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Commentary: Implications of Professor Scherer's Research for the Future of Antitrust

Robert H. Lande
University of Baltimore School of Law, rlande@ubalt.edu

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One way to test the accuracy of Professor Scherer's research is to compare it to the best previous work in the area. Prior to his current article the best analysis of the state of economic thinking and knowledge during antitrust's formative period was presented twelve years ago by—Professor Scherer.[1] This was a skeletal precurser to the well-documented version that he now presents, but his overall conclusions are identical. During the twelve years since his conclusions were presented in the *Yale Law Journal* no one has demonstrated that his research is in any way faulty or misleading, even though many have had a strong incentive to do so. We have, in effect, a "market test" validation of his thesis (in addition to the extraordinary modest critique I can provide). I therefore will primarily discuss why his conclusions are so important for the future of antitrust.[2]

ECONOMIC KNOWLEDGE IN 1890

To vastly oversimplify, economists today know that trusts, cartels and monopolies (hereinafter trusts) can cause three basic categories of economic effects. First, they can cause positive or negative effects on firms' productive efficiency.[3] In addition, trusts can enable firms to acquire market power, and market power causes two types of economic effects: allocative inefficiency and the transfer of wealth from consumers to the trusts.[4]

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* Assistant Professor, University of Baltimore School of Law. I am grateful to Alan Fisher and David Levy for insightful comments on an earlier draft.

1. Scherer, *The Posnerian Harvest: Separating Wheat from Chaff*, 86 YALE L.J. 974 (1977); *see also* Stigler, *The Economists and the Problem of Monopoly*, 72 AM. ECON. REV. PAPERS & PROC. 1 (1982)(explaining the views of economists when Congress passed the antitrust acts).

2. Much of the historical material in this commentary is based upon research first presented in Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982).

3. *See generally* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 13-21 (2d ed. 1980).

4. The line between allocative inefficiency and wealth transfers is sometimes blurry. For example, wealth transfers may be converted into inefficiency if the producers protect or enhance their power through rent-seeking behavior. *See* Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 7 W. ECON. J. 224 (1967). Judge Posner hypothesized:

> [A]n opportunity to obtain a lucrative transfer payment in the form of monopoly profits will attract real resources into efforts by sellers to monopolize, and by consumers to prevent being charged monopoly prices. The costs of the resources so used are costs of monopoly just as much as the costs resulting from the substitution of products that cost society more to produce than the monopolized product.

R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 11 (1976). Posner notes that this effect might also cause consumers or actual or potential competitors of the monopolist to waste resources. *Id.* at 11-12.

Professors Caves and Porter similarly show that monopolies often channel their competitive activities into activities such as advertising to create entry barriers that help to preserve their monop-

Professor Scherer shows that the economics profession has for more than a century possessed a relatively sophisticated understanding of many of the effects of trusts on productive efficiency.[5] In 1890 economists also understood the wealth transfer (or distributive) effects of market power quite well.[6] But the allocative inefficiency effects of market power[7] were virtually unknown, even within the economics profession, when the Sherman Act was passed.[8]

This is important not just for historical value. The knowledge of the

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oly position. Caves & Porter, *From Entry Barriers to Mobility Barriers: Conjectural Decisions and Contrived Deference to New Competition*, 91 Q.J. ECON. 241, 245-54 (1977).

Professor Liebenstein believes that the motivations and incentives of workers and managers are different when their firm does not have face to face competition:

> In situations where competitive pressure is light, many people will trade the disutility of greater effort, of search, and the control of other peoples' activities for the utility of feeling less pressure and of better interpersonal relations. But in situations where competitive pressures are high, and hence the costs of such trades are also high, they will exchange less of the disutility of effort for the utility of freedom from pressure, etc.

Liebenstein, *Allocative Efficiency vs. X-Efficiency*, 56 AM. ECON. REV. 392, 413 (1966).

Similarly, monopolies can create "organizational slack" by tolerating inefficiency and waste. Without the discipline of competition, monopolies may have less incentive to cut waste or search for ways to reduce costs. Professor Scherer believes it is "eminently plausible" that inefficiencies resulting from weak competitive pressures "are at least as large as the welfare losses from [allocative inefficiency]." *See* F. SCHERER, *supra* note 3, at 466.

Of course, many do not believe that the above phenomena occur to a significant degree and consequently believe that monopolies continue to enjoy their full monopoly profits. But if these effects do occur, some or all of the resources that otherwise are thought to be transferred from consumers to the monopolist instead would constitute additional inefficiencies from market power.

