Competition Policy International

Volume 5 | Number 1 | Spring 2009

Introduction to The Neal Report and the Crisis in Antitrust & A Reprint of the Neal Report

Herbert Hovenkamp

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Published in Competition Policy International (print ISSN 1554-0189, online ISSN 1554-6853), Spring 2009, Vol. 5, No. 1. For articles and more information, visit www.globalcompetitionpolicy.org.

Introduction to The Neal Report and the Crisis in Antitrust

*Herbert Hovenkamp**

I. Introduction

The Neal Report[1] ("Report") was secretly commissioned by President Lyndon Johnson in late 1967. The President asked Phil C. Neal, Dean of the University of Chicago Law School, to lead a group of distinguished lawyers and economists in reporting on the state of competition in American industry and recommend reforms of the antitrust laws. President Johnson requested the Report by June 30, 1968, about four months prior to the election, and its release was intended to be part of the LBJ re-election strategy. However, Johnson's political standing was severely damaged by the unpopular war in Vietnam, and in March, 1968, he announced that he would not run for reelection. The authors finished the Report nevertheless, and it was submitted to President Johnson in July, 1968, and released to the public early in 1969.[2]

This reprint of the Neal Report includes the authors' Summary of the Report, as well as the main body's most important components, which are an introduction on market structure and the role of competition; and a section on oligopoly, monopoly and industrial concentration, including the Report's controversial proposal of a "Concentrated Industries Act." Omitted are a section on conglomerates and conglomerate mergers, as well as concluding sections on the Robinson-Patman Act and patents.

The authors of the Report included six law professors who were teachers and scholars of antitrust,[3] three economists,[4] and three practicing antitrust attorneys.[5] The entire project took only seven months to complete, involved no new research, and contains virtually no citation. Yet it proposed expansive antitrust reforms, including most centrally a "Concentrated Industries Act" which gave the Attorney General a mandate to "search out" oligopolies[6] and order divesti-

*Ben V. & Dorothy Willie Professor of Law, University of Iowa.

tures to the point that no firm would end up with a market share exceeding 12 percent. In addition, the Report recommended a much more aggressive merger provision that essentially would have condemned mergers in any large industry where the four-firm concentration ratio ("CR4") exceeded 50 percent and one of the firms involved in the merger exceeded a market share of 10 percent. It is worth noting that such a market could have a Herfindahl-Hirschman Index ("HHI") as low as 650, well under the 1000 HHI that the government's Merger Guidelines currently in force regard as "unconcentrated," and in which mergers have a virtual safe harbor. In addition, the Report recommended several amendments to the Robinson-Patman price discrimination statute, many of which were designed to weaken it. The Report also recommended patent reform that went not to the quality and quantity of issued patents, but rather to their licensing and use. The principal recommendations were a requirement that all patent licenses be registered, and that if a patent was licensed to one licensee it must be licensed to all other prospective licensees on nondiscriminatory terms. Finally, the Report recommended that a repository of economic data concerned mainly with industry structure and profits be collected and disseminated.

A couple of historical footnotes: First, Robert H. Bork wrote a stinging dissent from the Report's recommendations and firmly aligned himself with the Chicago School critique.[7] William F. Baxter kept silent but would largely repudiate the Report later as he learned more about economics.[8] Second, all of the recommendations in the Neal Report were ignored, in part because the change in Administration from Johnson to Nixon killed any political momentum for massive antitrust reform. President Nixon appointed a second, competing Commission, this one chaired by George J. Stigler, another prominent member of the University of Chicago faculty, although this time in the economics department, as well as several of his colleagues.[9] The Stigler Report was never officially released,[10] but it leaked out in May, 1969.[11] The Stigler Report disagreed with the industrial concentration warnings in the Neal Report, largely rejected the correlation between market concentration, profits, and anticompetitive results that the Neal Report purported to find, and made several technical recommendations for revision of the antitrust laws. At least in the short term, its recommendations fared no better than those contained in the Neal Report.

Reading the Neal Report today is a trip to another world. But, in fact, it represented the received orthodoxy of its day. The tragedy of the Neal Report is that the model it represented was just on the verge of complete, catastrophic replacement. The views expressed there reflected the culmination of thirty years of industrial organization thinking that we today identify as the "structure-conduct-performance" (S-C-P) paradigm.[12] Indeed, the publication of the Neal Report played no small part in instigating a massive reaction among younger academics that eventually cast the S-C-P paradigm onto the dung heap of defunct economic doctrines.

The S-C-P paradigm was one of the most elegant and certainly the most tested model of industrial economics up to its time. Indeed, its greatest perceived virtues were its simplicity and its robustness. The theory represented the high point of structuralism in industrial organization economics, resting on the proposition that certain market structures were highly concentrated and experienced high barriers to entry, making certain types of conduct inevitable. Oligopolists simply could not avoid setting prices above costs and continuously and excessively differentiating the products. The result was high short-run profits, excessive investment in product differentiation and advertising, reluctance to cut price in order to grow market share, and general stagnation. The theory appeared to be verified by numerous studies showing positive correlations between industrial concentration and profits—the more concentrated the industry, the higher its price-cost margins.[13] By contrast, the relationship between conduct and poor performance was thought to be virtually impossible to quantify.

INDEED, THE PUBLICATION OF THE NEAL REPORT PLAYED NO SMALL PART IN INSTIGATING A MASSIVE REACTION AMONG YOUNGER ACADEMICS THAT EVENTUALLY CAST THE S-C-P PARADIGM ONTO THE DUNG HEAP OF DEFUNCT ECONOMIC DOCTRINES.

