of research for the Mises Institute might respond, faster than most consumers, in substituting away from paper. The price increase might induce the Mises Institute to rely more on distributing its literature in digitized form; there might be a shift in demand for internet services and formatted diskettes.

I have every confidence that savvy consumers will find ways to trim the power of the paper monopoly, and I have confidence that in the long run the economic power of the paper monopoly will be cut. But I have less confidence that there would not be adverse short-run effects for consumers as a result of this hypothetical merger. Whether one considers these effects immoral depends upon whether one considers sellers extracting wealth from consumers by output restriction—rather than by superior skill, foresight, and industry—to be immoral.

The Scriptures are favorably disposed to the pursuit of profits when it entails good stewardship over society's scarce resources, honesty in one's dealings, and honoring God by giving Him the first fruits of the return (Prov. 3:9-10). Economic theory teaches that monopolistic output restriction is inefficient. Inefficiency in a world of scarcity may itself be immoral from the standpoint of the biblical principle of stewardship.

A business community that outwardly prides itself on the virtues of free enterprise but engages in extensive horizontal integration intended to eliminate competing sources of supply and disconnected from efficiency gains, cannot expect to persuade a skeptical audience of the merits or the moral-

ity of free enterprise. To John Q. Public and Mary Q. Public, free enterprise connotes not only freedom of contract among sellers but the freedom to shop among alternative sources of supply. At the taproot, that is what the antimerger law seeks to accomplish. To tell John Q. Public and Mary Q. Public, whose freedom to shop among alternative sources of supply has been curtailed by mergers, to "fear not, I bring you glad tidings, for born this day in the country of Austria is the proposition that no monopoly is permanent" may be true, but not fully responsive to their concerns.

New technology and new entry in the long run will dissipate a monopolist's power in ways more profound than is revealed by conventional blackboard economics. It has been the Austrian economists who have taught this important truth. But the proposition does not eliminate from discussion whether antitrust can offer a short-run solution to mergers-for-monopoly, especially when it is not blindingly clear how long John Q. Public and Mary Q. Public must wait for the long run to arrive.

In a fallen world, lots of questions are hard to answer. Even antitrust experts often disagree on the merits of a particular merger. In the case of horizontal mergers, the combining firms may secure market power that will harm consumers; or the combining firms may exploit economic efficiencies that will benefit consumers. It is sometimes tricky to sort mergers into competitive and anticompetitive categories. Should we, for that reason, give all corporate marriages a pass so long as all the firms come to the altar willingly? It is an act of faith (in markets, not the Scriptures) to believe we can dispose of antitrust in the merger arena just because antitrust authorities may sometimes stop benign or efficient mergers or neglect to unravel anticompetitive mergers.

Antitrust and Other Business Practices

Jeffrey Tucker's argument *contra* antitrust is more congenial outside the antitrust realm of deterring cartels and large-scale horizontal mergers. In the area of vertical agreements, where firms are in a buy-sell relationship, there is indeed very limited scope for antitrust enforcement that benefits consumers. Most of the history of antitrust against vertical arrangements—resale price maintenance, exclusive dealing arrangements, exclusive territory contracts, tying contracts, and franchise agreements—has represented an inhibition on voluntary contracts that has had no connection to promoting competition. Thus, consumers have seen little benefit from this kind of antitrust effort and often have been harmed.

But when Tucker turns to antitrust policy and the offense of single-firm

monopolization, I find his critique of antitrust unclear. If he is saying *every* firm that dominates some product market is vulnerable to antitrust attack, then Tucker has built a straw man. His claim that the first jewelry store in rural Montana might be construed as a monopoly and consequently must live in fear of the reach of the Sherman Act is an argument that itself is a long reach. He can relax: the lone fruit stand on a country road remains safe from antitrust attack.

Jumping from an unnamed jewelry store in rural Montana to the recent celebrated antitrust cases against *Toys "R" Us* and *Microsoft* is another long reach. High-profile cases like *Toys "R" Us* and *Microsoft* are statistical outliers on the antitrust spectrum. I will not comment on either of these cases other than to say the issues in each one are more complex than Jeffrey Tucker's summary suggests.