5. Marshall observed that the monopoly price can even be lower than the competitive price, particularly in the long run, if the monopolist can increase innovation without sharing the benefits of any advances made, is more efficient, wastes less in advertising, or has greater access to capital. A. MARSHALL, PRINCIPLES OF ECONOMICS 484 (1st ed. 1890).

6. *See, e.g., id.* at 484. In his chapter entitled "The Theory of Monopolies," Marshall gave considerable attention to the distributive (wealth transfer) effects of trusts. *Id.* In addition, Marshall demonstrated that a monopolist will reduce supply to maximize profit:

> The monopolist would lose all his Monopoly Revenue if he produced for sale an amount so great that its supply price, as here defined, was equal to its demand price: the amount which gives maximum Monopoly Revenue is always considerably less than that. It may therefore appear as though the amount produced under a monopoly is always less and its price to the consumer always higher than if there were no monopoly.

Id.

7. The allocative efficiency effects of market power are complex. For a discussion and formal proof that market power leads to allocative efficiency, see E. MANSFIELD, MICROECONOMICS: THEORY AND APPLICATIONS 277-92 (4th ed. 1982); G. STIGLER, THE THEORY OF PRICE 78-81 (1966).

8. *See* A. MARSHALL, *supra* note 5, at 466-67 n 1. This obscure footnote in effect discusses allocative inefficiency, so one can only say that the concept was virtually unknown in 1890. However, Marshall's discussion of how monopoly pricing leads to economic inefficiency will not win any prizes for effective communication. The accompanying text reads:

> If the Consumers' Rent which arise from the sale of the commodity at any price, is added to the Monopoly Revenue derived from it, the sum of the two is the money measure of the net benefits accruing from the sale of the commodity to producers and consumers together, or as we may say the TOTAL BENEFIT of its sale. And if the monopolist regards a gain to the consumers as of equal importance with an equal gain to himself, his aim will be to produce just that amount of the commodity which will make this Total Benefit a maximum.

Id. at 466-67. This paragraph contains a call for a footnote that reads:

> In fig. (38) DD', SS', and QQ' represent the demand, supply and Monopoly Revenue curves drawn on the same plan as in fig. (36). From P_1 draw P_1F perpendicular to Oy: then DFP_1 is the Consumer' Rent derived from the sale of OM thousand feet of gas at the price MP_1. In MP_1 take a point P_4 such that $OM \times MP_4$ = the area DFP_1: then as M moves from O along Ox, P_4 will trace out our fourth curve, OR, which we may call the

economics profession in 1890 sets the outer bounds for what Congress reasonably could have known when it passed the Sherman Act. If even the economics profession did not really understand the concept of allocative inefficiency in 1890, and certainly accorded it no special significance, it is incredible to assert that Congress's sole concern with market power was with its allocative inefficiency effects. Yet, as Professor Scherer reminds us, the dominant paradigm today is that the only goal of the existing antitrust laws is to increase economic efficiency, and the only problem with market power is that it leads to allocative inefficiency.

EFFICIENCY AS THE EXPLANATION FOR ANTITRUST

How did we get to this counterintuitive situation? We largely have Judge Robert Bork to thank.[9] Bork wrote a highly influential article in 1966 that analyzed the legislative history of the Sherman Act in detail.[10] He concluded that Congress's only goal was to maximize economic efficiency.

Bork first disposed of possible socio-political concerns. Regardless whether these considerations explained why Congress was angry at the trusts, Bork asserted that they did not reflect what Congress actually meant to accomplish when it passed the Sherman Act.[11] Bork then presented a number of quotations showing that Senator Sherman and the other legislators appreciated the productive efficiency benefits of the trusts.[12] After all, Congress was aware that trusts often brought capital, management and business expertise to an industry, and could introduce and finance large-scale efficient production. Congress applauded the efficiency of large, modern corporations.

If Congress appreciated trusts' efficiency, what was the legislature's

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CONSUMERS' RENT CURVE. (Of course it passes through O, because when the sale of the commodity is reduced to nothing, the Consumers' Rent also vanishes).

