The history of competition policy as economic history

BY GÉRARD DUMÉNIL, MARK GLICK and DOMINIQUE LÉVY*

I. Introduction

The concept of legal rhetoric is a central focus in Rudolph Peritz's new book, *Competition Policy in America 1888–1992, History, Rhetoric, Law*. His basic hypothesis, summarized in his own words, is as follows:

> . . . this book emerges from my view of a rhetorical structure both shaping and shaped by material circumstances. . . . rhetorics as ethical commitments coupled with logics—as political strategies—provides a framework for understanding the history of American competition policy. . . .[1]

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[1] *See* RUDOLPH PERITZ, COMPETITION POLICY IN AMERICA 1888–1992, HISTORY, RHETORIC, LAW 4–5 (1996).

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While we fully agree with the notion of a reciprocal influence between a "rhetorical structure" and "material circumstances," Peritz's analysis gives primacy to rhetoric. In contrast, we take "material conditions" and "struggles and confrontations" or, more generally, economic history, as our point of departure in attempting to make sense of the history of antitrust law.

Economic history is a broad discipline. While we will draw together several important connections between economic history and antitrust law, this article in no way purports to be a comprehensive treatment. In this article we will connect important events in the history of antitrust law to three specific sets of underlying economic phenomena:

1. The pattern and evolution of technological change and distribution over the last century.
2. Important institutional transformations in property relations, internal firm organization, financial intermediaries and government economic policy.
3. Power and class relationships, meaning the economic and political influence of various groups in society.

The originating thesis of this article is that these three aspects of economic history can provide a basic foundation for explaining the evolution of competition policy in the United States.

The first part of the article summarizes in broad fashion the essential elements of the transformation of the American economy during the period stretching from the end of the Civil War to the present.[2] Then in the second part we describe how economic history helps explain some of the central events in the history of competition policy.[3]

[2] The term "industry" will refer to the total private economy, excluding the financial sector (including financial institutions as well as individual shareholders).

[3] The second section of this study borrows from: GÉRARD DUMÉNIL & DOMINIQUE LÉVY, THE ECONOMICS OF THE PROFIT RATE: COMPETITION, CRISES, AND HISTORICAL TENDENCIES IN CAPITALISM (1993); Gérard Duménil & Dominique Lévy, *The Great Depression: A Paradoxical Event?* (Cepremap #9510 1995); GÉRARD DUMÉNIL & DOMINIQUE LÉVY, LA

II. Basic trends in the economic history of the U.S. economy

This first section provides a general framework for our interpretation of the transformations of the U.S. economy since the Civil War.

A. *Technology, distribution, and structural crises*

We begin by briefly describing the evolution of technology and distribution since the Civil War. Connected with this evolution are what we will refer to as three structural economic crises.

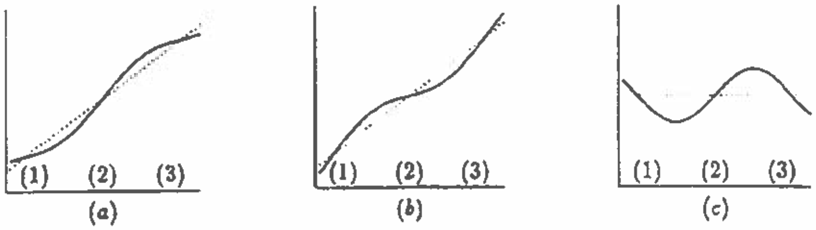
1 TECHNICAL AND DISTRIBUTIONAL TRENDS In our view, technology and distribution evolved historically in the United States over three district stages. These three stages broadly correspond to the late 19th century (from the Civil War to 1900 or World War I), the first half of the 20th century (up to the mid-1960s), and from the late 1960s onward.[4] To describe technology and distribution, we isolate the long-run trends in labor productivity, real wages, the capital-labor ratio, capital productivity and the rate of profit on fixed assets. The rates of growth of these variables clearly display a three stage division. The profiles of labor productivity and the labor cost are very similar (panel (a) of the figure). They grew slowly in the late 19th century, then more rapidly up to the mid-1960s, and then slowly again after 1970. The same pattern in three stages can also be observed for the capital-labor ratio (panel (b)), but the sequence is reversed. The growth rate was rapid during the first period, slow during the intermediate period, and rapid again in the latter decades. These three historical stages are even

DYNAMIQUES DU CAPITAL: UN SIÈCLE D'ECONOMIE AMERICAINE (PUF 1996). The third section relies on: GÉRARD DUMÉNIL & DOMINIQUE LÉVY, DYNAMIQUE DU CAPITALISME ET POLITIQUES DE CLASSE: UN SIÈCLE DE CAPITALISME AMÉRICAIN, COMMUNICATION AU COLLOQUE KARL MARX ET LA DYNAMIQUE ACTUELLE DU CAPITALISME (Université du Littoral, Dunkerque, Cepremap 1996).

[4] We will not discuss here the possible transition to a fourth period in recent years.

more discernible for the remaining variables (panel (c)), since they successively declined, increased, and declined during the three periods.[5]

Figure



From the point of view of technology and distribution, the late 19th and the late 20th centuries are quite similar. Both displayed trends we would consider unfavorable. In both periods there was a diminished growth of labor productivity. Capital formation was rapid in comparison to the growth of employment (captured by the capital-labor ratio) or compared to output (measured by the productivity of capital). The distributional performance of both periods was also poor: the profit rate declined, while the growth rate of the real wage rate remained below its secular average.

These features of the late 19th and 20th centuries contrast sharply with those of the intermediate period. During the years from World War I to the 1960s (interrupted by the Depression), labor productivity and the real wage rate grew at an unusually strong pace, the stock of fixed capital continued to increase, but output increased even faster. The growth rate of the real wage rate was larger than its secular average, and simultaneously, the profit rate rose.

[5] The average annual growth rate of the hourly real wage was 1.47% for the period 1869–1912, 2.32% for 1912–1951, and 1.53% for 1951–1989. The average annual growth rate of the profit rate was –1.60% for the period 1869–1912, +1.44% for 1912–1951, and –0.84% for 1951–1989. *See* DUMÉNIL & LÉVY, THE ECONOMICS OF THE PROFIT RATE, *supra* note 3, at 264.

2. STRUCTURAL CRISES Two structural crises are connected with the periods of unfavorable historical trends in technology and distribution. These two crises occurred in the late 19th century (culminating in the 1890s) and again in the late 20th century (the 1970s). We have adopted the term "structural crises," to refer to these comparatively lengthy periods of economic distress, in contrast to the typical recession. Aside from the poor performance of technical change and distribution (slow technical change, low profitability, and stagnating real wages), structural crises appear to combine a sluggish rate of growth with sustained persistent unemployment and general macroeconomic instability.

The declining profit rates in the late 19th and 20th centuries were responsible in part for the weak levels of investment and the overall instability of the macroeconomy. The diminished rates of capital formation and the recurrent recessions combined to produce large and persistent levels of unemployment. Firms generally reacted to these falling profits by increased resistance to wage increases.

A third structural crisis, the Great Depression of the 1930s, was distinct in nature. While the Depression was also connected to a particular pattern of technological change and distribution, it occurred during the favorable intermediate period. Many factors combined to create the Depression and there is a large literature and debate regarding its causes. For our purposes we wish to focus on a factor that is largely overlooked but which we believe is related to the depth of the crash and its relationship to competition. The change in the pattern of technical and distributional change at the turn of the century described above created a large heterogeneity among industrial firms. One group of firms grew in size and efficiency, while another group remained small, relatively backward, and traditional. This heterogeneity was a result of the fact that not all sectors of industry were involved in the technological and institutional transformation of the late 19th century, and many smaller firms lagged behind. When the contraction of output began in 1929, the less efficient sector collapsed, causing analysts at the time to focus on competition as a primary cause of the Depression.