Under the principle of excluded middle, if the structure dictated the conduct and the conduct dictated the performance, then conduct dropped out as an interesting subject of study. Thus the S-C-P paradigm led directly to the conclusion that structure and not conduct is what antitrust policy should be about. Thus the Neal Report could state that:

> "Effective antitrust laws must bring about both competitive behavior and competitive industry structure. In the long run, competitive structure is the more important since it creates conditions conducive to competitive behavior."[14]

This emphasis on structure and de-emphasis of conduct also motivated Donald F. Turner's proposal in the early 1960s that firms in oligopolistic industries should be broken up because price competition in such markets could not be expected to emerge.[15] The editors of the *Antitrust Law and Economics Review*, who were deeply sympathetic to the Neal Report and hostile toward the Stigler Report, introduced their publication of the latter with a proposed set of "Guidelines" for the antitrust enforcement agencies. The Guidelines were entitled *A Structure-Conduct-Performance Questionnaire*, and consisted of queries about the size of markets, the level of concentration, the amount of product differentiation, and the height of entry barriers. A few conduct questions were tacked on to the end.[16]

Today we can find much to criticize and even mock in the Neal Report. But it was largely faithful to the dominant industrial economics and law of its day. Its recommendations were built on some of the best theory coming out of an economic model that was just in the process of ending its period of domination. The tragedy of the Neal Report is that, while it was highly sensitive to where the intellectual winds were blowing from, it paid too little attention to where they were going.

Initially the S-C-P paradigm had offered a robust solution to problems that had festered within competition theory ever since the rise of marginalist economics in the late nineteenth century. [17] Prior to the Great Depression, industrial economists had been unable to solve a problem that Alfred Marshall had observed already in his *Principles of Economics* in 1890: In the presence of fixed costs, competition tends to drive prices down to marginal cost without enough left over to cover fixed costs, leading to "ruinous" competition.[18] During an era when technological progress was greatly increasing the proportion of fixed costs in production, this theory seemed to explain why so many economists opposed the antitrust laws and tended to favor collusion-facilitating cooperative ventures such as trade associations.[19] The prevailing models assumed fungible products and "representative" firms—i.e., firms that were all more-or-less the same in significant characteristics.

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Edward Chamberlin's *Theory of Monopolistic Competition* largely solved the equilibrium problem in 1933,[20] but did so by abandoning the Marshallian notion that firms in multifirm markets pursued relentless price competition. Instead, they competed by differentiating their products. Further, this differentiation was "excessive," in the sense that it was driven by pursuit of mini-monopolies rather than by consumer interest in an optimal variety of products at competitive prices. While the Marshallian story denigrated antitrust, Chamberlin's theory seemed to call for a great deal of it. Indeed, this change in dominant models explains why the Roosevelt Administration so abruptly shifted its policy from virtual abandonment of antitrust and encouragement of collusion to one of aggressively enforcing the antitrust laws.

But that left open the question how the antitrust laws should be applied. While Marshall tended to see firms as similar, the Chamberlin story was one of extreme diversity in both strategy and behavior. The one unifying element was structure,

a result of the picture that Chamberlin painted of firms ever searching to distinguish themselves from others so that they could operate in as small a market as possible. An important characteristic of industrial organization models at this time were formulas that related the markup of price over cost to two principal variables: the number of firms in the market and their size disparities.

Monopolistic competition largely solved the fixed-cost problem and made equilibrium possible. Chamberlin's equilibrium would always be suboptimal, however, with prices above marginal cost, continuous excess capacity, and excessive investment in product differentiation. In 1940 John Maurice Clark published his pathbreaking essay, *Workable Competition*, which argued that antitrust policy should not trouble itself with the pursuit of perfect competition.[21] Rather, it should be satisfied with a set of compromises. Clark's genius lay in his observations that market imperfections have a way of cancelling each other out—for example, product differentiation made perfectly competitive equilibria impossible, but it also made collusion much more difficult to maintain. The interesting cases for Clark were the middles ones that fell between the monopolistic and the highly competitive, where policy making could have its most important role.

A few years later Joe Bain, the most prominent industrial organization economist prior to the rise of the Chicago School, exalted the strong link between market structure and the workability of competition. In the process, Bain laid the foundation for an antitrust policy whose principal goal was to ensure that industry did not become excessively concentrated, but would maintain just enough firms to ensure that price competition remained a part of business strategy and that product differentiation did not become excessive.[22] For Bain, one of the most important problems was high concentration accompanied by high barriers to entry. Chamberlin's basic model of monopolistic competition and product differentiation had assumed that entry was easy. Competition seemed to be more workable, with prices driven to total costs, when entry was easy. But high concentration accompanied by high entry barriers led to the worst of both worlds—namely, excessive product differentiation and excessive profits. [23] To the extent the theory offered a set of ideas that were useful for policy purposes, they were ideas about structure. In his market-dominating book, *Industrial Organization*, which was published in 1959, Bain concluded that conduct was too heterogenous and too difficult to evaluate. The verifiable conditions for workable competition could be stated only by reference to industry structure. "We eschew," he wrote, "any general attempt to state an operational criterion of the conduct conditions of workable competition, and adhere in the main to a suggestion only of structural conditions." [24]

Bain's work and that of his Harvard teacher Edward S. Mason have come to be identified with the "Harvard School" of industrial organization and the S-C-P Paradigm.[25] The theory was unquestionably dominant among the industrial economist and policy-making gentry in the 1960s, including most of those in Neal's group. But when Neal and his colleagues began penning their Report it had already begun to crumble. Chicago School writers had already exploded the lever-

age theory of tying[26] and provided competitively benign explanations for resale price maintenance.[27] Stigler had written a formative article arguing that strict assumptions about oligopoly should be relaxed, that the number of firms was only one of many factors that indicated whether a market was prone to noncompetitive pricing, and that there was much more room for competition in highly concentrated markets than previously thought. The real key for Stigler was information—who had it and did not have it, and how easily it flowed from one market participant to another.[28] The Bainian definition of entry barriers was in dispute.[29] Richard Posner, a member of the competing Stigler task force, had written an answer to Turner's argument for structural solutions to the oligopoly problem, relying heavily on Stigler's competing theory of oligopoly.[30] A broad-based attack was being launched against the proposition that one could infer monopoly power from high accounting profits.[31] Finally, Robert H. Bork, a dissenting member of the Neal Commission, and Ward Bowman, who was on the Stigler Commission, had already published their influential *The Crisis in Antitrust*.[32]