Next from P_3P_1 cut off P_3P_5 equal to MP_4 so that $MP_5 = MP_3 + MP_4$. Then $OM \times MP_5 = OM \times MP_3 + MP \times MP_4$: but $OM \times MP_3$ is the total Monopoly Revenue when an amount OM is being sold at a price MP_1, and $OM \times MP_4$ is the corresponding Consumer' Rent. Therefore $OM \times MP_5$ is the sum of the Monopoly Revenue and the Consumer' Rent, that is the (money measure of the) Total Benefit which the community will derive from the commodity when an amount OM is produced. The locus of P_5 is our fifth curve, QT, which we may call the TOTAL BENEFIT CURVE. It touches one of the Constant Revenue Curves at t_5, and this shows that the (money measure of the) *Total Benefit is a maximum when the amount offered for sale is OW; or, which is the same thing, when the price of sale is fixed at the demand price for OW.*

Id. at 466-67 n. 1 (emphasis added)(diagram omitted).

Nobel laureate Paul Samuelson reflected on the state of knowledge concerning the allocative inefficiency that results from prices above the competitive level (the competitive level is where price equals marginal cost) in the economics profession during the mid 1930s, before pathbreaking work by the late Abba P. Lerner: "I can testify that no one at Chicago or Harvard could tell me in 1935 exactly why P=MC was a good thing, and I was a persistent Diogenes." Samuelson, *A.P. Lerner at Sixty*, 31 REV. ECON. STUD. 169, 173 (1964).

9. Lande, *supra* note 2, *passim*.

10. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966).

11. *Id.* at 41-44.

12. *Id.* at 26-31.

complaint? Why did Congress pass the Sherman Act? The answer is market power. Bork presented many quotations from the Act's legislative history showing that Congress disapproved when trusts used their market power to raise price and restrict output.[13] He then asked what could be wrong with market power. The answer, according to Bork, was that market power causes allocative inefficiency.[14]

Notice Bork's leap of logic. He omits another possible reason why Congress might not have liked market power—market power transfers wealth from purchasers to the firm with the market power.

Professor Scherer's common-sense counter to Bork's logic goes as follows. In 1890, even the economics profession did not really understand, and certainly did not emphasize, that market power causes allocative inefficiency.[15] Even a casual observer of the time knew that if price went up, those consumers who continue to buy will have some of their wealth extracted by firms with market power. It therefore must have been the wealth transfer (distributive) effect of market power that was bothering the legislature.[16]

An examination of the Sherman Act's legislative history indicates that Professor Scherer is correct. The legislative debates over the bill that became the Sherman Act are filled with statements that embody a concern with wealth transfers, not economic efficiency.[17] Congress repeatedly condemned the trusts using emotion-laden language that embodies distributive (or wealth transfer) concerns,[18] not a concern with

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13. *Id.* at 15-16.

14. *Id.* at 7, 9.

15. Scherer, *supra* note 1, at 979-81. Even if Congress had been aware of the allocative inefficiency effects of market power it might not have cared enough to pass the Sherman Act. The first estimate of the allocative inefficiency damage to the American economy caused by market power was presented by Arnold Harberger in 1954. If the results of Harberger's estimates were expressed in terms of 1989 dollars, they would amount to roughly $20.00 per person per year. *See* Harberger, *Monopoly and Resource Allocation*, 44 AM. ECON. REV. 77 (1954). Since Harberger's estimate is based upon a variety of assumptions it is hardly surprising that other economists arrive at different estimates, some of which are lower than Harberger's, while others are larger (some even by a factor of 50). *See* F. SCHERER, *supra* note 3, at 464. The more important question is what the magnitude of this loss would be if there were no antitrust laws to act as both deterrent and corrective systems. It is probably impossible, however, to formulate a meaningful estimate of this figure.

16. Scherer, *supra* note 1, at 976-79.

17. *See* Lande, *The Rise and (Coming) Fall of Efficiency as the Ruler of Antitrust*, 33 ANTITRUST BULL. 429, 449-50 (1988).

> Senator Sherman termed monopolistic overcharges "extortion which makes the people poor," and "extorted wealth." Congressman Coke referred to the overcharges as "robbery." Representative Heard declared that the trusts, "without rendering the slightest equivalent," have "stolen untold millions from the people." Congressman Wilson complained that a particular trust "robs the farmer on the one hand and the consumer on the other." Representative Fithian declared that the trusts were "impoverishing" the people through "robbery." Senator Hoar declared that monopolistic pricing was "a transaction the direct purpose of which is to extort from the community . . . wealth which ought to be generally diffused over the whole community." Senator George complained: "They aggregate to themselves great enormous wealth by extortion which makes the people poor."

Id. (citations omitted).