B. The institutions of modern capitalism

In addition to technology and distribution the evolution of institutional arrangements in economic history is also important for understanding competition policy.

1. THE CORPORATE AND MANAGERIAL REVOLUTIONS The evolution of technical change during the last decades of the 19th century described above necessitated an increase in average firm size and a change in firm structure.[6] This transformation, known as the "corporate revolution," culminated at the turn of the century in the sudden and dramatic rise of the number of new corporations and large firms formed through internal expansion and merger. The role of the financial sector was crucial in shaping these events. Financial institutions were an integral part of the formation of corporations and of mergers. This corporate revolution also coincided with a managerial revolution that is well described by Alfred Chandler.[7] Middle classes of managerial and clerical personnel mushroomed within the new modern corporation, and initiated a thorough reorganization of the internal workings of the firm.

[6] This is well documented by Anthony P. O'Brien, *Factory Size, Economies of Scale, and the Great Merger Wave of 1898–1902*, at 48 J. ECON. HIST. 639 (1988).

[7] We are in accord with Chandler's characterization of the managerial revolution, with the exception of his emphasis on transaction costs. We do not see the value in the comparison between the costs of internal and market coordination for the issues he addresses. As stated by Chandler: "This institution [the new modern firm] appeared when managerial hierarchies were able to monitor and coordinate the activities of a number of business units more efficiently than did market mechanisms." *See* ALFRED D. CHANDLER, THE VISIBLE HAND, THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 11 (1977). The contrast between markets and managerial coordination is misguided because the managers of the large corporations at the time did not actually perform the functions that markets were supposed to assume under individual management. The primary distinction between the new and earlier organization was not that the same functions were taken inside the firm, but that the new managerial coordination allowed for new processes that market coordination would not have permitted. The issue was not one of costs in a given technical environment, but one of technical change.

This transformation of management had dramatic consequences on the trends of technology and distribution.[8] The managerial revolution exactly coincided with the switch to the more favorable period of technological and distributional trends. By and large the new management was more efficient, economizing on costs and on the components of fixed capital. The central problem of the earlier unfavorable period was the heavy growth of fixed capital, coupled with a stagnant labor productivity. The new organization of production reversed this tendency. The introduction of the assembly line is representative of this new efficiency. Using assembly line technology, increased mechanization was accomplished without a sharp increase in the capital-labor ratio. This was achieved through the continuous and intensively efficient use of labor. Managerial transformations were so far-reaching at the turn of the century that the economy-wide stock of fixed capital actually diminished in comparison to output (the productivity of capital rose). As a result, the rate of profit rose, which in turn—and under the prevailing social and political conditions—allowed for a steady increase in the real wage rate. The generalization and extension to the entire economy of the new managerial organization corresponding to our second intermediate period, required several decades, lasting well into the post-World War II period.

2. MANAGING THE MACROECONOMY The issue of the comparative stability of the macroeconomy before the Great Depression and after (or after World War II) is very controversial. The available evidence suggests, however, that the business cycle on average became less severe in the 20th century. But this observation does not capture the degree to which macroeconomic policy advanced. The Depression in particular provided a crucial catalyst in this respect, inducing greater and more effective state intervention aimed at macrostabilization.

[8] Although Chandler does not present data on this issue he is well aware of this impact of the new organization on technical change: ". . . administrative coordination helps to account for a significant segment of what economists have defined as a residual, that is, the proportion of output that cannot be explained by the growth of input." *Id.* at 490.

The system that prevailed from the Civil War to World War I, before the Federal Reserve was created, was known as the National Banking System. Under this system large banks, typically located in New York, functioned as reserve banks for the remainder of the banking system. These banks reacted to financial shocks or problems within the banking system itself by modifying interest rates and influencing the flow of credit. During periods of crisis (such as a stock market collapse or a banking crisis), the reserve banks, using their control over clearing houses, developed techniques and practices aimed at stemming financial collapse and avoiding the suspension of payments. Such actions had important effects on industry in general and on the business cycle, despite the fact that they were not explicitly aimed as affecting these variables.

The creation of the Federal Reserve in 1913 did not in itself represent a thorough change from the National Banking System. Even after 1913 the Federal Reserve continued to conduct itself in a manner similar to the methods prevailing in the past. The major transformation in monetary policy did not occur until after World War II. Only after the Second World War did the government explicitly seek central control of macroeconomic stability.[9]

3. TRANSNATIONAL CORPORATIONS The development of large transnational corporations during recent decades is also important. In several significant respects the rise of transnational corporations is similar in nature to the transformations that occurred at the turn of the last century. The rise of international corporations is creating a strong heterogeneity within industry, with the large transnational corporations coexisting with more domestically based firms. Moreover, this current evolution is connected with the transformation of the financial institutions. The corporate revolution of the late 19th century would not have been possible without the development of a new corresponding financial frame-

[9] In more recent times, international capital markets (so-called Euromarkets) have had a dramatic impact on macroeconomic policy. Euromarkets developed outside the sphere of influence of the central banks, and are only subject to local rules.

work. The same is true of contemporary international capitalism. The progress of a worldwide financial system was a necessary parallel to the rise of the transnational corporations.

4. COMPETITION AND INSTITUTIONAL CHANGE The relationship between institutional change and competition policy is complex. Heterogeneity within industry creates tensions between industrial groups that get translated into state policy. In addition, there is an important link between competition policy and the stability of the macroeconomy generally. The perceived threat that competition may represent for the macroeconomy depends on the maturity and effectiveness of the policy institutions involved in stabilization. So, for example, the perceived impact of "excess" competition on the macroeconomy, prior to and after World War II, was thoroughly different, as a result of the development of Keynesian macroeconomic policy after the war.

C. Power and class relationships

The evolution of economic and institutional change shaped the dominant relationships of political power. The establishment of the new large firms at the turn of the century and the managerial revolution gave rise to power groups or classes with distinct political interests.

A vibrant rivalry developed between the leaders of the new segment of large corporations (including the financiers involved in their emergence, and the managers of the corporations) and the owner-managers of the traditional sector of industry. In point of fact, the elimination of the traditional segment of industry was already under way by the late 19th century and the worsening of the existing antagonism was inevitable. Competition policy was a primary field of battle for these two class segments in the first period described above.[10]

[10] The primary importance of this distinction does not mean that other divisions, such as between financiers and managers, can be neglected, they are simply less central to the interpretation of this period.

The political rivalry among various class segments in our intermediate period is more complicated.[11] This period of about half a century, stretching from World War I to the 1960s, witnessed at least two major transformations: (1) the gradual rise to dominance of the large corporation and its hierarchical management; and (2) the increased involvement of the state in the control of the macroeconomy. Both managers and state officials played an increasing role, in particular during the New Deal. Moreover, during the New Deal the leaders of the financial sector lost considerable political power because of the perceived failures of finance during the Depression.[12] In the meantime, corporate management and state officials developed a closer alliance that created the political conditions for the rise of Keynesianism.

The political setback of finance following the Depression was short lived. Several events contributed heavily to the reestablishment of the political power of the financial sector in the late 1970s including the failures of Keynesian policy and the crucial role finance was called upon to play in the internationalization of capital. Gradually, the finance sector increased its control over domestic and international monetary institutions, and greater political influence followed.

Moreover, the free movement of capital between countries became a crucial element in the development of transnational corporations. The restriction on capital movements required by domestic Keynesian stabilization policy were incompatible with

[11] Considerable complexity was introduced by the Great Depression. Moreover, the entire period could be divided into several shorter periods, the 1920s, the Depression years, and the 1950s and early 1960s.

