

12500
P
19
.1

For Release at 10:00 A.M. (EST), January 26, 1955.

COALESCENCE OF LEGAL AND ECONOMIC
CONCEPTS OF COMPETITION

Address by

Honorable Edward F. Howrey
Chairman, Federal Trade Commission

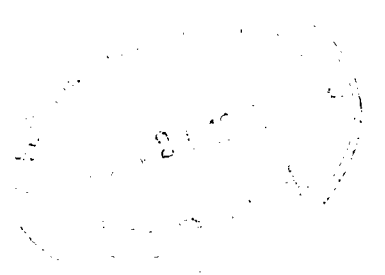
Prepared for Delivery

Before

The Section on Antitrust Law
of the New York State Bar Association

New York, New York

January 26, 1955



COALESCENCE OF LEGAL AND ECONOMIC CONCEPTS OF COMPETITION

The Attorney General of the United States recently prophesied that this year promises to be one of special antitrust significance in the work of his Department.^{1/} I venture to say that the same will be true at the Federal Trade Commission.

The Commission has already instituted various programs designed to give its statutes new vigor. The Antitrust Division has undertaken like measures, and, in addition, the Attorney General's National Committee to Study the Antitrust Laws has attracted national attention.

Certainly no one can deny that we are currently witnessing a re-affirmation by both agencies of the principle that a judicious national antitrust policy is an unexpendable article of faith in our political and economic democracy. While there may be differences of opinion with respect to the implementation of this policy, there should be no doubt in anyone's mind that the public is obtaining a progressively greater return on its antitrust dollar.

* * * *

Instead of listing our accomplishments during the past year, I should like to discuss, if I may, one of our most challenging and intriguing antitrust problems; namely, the per se doctrine versus the rule of reason approach, and the dependency of the latter on a greater coalescence of legal and economic concepts of competition.

The per se violation doctrine means that certain practices are in and of themselves unlawful, that is, the conduct is considered unreasonable per se; the effects on competition are automatically and conclusively presumed and are not dependent upon examination of industry and market facts.^{2/}

Diametrically opposed is the so-called rule of reason approach. This approach draws the line between zones of legal and illegal conduct through a consideration of relevant economic factors; the market is analyzed to determine whether the restraint merely

^{1/}New York Times, October 1, 1954, p. 10.

^{2/}Agreements among competitors involving such practices as price fixing and boycotts are frequently cited by the courts as per se violations. And Congress, itself, has prohibited certain practices as such - for example, sections 2(d) and 2(e) of the Robinson-Patman Act. This paper does not deal with these but rather with the growth and extension of the per se doctrine.

regulates competition or whether it is such as may suppress or even destroy competition.^{3/}

Stated another way, the question - in terms of FTC practice - is whether or not the Commission will sit as a tribunal of experts and conduct a factual inquiry into legal and economic issues.

In the past three decades the industry of this nation has seen growth and change that are without parallel in history. New products, new markets, and vast new industries have come into being; we have seen two important periods when our economy was so predicated upon war or preparation for war that almost every business in America was affected.

It is not surprising therefore that those charged with law enforcement or adjudicative responsibilities found the dynamics of our industrial complex difficult of analysis. It was quite human, and no doubt appeared to them more efficient, to develop and apply self-operative, automatic rules of illegality and thus to avoid the heavy burden of proof.

However valid this initial motivation may have been, administrative agencies and the courts should now shoulder the responsibility inherent in examining relevant economic factors. The very complexity of the economy itself demands that antitrust decisions should not be made in a factual vacuum. Almost every antitrust case presents issues which are basically economic; we use our legal procedures merely to resolve them.

During the years that followed the Trenton Potteries and Socony Vacuum decisions, the Commission probably did its share in expanding the per se approach. This prompted me to observe in 1953, at Ann Arbor, that critics of the Commission had maintained that it was not the body of experts Congress intended; that it had become instead a prosecuting agency employing laborious procedures and rigid interpretations without regard to the relationship of law, business economics and public policy. I took the position then, and still do, that if this were true, that if an administrative tribunal does nothing but promulgate per se doctrines, then the

^{3/}In the Chicago Board of Trade case, Mr. Justice Brandeis said:

"Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts." 246 U. S. 231, 238 (1918).

rationale for its creation disappears. It may as well give way to the prosecutor.