18. When we conclude that Congress passed the Sherman Act to prevent certain wealth transfers, we have to carefully distinguish this transfer from the larger, overall distributive questions or we will enter a morass. Professor Elzinga published a brilliant article analyzing the problems that

allocative inefficiency.

Neither Bork nor his followers are able to point to even one statement in the legislative debates that looks remotely like a concern with what we today call "allocative inefficiency." They do not exist. Given the state of economic knowledge in 1890 this is not surprising.[19]

The best way to explain congressional intent is in terms of property rights or entitlements. Congress, by passing the Sherman Act, in effect declared that consumers should have the property right (or entitlement) to purchase products and services priced at a competitive level. Not priced at a low level, but at whatever level the competitive market brings. In other words, American consumers were entitled to one of the sweetest fruits of capitalism—competitively priced products and services.

Given the rhetoric in the legislative history, an analogy to stealing would be apt. If I announced that I was going to try to steal Professor Scherer's wallet, society would attempt to prohibit my doing so on efficiency grounds. But society would be much more likely to do so on the simple grounds that the wallet is his property, and my theft would constitute an unfair wealth transfer, an unfair taking or extraction of his property without compensation. Society almost certainly would condemn my action regardless of its efficiency consequences.[20]

DIFFERENCES BETWEEN THE EFFICIENCY AND WEALTH TRANSFER VIEWS

What are the implications of Scherer's conclusion that Congress passed the antitrust laws primarily for distributive reasons? If there is no likely prospect of market power it does not really matter whether antitrust centers around efficiency or wealth extractions; there would be no problem under either approach.[21] Conversely, simple cartels would be attacked under either approach, either because they cause inefficiency or because they extract wealth from consumers.

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can arise when fairness or distributional considerations are incorporated into antitrust. *See* Elzinga, *The Goals of Antitrust: Other than Competition and Efficiency, What Else Counts*, 125 U. PA. L. REV. 1191 (1977). For example, one could ask whether a particular group of consumers is rich or poor, or whether they are richer or poorer than the stockholders or workers of the firm that manufactures the products. Professor Elzinga demonstrates that if we start getting into these questions we become bogged down in vague and unanswerable fairness problems. *Id. passim*. Congress was not, however, concerned when it passed the antitrust laws with the overall distribution of wealth in society. Congress merely wanted to stop one transfer—from consumers to firms with market power—that is considered inequitable. Lande, *supra* note 2, at 93-96.

19. Although I do not believe that the Congresses that passed the antitrust laws understood the concept of allocative inefficiency in any manner whatsoever, I do not mean to imply that these legislators were economically unsophisticated. Senator Sherman, for example, understood why entry barriers are so important to antitrust analysis: "[I]f other corporations can be formed on equal terms a monopoly is impossible." 21 CONG. REC. 2457 (1890).

20. We would prohibit this transfer regardless of its distributive consequences. Even if I am much poorer than Professor Scherer I still am not permitted to steal his wallet.

21. Of course, we might condemn certain practices, such as horizontal price fixing, even in an absence of proof of market power, for jurisprudential reasons.

Any more complex case involving competing market power and efficiency effects would, however, be greatly affected since the anticompetitive effects of market power would be magnified. As a crude approximation of the difference this could make, focus on the relative size of the allocative inefficiency effects of market power compared to the wealth transfer effects. Under the efficiency view, "what's wrong" with market power equals its allocative inefficiency effects. Suppose it is concluded that Congress also wanted antitrust to incorporate the transfer effects. Professor Scherer provided estimates of the relative sizes of the transfer and efficiency effects (with many caveats that I am going to leave out). He concluded that, on the average, the transfer effects of market power are probably at least as large, and perhaps are six times as large, as the allocative inefficiency effects.[22] Judge Easterbrook recently assumed they might be twice as large.[23] Using Judge Easterbrook's conservative estimate for simplicity, "what's wrong with market power" would be trebled if we also incorporate its transfer effects. Market power, in other words, was in the opinion of Congress approximately three times as "bad" as the efficiency school thinks it is.

This reevaluation should lead to significant changes in many aspects of antitrust policy. For example, the wealth transfer concept has just started to have some explicit influence with respect to horizontal merger policy. The National Association of Attorneys General (NAAG) Merger Guidelines explicitly rest upon the assumption that the principle problem with mergers is that they can lead to market power that will cause consumers to pay more for their goods.[24] This is one of the reasons why the NAAG Merger Guidelines are somewhat stricter, especially in practice, than the federal Merger Guidelines.