[12] Management and finance may also be at odds concerning the allocation of resources among various industries and uses. Modern firms typically produce multiple products and the funds available for investment are directed by managers between these activities. There is, therefore, an overlap between the functions of finance and management. State officials may also interfere, to different degrees, with capital allocation. An extreme form of this intervention was the planning experiment of the first New Deal, and the organization and financing of the war economy during World War II. In 1942, for example, two thirds of new investment was financed by the state.

the new economic realities. This evolution signaled a convergence of interests between finance and the upper management of the new transnational corporations. Finally, the low profits of the 1970s created greater resistance to increasing wage costs and threatened the alliance with the middle classes.

III. The evolution of competition policy in historical context

The events and transformations described above are linked to the development of competition policy in the United States. This section develops those links for several major events.

A. The crisis of competition and the Sherman Act

The Sherman Act was passed in 1890 in an atmosphere of severe political tension between the emerging large firms and the traditional sector. Moreover, the large firms were bleeding from vigorous price competition among themselves in an atmosphere of general deflation and falling profits. In response, new techniques to avoid the detrimental effects of competition, such as cartels, pools and the trust form, were created. We contend that the Sherman Act, while originally conceived to protect the weaker traditional fraction of the economy, evolved through congressional debate into a compromise that facilitated the development of the new industrial sector as well. This compromise is apparent from the common law language of the statute and its subsequent lax enforcement.

1. THE UNDERLYING CONDITIONS OF THE SHERMAN ACT Most historians agree that competition was quite intense during the decades following the Civil War. Contemporary discussions of the situation even describe it as a period of "excess competition." The increased intensity of competition after the Civil War occurred in part as a result of advances in transportation that brought former isolated geographic markets into rivalry with each other.

The post-Civil War period was also one of declining profit rates and deflation.[13] Competition became particularly severe during the recurrent recessions of the period. A most dramatic example of this instability was the 1873–1879 crisis, which only ended after the return to convertibility of the dollar. At this point a short-lived but strong boom was induced by the inflow of gold and a favorable foreign trade position. But shortly thereafter, the economy entered another recession in 1883.[14] These downturns had a particularly devastating impact because of the absence of an effective government stabilization policy.

The rising competitive pressure impacted unevenly upon the various sectors of industry, and this is where the heterogeneous features of industry described above became important. As described in section II, the years following the Civil War coincided with a process of mechanization, with its traditional "industrial revolution" features particularly the growth of fixed capital.[15] This new feature of technical change had significant consequences for competition. Thorelli states that as a result of "heavy fixed investments" by the new industrial firms:

> . . . Many old enterprises [were] unable or unwilling to expand fast enough and raise the capital necessary to keep abreast in their fields [and] were gradually, or in the recurrent slumps suddenly, forced to the wall.[16] To this extent at least a certain concentration of production

[13] The general price level had increased several fold during the Civil War. After the war, the federal government followed a deflationary policy by calling in the greenbacks. The policy was ended as a result of political opposition from the groups suffering most from the deflation. However, the growth of the economy continued in this environment of a stagnating stock of money. *See* ANNA SCHWARTZ & MILTON FRIEDMAN, A MONETARY HISTORY OF THE UNITED STATES, 1867–1960 (1963).

[14] Viewing these events from a distance, the average of growth rate of output during these years may appear unextraordinary, but this is because growth was concentrated in 1879. Growth rates were clearly deficient during the rest of the period.

[15] In concert with a sudden rise of the labor cost in the first half of the 1880s, these movements resulted in significantly diminished returns on capital despite the increasing size of the production units.

[16] *See* HANS B. THORELLI, THE FEDERAL ANTITRUST POLICY, ORGANIZATION OF AN AMERICAN TRADITION 66 (1955).

> to fewer firms became concomitant with the increase in optimum size . . . . .

It was under these circumstances that the most dynamic segments of the economy attempted to avoid competition by organizing profit pools, cartels, and trusts. And it was the result of the success of these efforts that made big business an object of hatred on the part of smaller competitors, farmers, and urban workers.

Thus, the economic and political circumstances that created the conditions for the Sherman Act were deeply rooted in the transformations of the American economy. They were the expression of a crisis of competition, intimately connected to the new trends of technology and distribution, and a new breed of firms that emerged simultaneously with the disappearance of local geographic markets. New patterns of relationships among firms were developing, threatening the survival of the traditional sector of the economy, and consequently, political pressure mounted for legislative protection.

2. A SOCIAL COMPROMISE The original purpose of the bill that would become the Sherman Act was to protect the traditional firms.[17] But the final legislative language embodied a social compromise between the two segments of industry.

Peritz clearly contrasts the views of the advocates of the two sectors during the congressional debates concerning the Sherman Act.[18] According to Peritz:

1. One view in Congress emphasized the preservation of the traditional segment of industry, "the small dealers and worthy men" threatened by the new "economic order of large scale enterprise."
2. A second tradition "celebrated a new economic order of large scale institutions emerging out of the very process of competition."[19]

[17] The preservation of small producers was an explicit concern in the drafting of the bill. *Id.* at 227.

[18] *See* PERITZ, *supra* note 1, at 14–15.

[19] Arguments concerning the consumer were used by both sides of the debate. Peritz attributes such arguments solely to the first view. The reference to protecting the consumer was also used by the second group

The final compromise that became the Sherman Act occurred when the words requiring "free competition" in the original bill were replaced with a prohibition on "restraints of trade" and "monopolization." By returning to the older and more ambiguous common law concepts, a measure of protection for smaller businesses was accomplished but without sacrificing or stemming the corporate revolution. As stated by Peritz:

> . . . Congress debated the explicit language of "full and free competition" for fifteen months, but rejected it just days before enacting a bill [the Sherman Act] radically revised to reflect the language of the common law.[20]

A further expression of this compromise is apparent from the reluctance to administratively enforce the new law during the first few decades:

> Efforts to apply the new law and probe its boundaries were halfhearted under Presidents Harrison, Cleveland, and McKinley. . . . The first real government victory over a close-knit combination, spearheaded by Theodore Roosevelt's accession to the presidency, came when a merger consolidating control over the Northern Pacific and Great Northern railroads was declared illegal.[21]

It was the compromise nature of the Sherman Act, and the difficulty of its interpretation, that fostered its overwhelming support (it was passed with only one dissenting vote in the Senate) and accounts for the weak subsequent enforcement in the first decade

but in relation to productive efficiency. Robert Bork has argued that consumer welfare was the only goal of the Sherman Act: "the legislative history of the Sherman Act displays the clear and exclusive policy intention of promoting consumer welfare." *See* ROBERT H. BORK, THE ANTITRUST PARADOX 61 (1978). We agree with Thomas Hazlett who states that: ". . . the Sherman Act was primarily intended not to improve consumer welfare but to satisfy the demands of an array of political interest groups." *See* Thomas W. Hazlett, *The Legislative History of the Sherman Act Re-Examined*, 30 ECON. INQUIRY 264 (1992). Hazlett bases his argument on the fact that the same congressmen, including Sherman himself, who defended antitrust legislation also voted in the same year for the McKinley Tariff Act.

[20] *See* PERITZ, *supra* note 1, at 12.

[21] *See* DAVID ROSS & F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 450 (3d ed. 1990).

following its enactment. However, this ambiguity, in our view, was less the result of philosophical debate as it was the political expression of a mutual compromise among competing economic groups.

When the act was finally ratified, the new modern segment of industry was rapidly developing, and congressional debate expressed implicit concern for preserving these new trends. At the same time, it was accepted that some degree of regulation of competition was necessary. The Sherman Act was enacted in a period of transition between two forms of economic and social organization (from the traditional small firms to larger units of production and larger firms), and a political compromise was necessary. Federalizing the common law in the form of the Sherman Act made sense under such circumstances.