One could continue with this list,[33] which makes it easy to criticize the S-C-P paradigm as structuralism run amok, to see it as preoccupied with making firms smaller, and as completely insensitive to economies of scale or scope. There is even a tendency to see it as anticonsumer, aided in no small part by some of the characterizations in Bork's and Bowman's famous *Crisis* essay.[34]

But the Neal Report was clearly not anticonsumer on its own terms. In fact, it concluded that "consumer welfare is . . . in the forefront of antitrust policy."[35] The difference between the milieu that came to an end just about the time the Neal Report was published—indeed, in part because of it—was not that the older regime was unconcerned about consumer welfare while the successor regime was. Rather, it lay in the set of economic premises upon which the theories were built. Nothing in the Neal Report favored the protection of small business for its own sake at the expense of consumers, and the authors specifically mentioned high prices as one of the evils produced by high concentration.[36] The whole premise of the Bainian analysis of entry barriers as factors that deter entry even while profits are high, or the use of accounting data to infer a relationship between concentration and high profits, was that high prices were in fact the evil to be addressed. The questions pertained to the set of economic assumptions that would get the job done. To that end, the turning point marked by the Neal Report and the reaction to it was at least as much a change in prevailing economic theory as in antitrust policy.

THE DIFFERENCE BETWEEN THE MILIEU THAT CAME TO AN END JUST ABOUT THE TIME THE NEAL REPORT WAS PUBLISHED—INDEED, IN PART BECAUSE OF IT—WAS NOT THAT THE OLDER REGIME WAS UNCONCERNED ABOUT CONSUMER WELFARE WHILE THE SUCCESSOR REGIME WAS. RATHER, IT LAY IN THE SET OF ECONOMIC PREMISES UPON WHICH THE THEORIES WERE BUILT.

1 Report of the White House Task Force on Antitrust Policy (May 27, 1969), originally published at 115 CONG. REC. 11, 13890, reprinted here at 227.

2 *See* Stephen Calkins, *Antitrust Modernization: Looking Backwards, Symposium, The Antitrust Enterprise: Principle and Execution*, 31 J.CORP.L. 421 (2006).

3 Phil C. Neal (chair, and Dean of the Univ. of Chicago Law School); Willam F. Baxter (Stanford Law School); Robert H. Bork (Yale Law); Carl H. Fulda (University of Texas Law School); William K. Jones (Columbia University Law School); James A. Rahl (Northwestern University Law School).

4 Paul W. MacAvoy (MIT), James W. McKie (Vanderbilt), and Lee E. Preston (Univ. of California, Berkeley).

5 Dennis G. Lyons (Arnold & Porter), George D. Reycraft (Cadwalader, Wickersham & Taft), and Richard E. Sherwood (O'Melveny & Myers).

6 Defined as CR4>70—that is, using the four-firm concentration ratio, the sums of the market shares of the four largest firms in the industry exceeded 70 percent.

7 Separate Statement of Robert H. Bork, 2 ANTITRUST L. & ECON. 53 (Winter 1968).

8 *See* Richard Schmalensee & Bill Baxter, *Antitrust Arena: an Economist's Appreciation*, 51 STAN. L. REV. 1317, 1319 (1999).

9 The members were George J. Stigler (University of Chicago, chair), Ward S. Bowman, Jr. (Yale, law and economics), Ronald H. Coase (Univ. of Chicago, economics), Roger S. Cramton (University of Michigan Law School), Kenneth W. Dam (University of Chicago Law School), Raymond H. Mulford (President, Owens-Illinois, Inc.), Richard A. Posner (Univ. of Chicago Law School), Peter O. Steiner (Univ. of Michigan law and economics), and Alexander L. Stott (vice president, AT&T).

10 It was subsequently published, however, at 115 CONG. REC. 12, 15933-15942 (June 16, 1969); and reprinted in 2 ANTITRUST L. & ECON. R. 13 (No. 3, Spring, 1969). The editors of that journal did not disguise the fact that they sided with the Neal Report and largely rejected the recommendations of the Stigler Report.

11 *See* Louis M. Kohlmeier, *Study of Conglomerates for Nixon Urges No Antitrust Suits to Block Their Mergers*, WALL ST. J., May 23, 1969. This article was published two days after the Neal Report was released. *See* Calkins, *supra* note 2, at 433.

12 *See* E. S. MASON, ECONOMIC CONCENTRATION AND THE MONOPOLY PROBLEM (1964).

13 *See* Leonard Weiss, *The Concentration-Profit Relationship and Antitrust*, *in* INDUSTRIAL CONCENTRATION: THE NEW LEARNING, (Harvey J. Goldschmid, H. Michael Mann, & J. Fred Weston, eds., 1974) (summarizing numerous pre-1970s studies). *See also* Joe S. Bain, *Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-1940*, 65 Q.J.ECON. 293 (1951). Other important work includes H. M. Mann, *Seller Concentration, Barriers to Entry, and Rates of Return in Thirty Industries, 1950-1960*, 48 REV. ECON. & STAT. 296 (1966).

14 Neal Report, *supra* note 1 at 227.

15 Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV.L.REV. 655 (1962). These recommendations appeared earlier in more truncated form in C. KAYSEN & D. TURNER, ANTITRUST POLICY 110-119, 266-272 (1959). Turner went on to be head of the Antitrust Division from 1965-1968, in the years leading up to the Neal Report.

16 *See Appendix: A Structure-Conduct-Performance Questionnaire*, 2 ANTITRUST L. & ECON R. 8 (Spring, 1969).

17 *See* Herbert Hovenkamp, *The Neoclassical Crisis in U.S. Competition Policy, 1890-1955*, MINN L. REV. (to be published in 2009).

18 ALFRED MARSHALL, PRINCIPLES OF ECONOMICS (1890). *See* D.H. Robertson, Piero Sraffa & G.F.S. Shove, *Increasing Returns and the Representative Firm 50*, reprinted in JOHN CUNNINGHAM WOOD & ALFRED MARSHALL, CRITICAL ASSESSMENTS (1993).