The Role of the Economist

This leads to a consideration of the role of economic data in administrative and judicial proceedings, particularly in ascertaining and adjudicating the ultimate question of injury to competition. Professor Oppenheim said in 1952, "Antitrust lawyers and antitrust economists face a joint task of overcoming existing barriers to greater coalescence of the judicial and the economic doctrines of antitrust. They are the ones who should provide the guides to clarification of ... fundamental antitrust issues ..."

This coalescence has not occurred nor has it progressed to a satisfactory degree. Lawyers and economists alike have the habit of emphasizing the differences between legal and economic concepts of competition, rather than recognizing that the antitrust laws are here to stay and require, or at least should require, the use of economic evidence in analyzing markets and in determining competitive effects.

When an economist speaks on the subject of competition, restraint of trade, or monopoly, he usually stresses the point that economic theories do not provide any legal standards nor formulate any tests or criteria of liability under antitrust laws. Many lawyers do likewise declaring that the legal significance to be given a particular set of facts has no relationship whatsoever to their economic significance.

The economist says he is a social scientist interested only in human behavior and the fundamental relationships between men and business. The lawyer says, "That's all right for the professors, but I am concerned merely with formal statutory rules enforceable in the courts."

This may all be true under current economic and legal theories. But if I may say so, without offense, it is about time the lawyers and the economists recognize that large and important changes have taken place in our economy, and prepare a new approach dealing with the problem of competition and monopoly in 1955 under present antitrust laws. Surely these laws were meant to deal with the subject that interests both the economist and the lawyer, namely, man and business.

If this is not done, and done fairly soon, I venture to prophesy that the forward march of the per se doctrine will continue and the rule of reason approach, for which we have been struggling at the Commission, will lose ground.

Lawyers frequently complain that they must exercise great care because the economist's use of a particular word may be misleading from a legal standpoint. Words like "monopoly," "competition,"

“discrimination,” etc., are given a meaning in economics which may sometimes differ considerably from the meaning in law, and vice versa.

This confusion of terms has been an important barrier to the successful use of economic analysis in antitrust cases, and yet the solution seems fairly simple. The economist should be asked to furnish an analysis of relevant economic factors within the context of the statute itself.^{4/} He should not be called upon to write a general treatise on competition or monopoly, nor should he be asked to interpret or define the statute, or to decide the boundaries or limitations of the law.

Economists generally agree, regardless of their school, that the competition which the antitrust laws seek to preserve cannot be defined in terms of absolute or perfect competition. Most economists regard “perfect competition” and “pure monopoly” only as theoretical extremes of possible market situations.^{5/} They recognize that between these extremes there are such concepts as “imperfect competition,” “workable” or “effective competition,” “oligopoly,” and “monopolistic competition.”

Some economists belong to the behaviorist school while others belong to the structuralist school. The former focus attention upon the performance of the industry and the behavior of the firms in the industry as the key to the competitive situation. The latter group looks to the market structure; e.g., to the number of sellers or buyers present in the particular market. My own belief is that these are not mutually exclusive viewpoints. In most situations market structure and behavior are inseparable and in many situations an examination of the relevant facts will involve both structural and behavior considerations.

In June of 1954 I gave a paper before the American Marketing Association in which I outlined 16 tests, standards or criteria for determining competitive effects. These tests were not meant to be all-inclusive and would, of course, vary from case to case. The market, the industry, the statute, and the type of violation involved would form the frame of reference. But they are, I think, the type of criteria that lawyers and economists should be able to agree upon as guides or factors in determining competitive effects in a particular market.

^{4/}See especially *U. S. v. E. I. duPont de Nemours and Co.*, 118 F. Supp. 41 (D. Del. 1953).