It is important to remember that additional corporate legislation favorable to the rise of big business was being enacted during the same years. This evolution is well described by William Roy in his new book.[22] Before the Civil War, the corporate form was only available for public works projects under the aegis of state governments. Corporations "were given special privileges including legal monopolies,"[23] and managers enjoyed a degree of autonomy from owners much larger than in the past. As corporations began to spread they became a vehicle for intercorporate stock ownership and management:

> New Jersey is well known for setting the standard for the more permissive end of the scale, gaining notoriety for liberalizing its laws in 1888 and 1889, essentially legalizing the holding company form of organization. . . . New York passed laws allowing corporations to own stock in similar lines of business in 1890 and 1892.[24]

This historical interpretation of the Sherman Act provides a good example of the difference between Peritz's approach and

[22] *See* WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA ch. 6 (1996).

[23] *Id.* at VI-3.

[24] *Id.* at VI-11.

ours. Congressional debate over the Sherman Act is viewed by Peritz as the embryonic form of two alternative "rhetorics," that became central in future debates about antitrust. In our view, Peritz underestimates the impact of economic, institutional, and power relationships—contrary to what is promised in his introduction. The actual tensions between conflicting groups are transposed by Peritz into the sphere of legal debate. This is obvious from the following passage:

> The Sherman Act passed through a Congress struggling with tensions between belief and experience; tensions between, on the one side, the economic mythology of artisans and local markets together with the political ideology of a yeoman citizenry and, on the other side, the actuality of a new economic order of large-scale enterprise and national markets.[25]

These tensions were obviously less between "belief and experience" than between two types of economic organizations in the economy and their political leaders.

B. The merger wave at the turn of the century: the birth of corporate capitalism

The first merger wave at the turn of the 19th century was a major event impacting competition and the continued rivalry between the two industrial sectors after the enactment of the Sherman Act. Its exact dating differs significantly among scholars. For example, Scherer and Ross[26] describe it as a comparatively lengthy episode stretching from the recovery of the recession of 1883 to the beginning of the century, 1887–1904. In contrast, N.R. Lamoreaux, 1985, dates the merger wave from 1895 to 1904.

1. THE ECONOMIC DETERMINANTS OF THE MERGER WAVE Regardless of the exact date of its onset, the first merger wave can be interpreted as a further development of the earlier transformations of the economy and tensions described above. Mergers were simply another method used by firms to extend the new managerial orga-

[25] PERITZ, *supra* note 1, at 24.

[26] ROSS & SHERER, *supra* note 21, at 153–55.

nization and increase in firm size.[27] Mergers were additionally encouraged by the unfavorable technical and distributional trends of the period. The decline of profitability created a strong incentive to increase efficiency, and the crisis of the 1890s added to the pressure.[28]

2. THE SHERMAN ACT AND THE NEW CORPORATE LAWS In our view, the early interpretation of the scope of the Sherman Act combined

[27] This view of the first merger wave is consistent with that of Alfred Chandler. *See* CHANDLER, *supra* note 7. Chandler's efficiency interpretation of the merger wave has been widely criticized as exceedingly deterministic and as teleological. *See* MAURICE ZEITLIN & RICHARD E. RATCLIFF, LANDLORDS AND CAPITALISTS, THE DOMINANT CLASS OF CHILE (1988); and ROY, *supra* note 22. Lamoreaux points out that Ralph Nelson's classical study (RALPH L. NELSON, MERGER MOVEMENTS IN AMERICAN INDUSTRY, 1895–1956 (1959)), contains a precursor to this criticism because Nelson also criticized the efficiency explanation of the merger wave. *See* NAOMI R. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895–1904, at 109 (1985).

[28] Several historians of the merger wave explain it as a new development of what we have called the "crisis of competition" in the latter decades of the 19th century. As stated by Lamoreaux: "Manufacturers formed consolidations to escape the severe price competition that developed during the depression of the nineties in certain types of industries: capital-intensive, mass-production industries in which firms were closely matched and in which expansion had been rapid on the eve of the Panic of 1893." *Supra* note 27, at 87. Lamoreaux relies on the report of the Industrial Commission at the turn of the century, which cited as the cause of the consolidations "ruinous competition." According to the Commission, competition was "so vigorous that profits of nearly all competing establishments [in some industries] were destroyed." *Id.* at 103. The severe impact of competition during the crisis of the 1890s does not detract from our emphasis on technical and distributional trends. O'Brien pushes the argument too far when he states: "the role of the great merger wave of 1898 to 1902 . . . should be downplayed; instead greater emphasis should be placed on developments of the 1870s and 1880s. Increases in concentration during the merger wave were motivated more by the desire to reduce price competition than by the desire to exploit scale economies." *See* O'Brien, *supra* note 6, at 649. In our opinion, these references to technology, on the one hand, and to the crisis, on the other, are not mutually exclusive. The crisis merely created the conditions for the emergence of new institutions created in reaction to the unfavorable economic trends.

with new corporate laws helped initiate the first merger wave. A widely held view is that the Sherman Act prescribed only "loose consolidation" (agreements, pools, and trusts), but not mergers. The Sherman Act thus channeled corporate activity into mergers. Moreover, the transformation of the corporate law also encouraged mergers.[29] William Roy, for example, stresses that "the [corporate] law played an autonomous role in shaping the social relations institutionalized in the new corporate organization of property."[30] According to Roy:

> Both proponents and opponents realized that these laws gave the corporations powers not available to individually owned businesses and heralded a new structure for organizing enterprises. . . . Thus the socialization of ownership created by intercorporate stock ownership and common stock-holders came to operate in tandem with the socialization of authority forged by shared directors, solidifying relations at the social as well as the individual level. Individually owned firms never had had this resource.[31]

The history of the merger wave of the turn of the century illustrates how antitrust and corporate laws, in the wake of a severe crisis and difficult economic conditions, not only did not check the rising industrial concentration, but instead defined an institutional framework favorable to big business, while simultaneously

[29] While frequent reference is made to G. Bittlingmayer, 1985, the debate is old. As early as 1955 Thorelli presented it as an ongoing controversy: "The result was a widespread theory that the new effect of the Sherman Act was to direct the combination movement toward various forms of consolidation rather than cartelization. Occasionally, legal commentators went so far as to suggest that the antitrust law actively stimulated the formation of consolidations." *See* THORELLI, *supra* note 16, at 604. The effect of antitrust legislation on consolidation is also explicit in Chandler's analysis: ". . . the United States Congress, responding to the increasing protests against the cartelization of so many American industries, passed the Sherman Antitrust Act, ... Immediately the 'New Jersey holding company' took the place of the trust as the legal form used to merge a number of single-unit enterprises . . . ." *See* CHANDLER, *supra* note 7, at 319. According to Chandler, efficiency gains were only realized through mergers, whereas the looser agreements had left the participating firms basically unaffected.

[30] *See* ROY, *supra* note 22, at VI-1.

[31] *Id.* at V-12–VI-15.

giving it a particular shape. This is a typical example of the reciprocal relationship between historical economic trends and legal responses.

3. THE MERGER BETWEEN FINANCE AND MANUFACTURING CAPITAL

Roy attributes great importance in explaining the early merger wave to the division between financial and manufacturing interests.[32] Indeed, he interprets the merger wave first in terms of confrontation, and later as a fusion between two class fractions, the financial class fraction and one sector of manufacturing:

> Finance capital revolved around first government finance, and, later, public improvement corporations, especially the railroad. But what set the late 19th century apart was the reorganization of the institutional structure within which business firms relate to each other. Finance capital and manufacturing capital merged. This was the really big merger in the merger movement, not just the combination of individual firms into major corporations, but the fusion of two formerly distinct class segments. The corporations that became linked together through these institutions constituted a distinctive and new class segment characterized by qualities we normally associate with "big business."[33] The traditional sector of industry was not able to compete effectively with this powerful new corporate combination:

> When class interests (or the interests of class segments) are at stake, such as when manufacturers were resisting corporate takeover, the outcome will be determined in large part by the extent to which people with a common class interest act in common. For example, the antitrust legal action corroded class solidarity among small and medium manufacturers, making it easier for corporate capitalists, who were knitted together by shared ownership and common investment institutions, to prevail both economically and legally.[34]

This confrontation adds a new element to the chain of explanatory elements. Following the development of unfavorable

[32] Roy's aim is to refute the "efficiency theory." He discusses his own analysis in relation to Chandler's work, but fails to consider other accounts of the relationship between finance and manufacturing.