19 On the impact of the fixed cost controversy in antitrust policy prior to the 1930s, *see* HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836-1937 at 308-322 (2001).

20 EDWARD CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION (1933). On the theory's profound impact on Marshallian equilibrium theory, *see* MARK BLAUG, ECONOMIC THEORY IN RETROSPECT at 375 (5th ed. 1996).

21 John Maurice Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 243 (1940).

22 Joe S. Bain, *Workable Competition in Oligopoly: Theoretical Considerations and Some Empirical E*vidence, 40 AM. ECON. REV. 35 (papers and proceeding) (1950). *Id*. at 38-39:

> Whatever the degree of association within oligopolies between competitive behavior and results, it seems quite likely that such behavior may be in turn either influenced or determined by certain characteristics of the underlying market structure. If so, a demonstrated association between market structure and results would establish the more fundamental determinants of workability of competition (and, also, determinants more easily influenced by conventional public policy measures).

23 JOE S. BAIN, BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES (1956).

24 JOE S. BAIN, INDUSTRIAL ORGANIZATION 427 (1959).

25 Although Bain was educated at Harvard he spent nearly his entire academic career (1939-1975) at the University of California, Berkeley economics department.

26 Ward Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957).

27 Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L.& ECON. 86 (1960).

28 George J. Stigler, *A Theory of Oligopoly*, 72 J.POL.ECON. 45 (1964).

29 GEORGE J. STIGLER, THE ORGANIZATION OF INDUSTRY 67 (1968).

30 Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L.REV. 1562 (1969). *See also* R. Posner, *Oligopolistic Pricing Suits, the Sherman Act, and Economic Welfare*, 28 STAN. L.REV. 903 (1976) (recapping the debate).

31 The literature is summarized in Franklin M. Fisher & John J. McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73 AM. ECON. REV. 82 (Mar. 1983). *See also* Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J.L. & ECON. 351 (1971); and Harold Demsetz, *Two Systems of Belief About Monopoly, in* INDUSTRIAL CONCENTRATION: THE NEW LEARNING 164 (Harvey J. Goldschmid, H. Michael Mann, & J. Fred Weston, eds., 1974).

32 R. Bork & W. Bowman, *The Crisis in Antitrust*, FORTUNE (Dec. 1963); and 65 COL.L.REV. 363 (1965).

33 For differing perspectives, *see* Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. Pa L. Rev. 925 (1979); Leonard W. Weiss, *The Structure-Conduct-Performance Paradigm and Antitrust*, 127 U. Pa. L. Rev. 1104, 1105 (1979).

34 R. Bork & W. Bowman, *supra* note 32, at 364:

> Long-standing contradictions at the root of antitrust doctrine have today brought it to a crisis of policy. From its inception with the passage of the Sherman Act in 1890, antitrust has vacillated between the policy of preserving competition and the policy of preserving competitors from their more energetic and efficient rivals. It is the rapid acceleration of the latter "protectionist" trends in antitrust that has brought on the present crisis. Anti-free-market forces now have the upper hand and are steadily broadening and consolidating their victory. The continued acceptance and expansion of their doctrine, which today constitutes antitrust's growing edge, threaten within the foreseeable future to destroy the antitrust laws as guarantors of a competitive economy.

35 Neal Report, *supra* note 1 at 231.

36 *Id*. at 234.

The Neal Report

*Report of the White House Task Force on Antitrust Policy**

I. Summary

A. WE RECOMMEND SPECIFIC LEGISLATION ON THE SUBJECT OF OLIGOPOLIES, OR HIGHLY CONCENTRATED INDUSTRIES.

The purpose of such legislation would be to give enforcement authorities and courts a clear mandate to use established techniques of divestiture to reduce concentration in industries where monopoly power is shared by a few very large firms. Up to now such measures have been employed only in the rare instances where the monopolistic structure of an industry takes the form of a single firm with an overwhelming share of the market. Specific legislation dealing with entrenched oligopolies would rectify the most important deficiency in the present antitrust laws.

Effective antitrust laws must bring about both competitive behavior and competitive industry structure. In the long run, competitive structure is the more important since it creates conditions conducive to competitive behavior. Competitive structure and behavior are both essential to the basic concern of the antitrust laws—preservation of the self-regulating mechanism of the market, free from the restraints of private monopoly power on the one hand and government intervention or regulation on the other. In one important respect the antitrust laws recognize the necessity for competitive market structure: the 1950 amendment to section 7 of the Clayton Act has effectively prevented many kinds of mergers which would bring about less competitive market structures. Our proposed remedy, which would deal with existing noncompetitive market structures, is a necessary complement to section 7.

*Originally published on July 5, 1968, as Report of the White House Task Force on Antitrust Policy, Phil. C. Neal, Chairman.

Highly concentrated industries represent a significant segment of the American economy. Industries in which four or fewer firms account for more than 70% of output produce nearly 10% of the total value of manufactured products; industries in which four or fewer firms account for more than 50% of output produce nearly 24%. An impressive body of economic opinion and analysis supports the judgment that this degree of concentration precludes effective market competition and interferes with the optimum use of economic resources. Past experience strongly suggests that, in the absence of direct action, concentration is not likely to decline significantly.

While new legal approaches might be developed to reduce concentration under existing law—a result which should be encouraged—the history of antitrust enforcement and judicial interpretation do not justify primary reliance on this possibility. For this reason, we recommend a specific legislative remedy directed to the reduction of concentration. Our proposed Concentrated Industries Act, . . . , establishes criteria and procedures for the effective reduction of industrial concentration.

B. WE RECOMMEND ADDITIONAL LEGISLATION PROHIBITING MERGERS IN WHICH A VERY LARGE FIRM ACQUIRES ONE OF THE LEADING FIRMS IN A CONCENTRATED INDUSTRY.