^{5/}See opinion of Judge Leahy in *U. S. v. E. I. duPont de Nemours and Co.*, *supra*. For an excellent discussion, see Brief for the United States on Liability, *U. S. v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (1953); Oppenheim, *Divestiture as a Remedy Under the Federal Anti-trust Laws*, Economic Background, 19 Geo. Wash. Law Rev. 120-122 (1950); Stocking and Watkins, *Monopoly and Free Enterprise*, Twentieth Century Fund, pp. 13, 49 (1951).

I would like briefly to discuss some of these factors:

1. The number of comparable sellers in a market and their relative size.

An acceptably competitive condition requires a sufficient number of independent companies to assure that no one company will have monopoly power, that is, power over price or power to exclude competitors. Unless numbers are already large in a given market, a reduction of numbers may involve reduction of competition. Where it is alleged that genuine economies of scale, or other considerations (including the capacity to innovate), permit only a small number of sellers, close scrutiny must be given to the competitive situation.

In addition to numbers of sellers, their relative size is important. Relative size refers to market shares or market power. Absolute size, as measured by number of employees, dollar volume, or dollar value of assets, ordinarily has no particular significance in determining the presence or absence of effective competition. But the share of the market occupied by a particular firm is one of the important bits of evidence bearing on market power and competition.

2. Opportunities for entry into the market.

Freedom of opportunity for rivals to enter the market is a fundamental requisite of effective competition. This condition is necessary if there is to be, in the long run, a sufficient number of sellers to prevent markets from tending toward monopoly. The exclusion of new rivals is a major impairment of competition, and the power to exclude rivals is usually associated with the power to eliminate rivalry among those already in the industry.

When there is little or no new entry into a given field, alternative explanations must, of course, be considered. Perhaps, for example, there is no economic justification for new enterprise. In any event, the existence of barriers to entry is a matter of proof and should be shown. The facts should not be presumed.

3. Opportunity for survival.

Often competitive behavior can best be defined as a struggle for survival. Admitting that profit is the ultimate goal, a company must maintain its market position today in order to provide an acceptable balance sheet tomorrow. Thus withdrawals of firms from a market should be carefully analyzed. Facts of mortality and exit may be as important as those relating to entry.

4. Growth and profits.

It is quite obvious that growth and profits are linked together as objectives of a healthy and successful business enterprise. The

principal road to increased profits is expansion. Opportunities for growth are therefore necessary for a competitively effective market.

In a rapidly expanding industry, it is generally more difficult for established firms to dominate the market. In a static industry, on the other hand, where certain firms have a tight hold and are not actively competitive, they may, by inaction, not only discourage the entry of rivals but also discourage new methods and techniques.

* * * *

Other factors which may be relevant to an appraisal of the competitive characteristics of a market include (5) effective consumer choice of alternative goods and services, (6) balance of bargaining power between seller and buyer, (7) level of concentration, including the trend of mergers and acquisitions, (8) relationship between size and efficiency, (9) degree of price competition and competitive meeting of prices, (10) responsiveness of price to changes in costs, (11) degree of independence, (12) efficiency in production, (13) efficiency in distribution, (14) flexible adjustments to changing markets, (15) presence or absence of unfair methods of competition, and (16) national defense requirements.

These sixteen tests represent criteria that have received considerable attention by economists and it is not unreasonable to conclude that by now they should be prepared to fit them into the framework of the antitrust laws.

It has been suggested that these factors cannot be administered successfully by the average district court; that to ask courts to go into matters of this kind might cause antitrust administration to become mired in a bottomless bog.

This may or may not be true of the courts - personally, I do not think it is - but the Federal Trade Commission was designed and set up for the specific purpose of dealing with complex problems of industries and markets. It was to be staffed with business specialists - lawyers, economists, marketing experts, accountants and statisticians who could appraise economic data and market facts. It was given wide powers of inquiry and compulsory disclosure. It was, in short, created for the purpose of supplementing the work of the courts by furnishing expert guidance as to competitive effects.

The importance of factors of this kind should therefore be recognized by the Commission at all stages, that is, in the initiation of antitrust cases, in the development of a theory of the case, in planning and conducting the investigation, and in prescribing the remedy.