[33] Roy, *supra* note 22, at I-30.

[34] *Id.* at I-18.

technical and distributional trends, a crisis in the 1890s (related to these trends), created the economic and social conditions for a new economically efficient institutional framework, that of corporate capital, led by financiers and the owner-managers of the advanced sector of industry.

C. The competitive framework of the early 20th century

Judge White's rule of reason interpretation of the Sherman Act, the enactment of the Clayton Act, the creation of the Federal Trade Commission, and the rise of trade associations are the four major events that occurred and impacted competition and antitrust policy during the progressive era.

In spite of World War I and the recessions of 1907 and 1921, the early 20th century was a period of relative stability and steady economic improvement. This was true both with respect to technological and distributional trends, as well as the social control of the macroeconomy. The benefits of the managerial revolution in the corporate sector of the economy were beginning to be felt in these years. Moreover, the financial and banking system was thriving. Deflation appeared to be conquered and prices were stable throughout the 1920s. The traditional sector was not eliminated by the earlier unfavorable economic trends, and the traditional and advanced sectors of industry seemed to coexist in this stable environment.

We interpret the evolution of antitrust legislation during these years as the expression of the rise to dominance of big business, and the development of a framework for its competitive rivalry. This section develops this interpretation.

1. THE CONTROVERSY OVER COMPETITION POLICY DURING THE PROGRESSIVE ERA Historians addressing the legislative events impacting competition during the progressive era have taken two opposite positions. At issue was whether competition was deficient or excessive, as well as the role of the state and its relationship to the various industrial groups.

The so-called progressive historians contended that the problem of monopoly and, more generally, competition and big business, had been solved by the onset of World War I as a result of antitrust enforcement. A straightforward summary of this view is provided by Arthur Link:

> . . . by the end of the Taft administration the primary objectives of the antitrust movement had been fairly accomplished. There was no longer any constitutional doubt that the federal government possessed ample power to prevent monopoly and suppress unfair trade practices in the day to day operations of businessmen. Because of Roosevelt's and Taft's vigorous prosecutions, moreover, the age of monopoly was over. Great corporations remained and dominated certain industries, but these oligopolies existed by the sufferance of public opinion and a government that jealously guarded their smaller competitors.[35]

A quite different view was advanced by a second group of historians, sometimes called the "new left historians." In their analysis, antitrust legislation prevented excess competition, and was actually enacted under pressure from big business. As Gabriel Kolko describes:

> Despite the large number of mergers, and the growth in the absolute size of many corporations, the dominant tendency in the American economy at the beginning of this century was toward growing competition. Competition was unacceptable to many key business and financial interests, and the merger movement was to a large extent a reflection of voluntary, unsuccessful business efforts to bring irresistible competitive trends under control. . . . As new competitors sprang up, and as economic power was diffused throughout an expanding nation, it became apparent to many important businessmen that only the national government could rationalize the economy. Although specific conditions varied from industry to industry, internal problems that could be solved only by political means were the common denominator in those industries whose leaders advocated greater federal regulation. Ironically, contrary to the consensus of historians, it was not the existence of monopoly that caused the federal government to intervene in the economy, but the lack of it.[36]

[35] *See* AMERICAN EPOCH by Arthur S. Link. Copyright 1959 by Alfred A. Knopf Inc. At 114. *Quoted in* LOUIS GALAMBOS, THE PUBLIC IMAGE OF BIG BUSINESS IN AMERICA, 1880–1949: A QUANTITATIVE STUDY IN SOCIAL CHANGE 279 (1975).

[36] From THE TRIUMPH OF CONSERVATISM: A REINTERPRETATION OF AMERICAN HISTORY, 1900–1916 by Gabriel Kolko. Copyright ©1963 by The Free Press, a Division of Simon & Schuster. Reprinted with permission of the publisher. At 4–5.

Kolko may have exaggerated the direct influence of the leaders of big business on federal regulation. But what is important is that the interests of big business were not ignored by antitrust legislators and antitrust enforcers. The antitrust laws recognized and facilitated the growth of big business. In contrast to Kolko, however, the leaders of big business had to fight vigorously for their legislative program during this period against the traditional segment of industry.

2. THE BUREAU OF CORPORATIONS AND THEODORE ROOSEVELT'S STANCE TOWARD BIG BUSINESS The anxiety created by the merger wave of the turn of the century led to the establishment of the United States Industrial Commission in 1898, and the Bureau of Corporations in 1903. Neither institution attempted to reverse the growth of the large corporations:

> Both agencies assumed the affirmation and regulation of corporate consolidation, rather than its prohibition or breakup. Under the chairmanship of James R. Garfield, the Bureau's first annual report[37] distinguished between "two classes" of "antitrust" legislation—"the one which is aimed at prohibition of monopoly and the restraint of trade, and which is more properly 'antitrust', and the other, which is aimed at improper rebates, discrimination, and unfair competition, and which has no necessary connection with combinations."[38]

The bureau rejected the project of stopping the first component as "a futile attempt to stop the operation of strictly economic law by statutory enactment."

Theodore Roosevelt, the alleged "trust buster," assessed the situation in much the same way. In his message to Congress in 1905, Roosevelt made the following statement:[39]

> This is an age of combination, and any effort to prevent combination will not only be useless, but in the end vicious, because of the con-

[37] *See* BUREAU OF CORPORATIONS, ANNUAL REPORT 40–41 (1904).

[38] *See* JAMES WEINSTEIN, THE CORPORATE IDEAL IN THE LIBERAL STATE, 1900–1918, at 70, Beacon Press (1968).

[39] Weinstein focused on the relationship between the administration and the National Civil Federation (NCF) in promoting the views of large corporations, as opposed to the National Association of Manufacturers (NAM) that represented the traditional business sector.

> tempt for law which the failure to enforce law inevitably produces. [What was needed was] not sweeping prohibition of every arrangement good or bad, which may tend to restrict competition, but such adequate supervision and regulation as will prevent any restriction of competition from being to the detriment of the public.[40]

3. THE HEPBURN BILL OF 1908 AND THE ELECTIONS OF 1912 The crisis of 1907 revived the corporate opposition to antitrust, since it again raised concern for the danger of excess competition. In response to the crisis, the National Civic Federation, representing big business, drafted the text of the Hepburn bill which was aimed at amending the Sherman Act. The bill combined a number of elements including (1) an explicit exemption for labor from the Sherman Act (which had been increasingly used against trade unions); (2) a legislative affirmation of the rule of reason approach to the Sherman Act; and (3) a 30 days' limit for the Bureau of Corporations to declare a contract illegal, after which it was precluded from taking action. Roosevelt favored the new law:

> By 1902, Roosevelt's general support for federal regulation had translated into specific endorsement of a federal incorporation law, to be enforced by a national commission lodged in the executive branch.[41]

In spite of his involvement during the preparation of the bill, in the end Roosevelt did not support it because of the strong opposition of small businessmen (organized by the National Association of Manufacturers). The bill failed but, in the meantime, the Supreme Court abandoned its "literalist" interpretation of the Sherman Act and adopted the rule of reason approach in the *Standard Oil* case in 1911.

A year later, in the campaign for president in 1912, big business and antitrust became two of Roosevelt's central themes:[42]

[40] WEINSTEIN, *supra* note 38, at 71.

[41] *See* LAMOREAUX, *supra* note 27, at 170.

[42] Similar views can be found in Michael O. Wise, *Robert M Lafollette's Progressive "Wisconsin Idea" and the Origin of the Federal Trade Commission*, ANTITRUST REPORT (1995), at 10–12.