This legislation would supplement section 7 of the Clayton Act, which prohibits mergers which may tend substantially to lessen competition. The primary impact of the new legislation would be on diversification or "conglomerate" mergers. Under section 7 of the Clayton Act, such mergers may be prevented if adverse effects on competition can be anticipated. But the detection of such effects frequently depends on factual and theoretical judgments that are highly speculative. As a result, some mergers with potentially adverse effects on competition may escape attack and mergers which will not harm competition will be prohibited because the effects cannot readily be predicted. Because of the inherent limitations of the competitive standard of section 7, the recently published Merger Guidelines do little to resolve these difficulties.

Our proposed legislation would prevent some possibly anticompetitive mergers which might have gone unchallenged because of the difficulty of applying section 7 standards, and thus would act as an effective supplement to existing policy. In addition, the proposed legislation would have affirmative aspects in channeling merger activity into directions likely to increase competition. If large firms are prevented from acquiring leading firms in concentrated industries, they will seek other outlets for expansion which may be more likely to increase competition and decrease concentration.

This policy of deflecting conglomerate mergers into desirable channels is preferable to any rule that would limit mergers without regard to considerations of market structures. Although the number of conglomerate mergers has

increased sharply in recent years, there is only a moderate tendency toward increase in the overall concentration of manufacturing assets in American industry. Nor does the present merger movement threaten to reduce the aggregate number and proportion of smaller firms. Remedial measures based on size alone would constitute a radical innovation in our antitrust policy and no rationale is available for determining the appropriate upper limit on the size to which a single firm may grow.

We therefore believe that restrictions on mergers should continue to be based on considerations related to competitive market structure. The policy we recommend would permit the continued growth of firms by diversification as well as by internal expansion but would, we believe, promote the development of more competitive structures. . . .

C. WE RECOMMEND A THOROUGH REVISION OF THE ROBINSON-PATMAN ACT TO REMOVE FEATURES THAT UNDULY RESTRICT THE FREE PLAY OF COMPETITIVE FORCES.

It has long been recognized that many aspects of the Robinson-Patman Act in its present form have serious anticompetitive effects. The course of enforcement and interpretation of the Act have in many instances aggravated those effects. In addition, the ambiguities and complexities of the statute as written have posed unusual difficulties of compliance. Experience with the Act and the extensive criticism to which it has been subjected provide the basis for a general revision that will make it consistent with the major aims of antitrust policy. In our view such a revision is long overdue.

The purpose of the Robinson-Patman Act is to eliminate price discrimination that unduly favors national over local sellers or confers unjustified advantages on large purchasers merely because of their size. But not all price differentials represent discrimination and not all discrimination is undesirable. Some price discrimination does have anticompetitive effects. But in other cases price discrimination improves the functioning of the competitive system. A statute designed to restrict price discrimination should therefore be narrowly drawn, so that the important benefits of competition as evidenced in price differentials will not be lost in an excessive effort to curb limited instances of harm. Our proposed revision is intended to leave room for price behavior which is related to the improved functioning of the competitive system.

The Robinson-Patman Act contains several prohibitions supplementing the price-discrimination prohibition. These prohibitions should be repealed. They accomplish little that could not be accomplished by a properly drawn price-discrimination prohibition. In their present form, they often impair competition; they discourage legitimate transactions; and they promote irrational distinctions. . . .

D. WE RECOMMEND LEGISLATION TO ESTABLISH THE PRINCIPLE THAT A PATENT WHICH HAS BEEN LICENSED TO ONE PERSON SHALL BE MADE AVAILABLE TO ALL OTHER QUALIFIED APPLICANTS ON EQUIVALENT TERMS.

Patents are one of the principal sources of monopoly power, since they confer upon the patentee the right to exclude others from the field covered by the patent. An important goal of antitrust policy is to prevent the use of a patent by the patentee in collaboration with others to create a monopoly broader than the patent itself. That goal will be served by denying the patentee the right to confine use of the patent to a preferred group and requiring that if the patent is licensed it shall be open to competition in its application. Such a principle does not prevent the owner of a valid patent from fully exploiting the monopoly conferred by the patent. Our proposal does not fix or limit the royalty to be charged by the patentee, nor does it involve compulsory licensing. It merely requires that if the patentee chooses to license others rather than exploiting the patent himself he shall make such licenses available on nondiscriminatory terms to as many competitors as may desire it.

Supplementary provisions in our proposal would require the public filing of all patent license agreements and would bar enforcement of a patent against particular infringers if the patent owner has not take reasonable steps to enforce the patent against others. We believe that each of these measures has some independent value in deterring misuse of patents and that they could be adopted independently of the requirement of nonexclusive licensing.

E. WE RECOMMEND THAT STEPS BE TAKEN TO IMPROVE THE QUALITY AND AVAILABILITY OF ECONOMIC AND FINANCIAL DATA RELEVANT TO THE FORMULATION OF ANTITRUST POLICY, THE ENFORCEMENT OF THE ANTITRUST LAWS, AND THE OPERATION OF COMPETITIVE MARKETS.

Specifically, we recommend formation of a standing committee of representatives of the Census Bureau and other Government agencies which gather or use economic information to consider (1) improving the gathering and presentation of economic information within the statutory limits on disclosure of information on individual firms; (2) new interpretations of existing law or, eventually, new legislation to minimize restrictions on disclosure of types of information which are not highly sensitive from the point of view of individual firms but are of great value in the formulation of policy and the application of law; and (3) machinery for developing information on the competitive structure of relevant economic market, because such markets do not necessarily coincide with Census industry and product classifications. These recommendations could be implemented immediately, without new legislation or appropriations.

In addition, the role of financial information in the operation of competitive markets should be reflected in the formulation of financial reporting require-

ments by the Securities and Exchange Commission. These requirements are now imposed pursuant to the Securities Exchange Act of 1934, which is oriented to investor protection. We recommend that the Act be amended to recognize the role of financial information in the operation of a competitive economy, and to require that the SEC consult with antitrust enforcement agencies in formulating reporting requirements.