Problems of Evidence

The success or failure of a rule of reason approach may ultimately depend upon standards of admissibility for economic evidence. It is important to remember in this connection that the Commission is an administrative tribunal, not a court; that while Commission action must be supported by "reliable, probative and substantial evidence,"^{6/} technical rules of evidence are not applicable to administrative hearings.^{7/} At the same time I believe that the courts, as well as the Commission, must recognize a degree of flexibility in their procedures sufficient to permit reception of evidence of competitive effects not based wholly on absolute facts such as precise sales, costs, or profits.^{8/} Hearing officers and judges should permit industry and company history, industry and company statistics, pricing and trade practices, price levels and variations in price, and other business facts to be shown by methods usually employed by practical marketing men - methods "resting mainly on common sense," that is, upon "such * * * evidence as a reasonable mind might accept as adequate to support a conclusion."^{9/}

Perhaps a sharper distinction could be made between facts designed to show competitive consequences and facts that are necessary to show conspiracy or a per se violation. Once a set of facts is in the record, the weight to be ascribed to different facts can be determined; it need not and often cannot be determined in advance.

Market data should be considered admissible in the same proportion as the rule of reason approach is applied. This is essential because market information is never as precise or as subject to verification in cases where the rule of reason approach is taken as in those cases where one crucial fact or a few facts make the conduct unlawful per se.

Data concerning companies not party to a proceeding are frequently necessary and present special problems. Such data are often required to determine market shares or relative standings of particular companies, or opportunity for entry, rate of growth, relative prices, and other matters relevant to an appraisal of the practice under scrutiny. It is, of course, true that in such cases the need for concrete and verifiable information must be balanced against the rights of companies not parties of record to protect themselves from disclosure of confidential information and trade secrets.

^{6/}Sec. 7(c) of the Administrative Procedure Act, 5 U.S.C. 1006c.

^{7/}Attorney General's Manual on the Administrative Procedure Act, p. 76 (1947); F.T.C. v. Cement Institute, 333 U. S. 683, 705 (1948).

^{8/}See 3% sample of shoe factories selected by Judge Wyzanski in U. S. v. United Shoe Machinery Corp., *supra*; see also projection of salesmen's reports to show substitute product competition in U. S. v. E. I. duPont de Nemours and Co., *supra*.

^{9/}See In the Matter of Pillsbury Mills, Inc., Docket No. 6000, decided December 28, 1953; Consolidated Edison Co. v. N.L.R.B., 305 U. S. 197, 229 (1938).

Summaries, tabulations, charts, graphs, sampling and polls of opinion should be admitted into evidence if antitrust enforcement is to succeed as a practical matter. The lawyer, the Commission and the courts should make a sincere effort to eliminate the unfavorable stigma that has attached to these devices. To put it another way, the statistical literacy of lawyers and judges should be improved. As one economist recently said:

"In corporation management, when economic pressure compels the greatest efficiency compatible with prescribed reliability, this problem is solved by sampling. In judicial proceedings, however, the use of sampling is amazingly limited. One reason is that judges, having been lawyers themselves, are properly suspicious of the zeal of lawyers seeking to advance the cause of their clients. Judges feel inadequately protected when they are forced to rely upon samples selected by adversaries. They are aware of the ease with which a sample can be rigged and the difficulty of detecting such bias. Because of this reluctance to rely on sampling, courts often do without relevant evidence or try to escape the peril of bias by rushing into the costly and time-killing citadel of the complete census. * * * Fortunately, there are sampling procedures which eliminate bias and which produce results of measurable accuracy."^{10/}

* * * *

Administrative agencies and the courts are presently weighing the two antithetical approaches to enforcement I have mentioned. At the Federal Trade Commission, I am glad to say, we have moved in the direction of a rule of reason approach in our recent decisional work. If this trend is to continue there must be a greater coalescence of legal and economic concepts of competition.

Certainly the Congress intended that the Commission, as an expert body, enforce its laws not by applying a legalistic yardstick but by digging into the facts, analyzing them carefully, and issuing clear decisions.