Two colleagues and I also have started to analyze the implications of incorporating wealth transfers into merger policy.[25] Most merger analysis by the federal antitrust enforcement officials during the Reagan administration consisted solely of a balancing of merger efficiencies and inefficiencies, and permitted price to rise so long as the resulting firm was (net) efficient.[26] Suppose, however, we believe that Congress did not want to permit mergers that would lead to higher prices for consumers

22. F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE ch. 17 (2d ed. 1980).

23. Easterbrook, *Panel Discussion*, 55 ANTITRUST L.J. 123, 126 (1986).

24. "When a firm or firms exercise market power by profitably maintaining prices above competitive levels for a significant period of time a transfer of wealth from consumers to those firms occurs. This transfer of wealth is the major evil sought to be addressed by section 7." Horizontal Merger Guidelines of the National Association of Attorneys General, [52 Special Supp.] Antitrust & Trade Reg. Rep. (BNA) No. 1306, at S-4 (Mar. 12, 1987)(footnotes omitted).

25. *See* Fisher, Johnson & Lande, *Price Effects of Horizontal Mergers*, 77 CALIF. L. REV. 777 (1989).

26. This balancing is performed primarily through Merger Guidelines rather than on a case-by-case basis. *Id.* at 810-18. *But see* Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381 (1980).

since this would entail a transfer of consumers' wealth to the firms acquiring market power. Efficiencies would still be relevant since, *ceteris paribus*, they can cause price to decrease. Under a price standard we would balance the downward pressure from potential efficiency gains against the upward pressure from potential increased market power. To do this is extremely complex, but one safe conclusion that emerges is that a price standard, instead of an efficiency standard, should lead to significantly stricter merger enforcement.[27]

In many other areas of antitrust, however, no one has even started to analyze the effects of incorporating a concern with wealth transfers. For instance, many examples of price discrimination might be evaluated differently since price discrimination has dramatic wealth transfer effects. What about tying arrangements implemented so the firm using the tie can price discriminate, or many instances of price discrimination that violate the Robinson-Patman Act? No one has ever done a good job analyzing these antitrust issues from a wealth transfer, rather than efficiency, perspective.[28] Similarly, many vertical restraints can be used to price discriminate or extract wealth from a firm at a different stage in the distribution process.[29] In addition, recall the predatory pricing debate started by Areeda and Turner;[30] their famous proposal was followed by an avalanche of articles by distinguished economists and lawyers, including Professor Scherer, containing many sophisticated attempts to discern whether predatory pricing should be judged in terms of average variable cost, average total cost, output, et cetera.[31] To my knowledge, virtually all these analyses proceeded under an efficiency model.[32] Suppose we now attempt to determine the optimal standard towards predatory pricing using a wealth transfer model. Would it make significant difference in our judgment as to the optimal rule? I do not know, but the profession should start to find out.

Historical analysis can help set the bounds on what is appropriate for current antitrust analysis. Of course, history must be examined accurately, especially to the extent that strict constructionism is appropriate. To illustrate the potential pitfalls from an incorrect use of the historical record, consider the mischief that could result from a literal reliance upon my favorite legislative history quotation (from the legislative his-

27. Fisher, Johnson & Lande, *supra* note 25, at 815-18.

28. The author currently is attempting to analyze the wealth transfer effects of tying arrangements. See R. Lande, Untangling Tying (1990)(unpublished manuscript).

29. This is similar to rent-seeking analysis. *See supra* note 4.

30. Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

31. *See generally* Hurwitz & Kovacic, *Judicial Analysis of Predation: The Emerging Trends*, 35 VAND. L. REV. 63 (1982)(contains citations to and cogent analysis of many of these articles).

32. The only predatory pricing analysis of which I am aware that even takes a token step in this direction is Zerbe & Cooper, *A Theoretical and Empirical Analysis of Alternative Predation Rules*, 61 TEX. L. REV. 655 (1982).

tory of the Federal Trade Commission Act). Senator Kenyon quoted Senator Martine for the proposition that "everybody should be permitted to kill one lawyer and not be punished for it."[33] Fortunately, even if this were permitted we would still be able to rely upon the scholarship of nonlawyers like Professor Scherer. His analysis of the knowledge of the economics profession during antitrust's formative years is extremely important. Lawyers and economists should begin to take his conclusions seriously and start to determine the differences this will make for antitrust.

33. 51 CONG. REC. 13,196 (1914). Most economists love this quotation. They typically complain, "Why only one?"