Pending adoption of this recommendation, the antitrust enforcement agencies should be requested to consider submitting recommendations to the SEC in connection with the current divisional reporting inquiry.

F. WE HAVE A NUMBER OF ADDITIONAL RECOMMENDATIONS FOR FURTHER ACTION OR FURTHER STUDY.

These include advance notification of mergers and a reasonable statute of limitations on lawsuits attacking mergers; a limit on the duration of antitrust decrees; an examination of the effects of the income tax laws on merger activity and market concentration; a review of the extent to which competition may be substituted for regulation in the regulated industries; and the abolition of resale price maintenance.

II. Introduction

The antitrust laws reflect our Nation's strong commitment to economic freedom and the material benefits that flow from this freedom. The antitrust laws are based on the recognition that optimum use of economic resources and maximum choice and utility for consumers can best be obtained under competition. Moreover, they assume that the preservation of a large number and variety of decision-making units in the economy is important to ensure innovation, experimentation and continuous adaptation to new conditions. While consumer welfare is thus in the forefront of antitrust policy, important corollary values support the policy. Not only consumers, but those who control the factors of production—labor, capital and entrepreneurial ability—benefit when resources are permitted to move into the fields of greatest economic return; competition induces such movement and monopoly inhibits it. Antitrust policy also reflects a preference for private decision-making; a major value of competition is that it minimizes the necessity for direct Government intervention in the operation of business, whether by comprehensive regulation of the public utility type or by informal and sporadic interference such as price guidelines and other ad hoc measures.

The function of the antitrust laws in the pursuit of these goals is twofold; they are concerned both with preventing anticompetitive behavior and with preserving and promoting competitive market structures. Our Task Force has understood its assignment to be to examine the antitrust laws in broad perspective and consider ways in which they might be made more effective in this dual role.

In relation to the principal kinds of anticompetitive behavior, such as price-fixing, market division and other forms of collusive action among independent firms, we believe the present laws are generally adequate. Their effectiveness depends principally upon vigilance to provide sufficient enforcement resources and the vigorous use of enforcement power. We have identified three areas, however, in which modification of present laws would assist the effort to maximize competitive behavior. *First*, it is important to ensure that laws aimed at preserving competition do not themselves unduly restrict the free play of market forces. The Robinson-Patman Act in its present form has such effects and we recommend its revision to eliminate its anticompetitive tendencies. *Second*, patents are susceptible of being used to facilitate collusive arrangements in ways difficult to disentangle from legitimate exploitation of the patent monopoly. We recommend certain restrictions on patent licensing that are designed to discourage such use. *Third*, we share the view that the provisions of law permitting resale price maintenance encourage anticompetitive practices and we favor the repeal of these provisions.

Our consideration of the present state of the antitrust laws focuses to a considerable extent on problems of market structure. The principal laws presently concerned with competitive market structure are section 7 of the Clayton act, dealing with mergers, and section 2 of the Sherman Act, which is addressed to cases of monopoly. We believe these laws can be made more effective by certain additional legislation on mergers and on oligopoly industries.

Market structure is an important concern of antitrust laws for two reasons. *First*, the more competitive a market structure (the larger the number of competitors and the smaller their market shares) the greater the difficulty of maintaining collusive behavior and the more easily such behavior can be detected. *Second*, in markets with a very few firms effects equivalent to those of collusion may occur even in the absence of collusion. In a market with numerous firms, each having a small share, no single firm by its action alone can exert a significant influence over price and thus output will be carried to the point where each seller's marginal cost equals the market price. This level of output is optimal from the point of view of the economy as a whole.

Under conditions of monopoly—with only a single seller in a market—the monopolist can increase his profits by restricting output and thus raising his price; accordingly, prices will tend to be above, and output correspondingly below, the optimum point. In an oligopoly market—one in which there is a small number of dominant sellers, each with a large market share—each must consider the effect of his output on the total market and the probable reactions of the other sellers to his decisions; the results of their combined decisions may approximate the profit-maximizing decisions of a monopolist. Not only does the small number of sellers facilitate agreement, but agreement in the ordinary sense may be unnecessary. Thus, phrases such as "price leadership" or "administered pricing" often do no more than describe behavior which is the inevitable result of

structure. Under such conditions, it does not suffice for antitrust law to attempt to reach anticompetitive behavior; it cannot order the several firms to ignore each other's existence. The alternatives, other than accepting the undesirable economic consequences, are either regulation of price (and other decisions) or improving the competitive structure of the market.

We believe that the goals of antitrust policy require a choice wherever possible in favor of attempting to perfect the self-regulating mechanism of the market before turning to public control. It is for this reason that we favor steps that will increase the effectiveness of the antitrust laws in promoting competitive market structure. Such steps are desirable, not only because the problem of concentrated industries is significant in economic terms, but because the existence of such concentration is a continuing (and perhaps increasing) temptation for political intervention. In a special sense, therefore, our recommendations have preventive as well as corrective purposes.

In devising antitrust measures for such purposes, alternative techniques or approaches may be considered. Under one approach, general standards expressed in terms of broad policy goals require the trier of fact to make ad hoc judgments as to the relevant scope of inquiry in any case. The general effect of such an approach is to require consideration of a wide range of complex and difficult issues, some of them of marginal significance. Such issues may include economic issues which are beyond our present capacity to gather and evaluate economic information; they may include issues such as motive and intent, which are both elusive and of marginal relevance to the central issue of market structure; and they may include an indirect measurement of competitive behavior or structure through an evaluation of performance, an approach requiring judgments more appropriate to regulation than to antitrust policy. Such an approach generally expands the scope and complexity of lawsuits and makes decisions less useful as precedents.

The other approach uses rules which are based on easily ascertainable criteria and avoids individualized consideration of complex factors which would be unlikely to affect the outcome. This approach simplifies litigation. More importantly, it provides businessmen and law enforcement officials with a better idea of what will be lawful and what will be unlawful.