> Roosevelt's response [to opponents of antitrust concerned about his position] was an article published in *The Outlook*[43] on "The Trusts, the People, and the Square Deal," which, "like a stroke of summer lightning" brought the possibility of his candidacy again before the country. Reiterating his belief that only those corporations guilty of unfair practices toward competitors and of procuring unfair advantages from railroads should be prosecuted under the Sherman Act, Roosevelt reasoned that "business cannot be successfully conducted in accordance with the practices and theories of sixty years ago" unless we abolish "all the modern conditions of our civilization." The effort to prohibit all combinations, good or bad, was "bound to fail, and ought to fail." The problem was not how to strangle the giant corporations, but how to regulate them so that their activity was consistent with the public interest. Along this line, Roosevelt urged the creation of an interstate trade commission and provision for federal incorporation of concerns in interstate commerce.[44]

Woodrow Wilson's view was nearly identical.[45] It was clear that, at least in the executive branch, the opinions of big business on competition matters held sway.

4. THE CLAYTON ACT AND THE FEDERAL TRADE COMMISSION Both the Clayton Act and the Federal Trade Commission Act were enacted simultaneously in 1914. The Clayton Act supplemented the Sherman Act by, among other things, reaching certain anti-

[43] *See* 99 THE OUTLOOK 649 (Nov. 18, 1911).

[44] *See* WEINSTEIN, *supra* note 38, at 149.

[45] "In the speech accepting his nomination to the presidency, in August 1912, Wilson repudiated his own party's platform, which denounced the Rule of Reason decision of 1911 . . . . Instead he identified with the views of Roosevelt, Garfield, and the Bureau of Corporations: 'I am not,' he said, 'one of those who think that competition can be established by law against the drift of a worldwide economic tendency; neither am I one of those who believe that business done upon a great scale by a single organization—call it corporation, or what you will—is necessarily dangerous to the liberties, even the economic liberties, of a great people like our own.' . . . 'I dare say we shall never return to the old order of individual competition, and that the organization of business upon a great scale of cooperation is, up to a certain point, itself normal and inevitable.' . . .Wilson proposed that the government prevent corporations from fixing prices, tying contract between manufacturers and retailers, controlling sources of raw materials, engaging in espionage and cuthroat competition." *Id.* at 163.

competitive practices in their incipiency. It also aimed at making specific practices illegal. The Federal Trade Commission proscribed "unfair methods of competition" and established an administrative enforcement procedure. According to Peritz:

> The Clayton Act would control judicial discretion by defining a list of specific antitrust violations, including price discrimination and anticompetitive mergers. The second statute would replace the corporatist Bureau of Corporations with an independent Federal Trade Commission, . . . empowered to define and regulate unfair competition—that is, the abuse of economic power.[46]

The establishment of this new framework is often described as an additional congressional step taken to curb the power of big business. The historian J. Weinstein disagrees:

> The Federal Trade Commission Act of 1914 is most often thought of as a Wilsonian reform embodying a bias against "big business." In fact, the principles underlying the FTC were enunciated by corporation leaders and their lawyers consistently through the Progressive Era in response to a series of legislative and judicial actions stretching over some seventeen years.[47]

As in the case of the Sherman Act, however, the impact of new legislation depends in part on how it is enforced. According to Michael Wise, with respect to the FTC:

> . . . doing something about the trusts was no longer the central issue of the day. Rather, it was a consensus whose details were being worked out. But the devil is in the details; the form the compromise package took foreshadowed the Commission's almost immediate troubles.[48]

The Clayton Act contained several loopholes that favored big business. Section 7 of the Act covered acquisitions of "the whole or any part of the stock or other share capital of another corporation." Use of the term "stock" excluded asset acquisitions from regulation. Likewise, section 8's prohibition on interlocking directors was easily circumvented by indirect interlocks.

[46] PERTIZ, *supra* note 1, at 65.

[47] WEINSTEIN, *supra* note 38, at 62.

[48] Wise, *supra* note 42, at 20–21.

5. THE TRADE ASSOCIATION MOVEMENT AND THE SECOND MERGER WAVE The previous sections described how the rising sector of big business was able to sidestep any substantial detrimental impact from the antitrust laws. By the 1920s the ascendancy of the new corporate fraction of industry was irreversible. The new firms sought to extend their management principles industry wide by the formation of trade associations. A trade association is a private organization of firms in one industry, whose purpose is to organize competition, sharing information and defining rules and standards of conduct. Trade associations first developed after the Civil War:

> Associations of the modem sort began to appear in the United States soon after the conclusion of the Civil War. Until the passage of the Sherman Anti-Trust Act in 1890 they appear to have been frankly regarded by their promoters as a substitute for the trusts . . . .[49]

Peritz[50] described the trade association movement as a new logic of "cooperative competition." Trade associations could have been viewed as a new form of trust, instead a powerful argument was advanced that the dissemination of information through trade associations actually increased competition.[51] In addition, avoiding the dangers of "cut-throat" competition was also an important justification that was put forward, especially in an economy in which the control of the macroeconomy was weak and ineffective. This threat explains why trade associationism was not only accepted by the government, but was even encouraged. As Harold Moulton of the Brookings Institution relates:

> Trade associations have on the whole been viewed with much less disfavor by the United States government than have consolidations. Whereas the evolution of monopolies in the 1880's was promptly followed by antitrust legislation intended to preserve free competition in the interest of the public welfare, the development of trade associations in the 1920's was systematically encouraged under the leadership of the United States Department of Commerce. Indeed, "stabilization"

[49] ARTHUR R. BURNS, THE DECLINE OF COMPETITION, A STUDY OF THE EVOLUTION OF THE AMERICAN INDUSTRY 43 (1936).

[50] PERITZ, *supra* note 1, at 76.

[51] ARTHUR J. EDDY, THE NEW COMPETITION (1912).

> was one of the fundamental policies of the Hoover regime—the stabilization of prices being regarded as a means of preventing market disorganization and hence key to stable production and permanent prosperity.[52]

In combination with the rule of reason interpretation of the Sherman Act, trade associationism defined a new framework in which the large corporations could continue to compete, yet simultaneously avoid mutually destructive competitive practices.

In spite of the interruption of World War I and the 1921 recession, the earlier movement toward mergers and concentration continued creating a second merger wave in the 1920s. But now the new favorable technical and distributional trends of the intermediate period were under way as the managerial revolution sunk deep roots. The traditional sector of industry was still politically active, but its power was declining.

D. The shock of the Depression: from planning to antitrust

Two dramatically different approaches to antitrust enforcement occurred during the Depression. The first New Deal of 1933 attempted to organize industries under "codes" aimed at eliminating competition. In contrast, the second New Deal after 1935 marked a return to aggressive antitrust enforcement. The radical character of the first New Deal and the sudden switch to the second is a puzzle that can only be understood when considered in an historical perspective.

The Depression itself disturbed the newly established institutional frameworks discussed above. At the same time, a large fraction of the traditional sector of industry was destroyed by the Depression. The relationship between the financial sector and the industrial sector was also altered as the political power of finance declined and a political alliance between state officials and the managers of industry was formed. This latter alliance led to the rise of Keynesianism.

[52] Income and Economic Progress by Harold G. Moulton. Copyright 1935 by The Brookings Institution. At 138.

1. SETTING THE STAGE FOR THE NEW DEAL: TECHNOLOGY, DISTRIBUTION, AND INSTITUTIONS As explained in the first part of this article, technological and distributional trends were crucial to the onset of the Depression. A favorable period of technical progress, resulting from the managerial revolution was in progress. Profits and wages were both rising. But at the same time, a large segment of industry was isolated from the managerial revolution. As a result, heterogeneity between the segment of new efficient large business and the obsolete population of traditional firms, grew. As described above, in the preceding decades competition policy had been a central issue in the rivalry between these two sectors.