Jack Benny's comedy persona was a tightwad. In his stage or television show, he often would be held up by a robber and told, "your money or your life!" Benny would pause, put his hand to his face, and stare at the robber. When the thug demanded again, "your money or your life!" Benny would reply, "I'm thinking! I'm thinking!" Millions laughed at this line because we recognize that some "choices" are not true choices. Your money or your life is one of them.

Jeffrey Tucker never addresses the question of whether a company (or group of companies) is behaving immorally by putting a customer in the position of an artificially constrained choice of: "pay my price or go without." When this occurs in the world of commerce instead of in the world of entertainment, there is no laughter from the audience of consumers. Nor does Tucker address the hard question of whether there might not be circumstances where government intervention, with all its principal-agent flaws, could improve upon such a situation.

The research of many economists in the United States generally favors market solutions over government regulation. The pro-market tenor of Tucker's paper squares with this literature. Economic research also shows that, in the House of Antitrust, there is much that needs correcting. But much of the correction has already taken place in areas such as vertical contracts, predatory pricing, horizontal mergers, and the use of antitrust as a political lever for deregulation.

A Quintet of Further Problems

Since this paper is a reply and not an initiative, let me only cite without

much elaboration five other troublesome components of Tucker's paper. He writes: "It is only state-connected enterprises that can truly set a price for their services and restrict all substitutes," implying that other monopolies have little authority over the price for their goods. However, the establishment of intellectual property does afford some companies (not just "state-connected enterprises") the ability to "set a price…and restrict all substitutes." Indeed, patents grant a temporary monopoly to the patent-holding company so that it can receive maximum profits without competition as a reward for the risks and costs associated with new product research and development. Yet Tucker writes that "the distinction, if there is one,…between market price and monopoly prices, is not at all obvious to the casual observer." I am not sure who the "casual observer" is, but customers almost always experience a reduction in price when a supplier's patent expires, allowing new competitors to enter the market.

Second, Tucker writes that antitrust law is "*ex post facto* law…[and] managers of a business can only know with certainty that they are guilty of monopolistic practices when the regulators or the courts say that they are." Again, a reader encounters Tucker's use of the word *only*. Actually, some parts of U.S. antitrust law are exceedingly clear. For example, if a sales manager calls a rival to fix prices on sales to downstream customers, the probability is 1.0 that they are violating the Sherman Act. That ought to be adequate for them to "know with certainty."

Third, Tucker writes that a business firm racing "first past the post is the very essence of the competitive process." There is much truth to Tucker's observation that static economic models of competition and monopoly *can* conceal the dynamic nature of market processes. But, let me offer a corrective to Tucker's equine metaphor of a horse being "first past the post." It also is true that a horse running *alone* on a track often appears to be moving very fast. Trainers know with some horses, in order to learn the animal's real potential, it must be paced by other horses. Many people believed AT&T did a fine job of delivering long-distance service. The company does much better now that it is being paced. With some monopolies, because they run alone, we may be mistaking a canter for a gallop.

Fourth, I should not resist commenting on the rhetoric of the Tucker paper. In describing antitrust, the author points out how it is immoral when "antitrust rulings…force companies to make management decisions under the duress of regulatory police tactics." Such language does make antitrust seem outrageous. One envisions an attorney from the Federal Trade Commission or Antitrust Division, whip in hand, sternly standing over a corpo-

rate manager who is perspiring from fear of being flogged. But note how Tucker's sentence can be recast to say it is immoral when "management rulings…force *consumers* to make purchase decisions under the duress of anticompetitive cartel tactics." Such language makes a world without antitrust seem less congenial.

Finally, what the term *antitrust* means is clear from the paper (though Tucker's illustrations of antitrust seem awkwardly tilted). However, it would have been helpful if the author had explicitly set forth a definition of "morality." He refers to "market ethics" and "moral costs" without defining the terms, and I am left unclear as to whether "morality" in the marketplace means nothing more than voluntary transactions among consenting business managers. If that is all there is to Tucker's definition of morality, then antitrust—whether effective or ineffective—would be *per se* immoral since it dares to articulate boundaries limiting the freedom of companies to lessen competition.

At one juncture in his paper, Jeffrey Tucker informs us what business firms in a market economy are "supposed to be doing." They are, he writes, to be "working to maximize profits through consumer service." There is much to be said for this objective. Unfortunately, cartels and mergers-for-monopoly also are ways of "working to maximize profits." What Tucker never makes clear is how they could possibly enhance "consumer service."