The judgment of members of the Task Force is that it is virtually impossible to gather all the data relevant to any particular case, and even the best of judges could not properly take account of all such data. Therefore, we believe that carefully drawn rules yield results superior to highly general admonitions to weigh all relevant factors. Accordingly, our proposals generally rely on fairly closely articulated rules. They are drafted to reflect general economic experience and theory, and they make allowance for actors which may be significant in individual cases. But they do not call for proof of an exactness beyond the present limits of economic knowledge. Of necessity, they are predicated, not on rigorously proven

theorems, but on a consensus of informed economic judgment which admittedly fragmentary economic knowledge tends to confirm.

III. Oligopoly, or Concentration in Particular Markets

The evils of monopoly are well known and the antitrust policy of the United States has sought from its beginning to provide safeguards against them. But those evils are not confined to situations conforming to the literal meaning of monopoly, i.e. an industry with but a single firm. In the years since the Sherman Act was adopted there has been growing recognition that monopoly is a matter of degree. A firm with less than 100% of the output of an industry may nevertheless have significant control over supply, and thus be in a position to impose on the economy the losses associated with monopoly: lower output, higher prices, artificial restraints on the movement of resources in the economy, and reduced pressure toward cost reduction and innovation. Likewise, a small number of firms dominating an industry may take a similar toll, either because the small number makes it easier to arrive at and police an agreement or because, without agreement, each will adopt patterns of behavior recognizing the common interest.

In general, it may be said that the smaller the number of firms in an industry—at least where that number is very small or where a very small number is responsible for the overwhelming share of the industry's output—the greater the likelihood that the behavior of the industry will depart from the competitive norm.

These propositions have found general acceptance in economic literature in the past 25 or 30 years. They have also found recognition in the policy of the antitrust laws: a major aim of section 7 of the Clayton Act, as amended in 1950 and as interpreted by judicial decision and the new Merger Guidelines, is not merely to prevent monopolies but also to prevent all combinations of business firms that significantly increase market concentration or reduce the number of firms in an industry.

Interpretation of the Sherman Act itself, however, has lagged behind these developments. Early cases involving giant firms emphasized the purposes and methods by which a firm was created as the basis of illegality, and looked for evidence of predatory or abusive exercise of power rather than the power of a firm or group of firms to control prices and output. Decisions affecting market concentration were confined to instances, such as the old Standard Oil and American Tobacco cases, where a single firm commanding nearly the entire market had been assembled by mergers of many previous competitors. Even such major combinations as United States Steel Corporation, United Shoe Machinery Company, and the International Harvester Company escaped condemnation by the Supreme Court. An important advance was registered when

Judge Learned Hand announced in the Alcoa case that a single firm, not resulting from merger, might be guilty of "monopolizing" merely by acquiring a sufficiently large market share and retaining its market share over a substantial period of time, if that market share was not the inevitable result of economic forces. That holding adopted and extended Judge Hand's early insight, in the Corn Products case of 1916, that "it is the mere possession of an economic power, acquired by some form of combination, and capable, by its own variation in production, of changing and controlling price, that is illegal." The United Shoe Machinery decision of 1953 applied and reinforced the new doctrine represented by the Alcoa case. In both of those cases, however, the monopoly section of the Sherman Act was invoked against a single firm with a predominant share of the market. While Judge Hand had intimated that a share as low as 65% might suffice, no subsequent case has tested that proposition or explored the limits of the Alcoa doctrine. Nor has any case yet provided a basis for treating as illegal the shared monopoly power of several firms that together possess a predominant share of the market, absent proof of conspiracy among them.

Thus a gap in the law remains.[1] While section 7 of the Clayton Act provides strong protection against the growth of new concentrations of market power in most instances, existing law is inadequate to cope with old ones.

This gap is of major significance. Highly concentrated industries account for a large share of manufacturing activity in the United States. . . . The highly concentrated industries . . . include such major and basic industries as motor vehicles, flat glass, synthetic fibres, aircraft, organic chemicals, soap and detergents, and many others, as well as a host of smaller but nevertheless significant industries.

If competitive pressures could be relied on to erode concentration in the reasonably foreseeable future, the direct reduction of concentration would be less urgent. But concentration does not appear to erode over time; rather, the evidence indicates that it is remarkably stable. In those industries with value of shipments greater than $100 million and four-firm concentration ratios by value of shipments greater than 65% in 1963, average concentration ratios were stable or declined insignificantly—by less than half a percentage point. Even though section 7 of the Clayton Act has generally been effective in forestalling increases in concentration through mergers and by other means, the antitrust laws and economic forces have not brought about significant erosion of existing concentration. The problem is not one which will disappear with time.

The adverse effects of persistent concentration on output and price find some confirmation in various studies that have been made of return on capital in major industries. These studies have found a close association between high levels of concentration and persistently high rates of return on capital, particularly in those industries in which the largest four firms account for more than 60% of sales. High profit rates in individual firms or even in particular industries are of course consistent with competition. They may reflect innovation, exceptional

efficiency, or growth in demand outrunning the expansion of supply. Above-average profits in a particular industry signal the need and provide the incentive for additional resources and expanded output in the industry, which in due time should return profits to a normal level. It is the persistence of high profits over extended time periods and over whole industries rather than in individual firms that suggests artificial restraints on output and the absence of fully effective competition. The correlation of evidence of this kind with the existence of very high levels of concentration appears to be significant.

We recognize the need for further refinement of economic evidence of this type and for additional knowledge, theoretical and empirical, about the behavior of oligopolistic industries. It would be less than candid to pretend that economic science has provided a complete or wholly satisfactory basis for public policy in this field. But public policy must often be made on the basis of imperfect knowledge, and the failure to adopt remedial measures is in itself the acceptance of a policy. The judgment of most of the members of the Task Force is that enough is known about the probable consequences of high concentration to warrant affirmative government action in the extreme instances of concentration. Moreover, as we have noted, such action does not require acceptance of a new premise for public policy. A conviction that concentration is undesirable underlies the present stringent policy toward horizontal mergers. The same premise supports a policy of attempting, within conservative limits, to improve the competitive structure of industries in which concentration is already high and apparently entrenched.