Despite the creation of the Federal Reserve, the control of the macroeconomy remained under the dominance of private finance in the 1920s and financial institutions thereby wielded considerable political power. But in the 1930s these private banking institutions failed to stabilize the economy when the obsolete sector of business began to collapse. The responsibilities of the Federal Reserve were not yet well established and it primarily focused on the stability of the financial and monetary institutions rather than on the macroeconomy as a whole.

The weakness of the traditional sector and this inadequate institutional framework account for the depth of the Depression. They also explain why such importance was placed on competition policy in the attempts to stem the collapse of the economy. Competition thus remained at the center of policy debates during the 1930s.

2. COMPETITION: PANACEA OR THREAT? The sudden transformation of competition policy between the first and second New Deals can only be understood in relation to the ambiguous manner that competition was viewed during the Great Depression. Some believed that excess competition was a crucial factor in the causes of the Great Depression (as had been the case in the 1890s). In contrast, other analysts blamed the Depression precisely on the lack of adequate competition.

An extreme version of the second stance was consistent with the views of Justice Brandeis. He was 77 years old in 1933, and embodied the tradition of Jefferson (and Wilson, of whom he had been an adviser). For him, concentration was a serious threat to traditional democratic values, and he wished to return to an economy dominated by independent small competitors. A well-known supporter of similar views was Senator La Follette of Wisconsin, who "was antimonopoly and hoped to restore an earlier era of free competition by and for small businessmen and farmers—through government dissolution of trusts and regulation of railroads."[53]

Many contemporary economists interpreted the problem of the Depression as one of price inflexibility. According to Arthur Burns, for example, the flexibility of prices had been lost when the new large corporations emerged.[54] When price flexibility is lacking, the theory goes, the economy is forced to adjust by changing output. The result can be dramatic recessions, and the obvious solution is a return to free competition. As one contemporary expressed:

> The fact that drops do occur in spending, production, and employment simply reflects the fact that prices do not move promptly enough to eliminate maladjustments before the maladjustments themselves produce new maladjustments.[55]

Another train of thought also focused on price flexibility but rejected a return to the past, advocating instead central planning. Gardiner Means' analysis was typical of the so-called planners who defended strong state intervention in place of competitive mechanisms. In his book on price inflexibility Means expressed what Arthur Schlesinger calls "a powerful statement" of the need for general planning:

> He [Means] cogently argued that administered prices had superseded market prices in vital parts of the economy, and that this was a necessary phase in economic growth. "Administrative coordination—the very thing that has made modern technology and a high standard of

[53] Weinstein, *supra* note 38, at 6. *See also* Wise, *supra* note 42.

[54] Burns, *supra* note 49.

[55] Sumner H. Slichter, Towards Stability. The Problem of Economic Balance 8 (1934).

> living possible—has destroyed the effectiveness of the market as a coordinator."[56]

These extreme positions do not fairly represent the entire spectrum of ideas. For example, another interesting figure was Harold Moulton of the Brookings Institution, who simultaneously[57] (1) praised the efficiency of large corporations and dismissed any return to smallness; (2) violently rejected planning; and (3) looked to price flexibility as the condition for recovery and economic progress. More specifically, Moulton contended that downward price flexibility would create additional purchasing power, provided that the nominal wage would be maintained:

> The basic economic policy which we are enunciating [diminishing prices with the purpose of increasing real wages] does, however, definitively attack what we regard as a serious abuse of the profits system and the institutions of private capital which have grown up in modern times. This is the tendency to centralize economic advantage, to protect existing business enterprises by protecting the price structure. For more than fifty years this process has been developing through the devices of corporate consolidation, pools, trusts, cartels, trade associations, and code authorities. Particularly since the World War, and often with the active assistance of governments, efforts have been going forward to "stabilize" existing business situations . . . . We believe the evidence is clear that such attempts, however well intentioned, are dangerously short sighted. They result inevitably in "freezing" situations which in the interest of economic progress must be left as fluid as it is possible to make them.[58]

Although Moulton never made clear how such flexibility could be restored, he implied that antitrust legislation would play an important role.

3. COMPETITION POLICY DURING THE TWO NEW DEALS During the first New Deal the planners held ideological dominance in part due to the urgency created by the collapse of the economy. Their vehicle for planning was the National Recovery Administration

[56] 3 ARTHUR M. SCHLESINGER, THE POLITICS OF UPHEAVAL 218 (1960).

[57] Gérard Duménil & Dominique Lévy, *Pre-Keynesian Themes at Brookings, Communication to the Conference Annuele de la Société Européenne pour l'Histoire de la Pensée Economique* (Cepremap 1997).

[58] MOULTON, *supra* note 52, at 162.

(NRA), which organized business into industrial groups, each making collective decisions regarding market shares, prices, and wages.[59] The stated purpose of the codes was to prevent "cut-throat" competition and to centrally manage wages, prices, and outputs (to limit production and to share markets).

Large corporations originally welcomed the codes, and big business wielded a strong influence on their administration. Moreover, the codes provided a safe harbor from antitrust enforcement that large corporations had always disfavored. The views of Leon Henderson, the chief economist for the NRA were typical:

> The Anti-Trust Acts are a throw-back to the Neolithic Age of statesmanship, and their blind sponsorship is a sort of jittering caveman ignorance.[60]

When the NRA was declared unconstitutional in 1935, it was already under heavy criticism, and was felt by many to be unmanageable. Although the economy was certainly not out of the Depression, the first emergency situation was over, and the time was ripe for more conventional approaches. At the end of the first New Deal, Franklin Roosevelt was tempted to reorganize industries using a similar scheme, but under private control in the tradition of trade associationism. But in the end he decided to return to vigorous antitrust enforcement as a method to resolve the price flexibility problem. Here is how Herbert Stein summarized Roosevelt's dramatic change in attitude:[61]

[59] The relationship between the trade associations and the codes is analyzed by A.R. Burns: ". . . in the United States trade associations increased in number and extended their activities in a period of alleged devotion to laissez faire. The state first ignored them, then encouraged them, . . . and under the National Industrial Recovery Act, virtually adopted them as its chosen instruments for the control of industry." BURNS, *supra* note 49, at 43.

[60] 3 SCHLESINGER, *supra* note 56, at 390. Quoting Leon Henderson.

[61] Schlesinger summarized Henderson's about-face as follows: "Leon Henderson, the vigorous and resourceful chief economist of NRA, viewing the economic future late in 1935 from the rubble of his agency, outlined one program to test the possibilities of competition. . . . The key problem as Henderson saw it, was to restore price competition. He

> At the same time many of the President's advisers, even the "planners" among them, were afraid of giving so much control to the businessmen [within new "private" codes]. The prevailing view of this subject within the administration ran in the opposite direction—to take steps to curb the "concentration of economic power." Roosevelt went along with this to the extent of sending Congress a special message on the subject in April, 1938. Congress responded by setting up the Temporary National Economic Committee . . . .[62]

The Depression itself had a devastating effect on the traditional sector of industry. The collapse of these obsolete firms was described above as a major factor in the extent of the Depression, but it is also important to stress the other side of the coin, that the Depression was also an important event in the transition toward a new economy dominated by large efficient enterprises, both politically and institutionally. Without the rivalry of the traditional small firms, the importance of competition policy as a political issue diminished considerably. Accordingly, competition policy lost its place of urgency and macroeconomic policy became the central focus of the national policy debate.

4. THE NEW DEAL COALITION AND KEYNESIANISM While the importance of the conflict between the modern and traditional segments of industry diminished, a new pattern of social relationship emerged, combining new alliances and tensions. The Depression led to a closer working relationship between the managers of the large corporations and state officials, embodied in the so-called New Deal coalition. Simultaneously, the financial sector was blamed for the Depression and lost considerable political influence. Both Roosevelt and Keynes, for example, expressed disdain for the role played by finance during the Depression.