Endorsement of such a policy implies a judgment that the potential gains from reducing market shares and increasing the number of competitors in an industry will not be offset by losses in efficiency. We think there is little basis for believing that significant efficiencies of production are dependent on generally maintaining high levels of concentration.

There is little evidence that economies of scale require firms the size of the dominant firms in most industries that are highly concentrated. Evidence to the contrary is the fact that in most such industries very much smaller firms have survived in competition with the large firms. On the basis of studies covering a large number of industries Professor Stigler concluded that, "In the manufacturing sector there are few industries in which the minimum efficient size of firm is as much as 5 per cent of the industry's output and concentration must be explained on other grounds."[2] Similarly, there is no evidence of any correlation between size or market concentration and research and development activities.

The success of very large firms may, of course, be explained on the basis of efficiencies other than economies of scale, such as superior management talent or other unique resources. To the extent that such efficiencies exist, however, they may ordinarily be transferred and thus would not necessarily be lost by reorganization of the industry into a larger number of smaller units. The same is true of

advantages that inhere in legal monopolies, such as an accumulation of patents. It must also be borne in mind that efficiencies belonging to or achieved by a firm with some degree of monopoly power may be reflected only in higher profits rather than lower prices. Reduction of concentration would increase the chance that such efficiencies would be passed on to consumers through competition; indeed, a net gain from the consumer standpoint might result even though some efficiencies were lost in the process of reducing concentration.

The statute we propose would, however, take account of possible adverse effects on efficiency resulting from divestiture by forbidding relief that a firm establishes would result in substantial loss of economies of scale. It would be expected that a court would consider, among other factors relevant on this issue, the minimum size that experience has indicated is necessary for survival in the industry.

For the foregoing reasons we conclude that remedies to reduce concentration should be made available as part of a comprehensive antitrust policy. To assist in translating that conclusion into workable legislation we have drafted in some detail a proposed statue embodying our views.[3] That statute, entitled the Concentrated Industries Act, is attached to this report as Appendix A. While we believe, as hereafter noted, that some relief against concentration might be obtained through new interpretations of the Sherman Act, we also think that a statute such as the one we propose has several distinct advantages over reliance on existing law: (1) it would provide a clear determination of legislative policy and establish clear criteria for the application of that policy; (2) it would establish appropriate special procedures; and (3) it would limit the policy to remedial ends.

The Act establishes clear criteria for its application. It applies only to those industries in which four or fewer firms have accounted for 70% or more of industry sales, and it provides for steps to reduce the market shares of firms with 15% market shares in such industries. The act contains other provisions to limits its application to industries which are of importance in the economy as a whole and in which concentration has been high and stable over considerable periods of time. The criteria laid down in the Act are designed to minimize the likelihood that output levels over a short period of time will affect the applicability of the Act. Moreover, even if the Act does apply, there are no penalties but only prospective relief. Thus the possibility is minimized that corporations will resort to output-restricting strategies in order to avoid application of the Act.

The Act also lays the basis for defining relevant markets in terms that are more closely related to economic realities than are the definitions developed under existing antitrust laws. By and large, the Act limits the scope of inquiry to facts which are of relevance to its primary concern, the reduction of concentration, and which may be determined with reasonable precision. For these reasons, litigation under the Act should be relatively simple.

The Act establishes special procedures appropriate to the reduction of concentration. Under existing law, complex antitrust actions may be conducted by judges who have had little opportunity to become familiar with the kinds of questions involved, and who must rely on expert testimony offered by the parties. Expanding on the recently enacted provisions of 28 U.S.C. section 1407, the Act would establish a special panel of district judges and circuit judges to conduct deconcentration proceedings. In addition, it would enable the court to draw on the specialized knowledge and experience of its own economic experts. This feature of the Act should be of importance in arriving at appropriate market definitions. In addition, court appointed experts would assist in evaluating the probable effect of proposed decrees.

Finally, the Act is limited to prospective relief designed to reduce concentration. Unlike existing law, it makes no provision for criminal penalties or for private actions seeking treble damages. The absence of these collateral effects makes the Act a more appropriate tool for reducing concentration.

Those who support the proposed Concentrated Industries Act believe, in varying degrees, that more can be done about concentration than has been done under existing law. We recommend that the Attorney General be encouraged to develop appropriate approaches under existing law and to bring carefully selected cases to test those theories.

Under existing law, three statutory provisions might be brought to bear. Section 2 of the Sherman Act prohibits monopolization or attempts to monopolize any part of interstate or foreign commerce. Section 1 of the Sherman Act prohibits any contract, combination, or conspiracy in restraint of interstate or foreign commerce. Section 7 of the Clayton Act prohibits acquisitions which may tend substantially to lessen competition. While existing precedents and the history of antitrust enforcement do not justify widespread use of these statutes against concentrated industries, we believe that appropriate precedents might be developed which would be useful in some cases.

Courts may be reluctant to expand the scope of these statutes, because their application would expose defendants to criminal penalties and treble damage liability. Moreover, existing law does not readily lend itself to the establishment of sufficiently clear and workable criteria. While expanded enforcement efforts might make some inroads in reducing concentration, they would not preclude the need for new legislation.

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1 This gap has been recognized by noted authorities. *See, e.g.*, KAYSEN & TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS, 44 (1959)[hereinafter Kaysen & Turner]; Stigler, *The Case Against Big Business*, FORTUNE (May 1952), reprinted in E. MANSFIELD, MONOPOLY POWER AND ECONOMIC PERFORMANCE, 3 (1964); *cf.* J. K. GALBRAITH, THE NEW INDUSTRIAL STATE (1967).

2 G. STIGLER, THE THEORY OF PRICE, 223, (3rd Ed. 1966).

3 The idea of such legislation is not new, and our proposal was influenced by Kaysen & Turner (*supra* note 1). However, it differs from the Kaysen-Turner proposal in important respects.