The central element in this political set back for finance was its loss of hegemony over monetary mechanisms, both domestic

appreciated the strength of the tendency toward economic concentration, and price inflexibility. . . . I favor a positive program for securing laissez faire, said Henderson—a multiple attack on concentration and price rigidity, including the active use of the taxing power, the revision of the patent laws; vigorous antitrust action; encouragement in co-operatives; yardstick competition; tariff reduction, and so on." *Id.* at 388.

[62] HERBERT STEIN, THE FISCAL REVOLUTION IN AMERICA 104 (1969).

and international. We will not discuss here the rise of Keynesian economic policy during the second New Deal and after World War II.[63] The crucial point is that the Depression ushered in a new era marked by the involvement of the state in the control of the macroeconomy, under the theoretical auspices of Keynesian economics.[64]

E. Competition and the Keynesian compromise

The 1950s and 1960s are typically described as a period of revival for antitrust enforcement because of the Celler-Kefauver amendment to the Clayton Act. But the impact of the Celler-Kefauver Act on merger enforcement is less than evident. More generally, competition policy during these years should be understood as only one component of the new "Keynesian" compromise engineered by the New Deal coalition after the Depression and the World War.

1. FAVORABLE TRENDS AND MACRO POLICY IN THE 1950s AND 1960s

There was a close link between competition policy and two basic features of technology and distribution during this period. First, the strong heterogeneity among firms in the 1930s had been largely eliminated by the Depression. Second, the favorable trends of productivity of labor and capital were reestablished after World War II. Wages increased in concert with the profit rate.[65] As a

[63] *Id. See also* Duménil & Lévy, *supra* note 57.

[64] The opposition of finance to the Keynes-White plan was typical of the resistance of finance to the encroachment on its traditional hegemony. As recalled by William Domhoff: "The main opposition to the plan came from the banking community, especially from big banks in New York. It needs to be stressed that this opposition was not anti-internationalist. It was based first of all in a desire to maintain the large influence on monetary policy that traditionally had been enjoyed by large banks, . . ." G. WILLIAM DOMHOFF, THE POWER ELITE AND THE STATE, HOW POLICY IS MADE IN AMERICA 178 (1990).

[65] Although much of the new profits were transferred to the state through taxation. DUMÉNIL & LÉVY, THE ECONOMICS OF THE PROFIT RATE, *supra* note 3, at ch. 17.

result, this period stands out as a particularly prosperous one. Abstracting from the large heterogeneity in industry in the early 20th century, the relationship between these trends and competition policy is reminiscent of what occurred during the 1920s. The 1920s was a less favorable period compared to the post-World War II period, but like the postwar years it was marked by little economic pressure from unfavorable technological and distributional trends.

After World War II monetary and fiscal policy was targeted at the stability of the macroeconomy and the fight against unemployment. This new approach was given statutory expression in the Employment Act of 1946, which created the Council of Economic Advisors. There was relative price stability with little danger of deflation (after a difficult adjustment following World War II). In this new context, the fear that competition might cause a crisis seemed unfounded and concerns about excess competition disappeared.[66]

2. THE CELLER-KEFAUVER AMENDMENT, THE REVIVAL OF ANTITRUST, AND CONGLOMERATE MERGERS A widely held interpretation of the new direction of merger activity and antitrust is summarized by Scherer and Ross: Horizontal mergers declined from 39% of all manufacturing company acquisitions by asset value in 1948–1955 to 18.7% in 1956–1963 and 12.0% in 1964–1971. But merger making itself was not deterred. Instead, it was deflected into new directions—notably, into mergers aimed toward diversification.[67]

Mergers declined during the Depression, increased during World War II, and then diminished at the end of the war. Then a

[66] This change was often ascribed to a transformation of the nature of competition itself, as is well documented in chapter 4 of Peritz. Peritz refers to J.M. Clark's view (of 1940) that: ". . . oligopoly is beneficial in that it minimizes the dangers of 'ruinous competition'." PERITZ, *supra* note 1, at 186. The corresponding concept of "workable competition" was central in the Report of the Attorney General's National Committee to study Antitrust Laws of 1955.

[67] ROSS & SCHERER, *supra* note 21, at 156.

new increase in merger activity occurred after 1950.[68] When Congress passed the Celler-Kefauver Act in 1950, it actually foreshadowed the resurgence of mergers and acquisitions that was already in progress.[69]

The impact of the 1950 amendment is controversial. George Stigler reached the following conclusion: "These merger data suggest that the 1950 antimerger statute had been a powerful discouragement to horizontal mergers."[70] In contrast, Richard Posner argued that the 1950 amendment had little impact.[71] It seems, however, that a balanced assessment is possible. While the dominance of big business in the economy in the 1950s and 1960s was never threatened, some pressure was exerted to limit the most anticompetitive horizontal mergers. In this respect, the 1950s echoed the events of the 1920s.

The last part of the above passage from Scherer and Ross refers to the channeling of merger activity "into mergers aimed

[68] *Id.* at 154. *See also* PETER O. STEINER, MERGERS, MOTIVES, EFFECTS, POLICIES 6 (University of Michigan Press 1922), Richard A. Posner, *A Statistical Study of Antitrust Enforcement*, *in* THE CAUSES AND CONSEQUENCES OF ANTITRUST: THE PUBLIC CHOICE PERSPECTIVE 75 (Fred Machesney & William Shughart eds., 1995).

[69] The concern was to plug the "asset" loophole of the Clayton Act and to include vertical mergers under the proscriptions of the Clayton Act.

[70] G. Stigler, *The Economics Effects of the Antitrust Laws*, *in* THE CAUSES AND CONSEQUENCES OF ANTITRUST (1995), *supra* note 68, at 68. Stigler studied the 200 leading companies in manufacturing and mining, with a total of 720 mergers between 1948 and 1964. In Stigler's data the total number of horizontal mergers increased from 18 (out of 58 mergers) to 78 (out of 314) from the first period, 1948–1953, to the second, 1954–1959. The growth of vertical mergers was weaker, but substantial. The number of horizontal mergers only declined during the third period, 1960–1964, to 42 (out of 348). During the same periods, conglomerate mergers soared (respectively 34, 193, and 245, for each period). The growth of horizontal mergers is relatively slower up to 1960. From 1948 to 1964 it declined from 31% to 12% compared to the rise of conglomerate mergers.

[71] Posner, *supra* note 68, at 81.

toward diversification." It is widely believed that competition policy during the 1950s and 1960s directed corporate combination toward conglomerate mergers. Peter Steiner, for example, contends that this movement toward diversification was "wholly explained by the antitrust climate":[72]

> Large vertical mergers had become very vulnerable by the late sixties. The same was true for horizontal and market extension mergers in general, but the willingness of the Justice Department to permit major mergers among leading oil companies was an exception. Thus the only large mergers that were not relatively sure to invite Justice Department response were in the conglomerate categories—and the purer the better.[73]

Although conglomerate mergers were a general feature of the 1950s and 1960s, the conglomerate wave crested in the second half of the 1960s, and then declined sharply.[74] Our interpretation of these events is as follows:

1. In the wake of the Depression and World War II, the movement toward big business had reached a certain degree of maturity and benefited from the favorable overall economic conditions.
2. Antitrust enforcement limited the extent of the merger wave, and directed it toward conglomerate merger.
3. The conglomerate movement then dwindled during the 1970s when a new structural crisis asserted itself. This is a typical pattern for merger activity previously observed in the 1890s and 1930s.[75]

3. THE KEYNESIAN COMPROMISE We have claimed above that finance, after the Depression and the war, lost much of its hegemony over domestic monetary policy, and the restrictions on merger activity were also directly counter to their economic interests. These limitations on the traditional activities of the financial

[72] STEINER, *supra* note 68, at 81.

[73] *Id.* at 25.

[74] ROSS & SCHERER, *supra* note 21, at 154; STEINER, *supra* note 68, at 8.

[75] Actually, the decline of the profit rate in 1966 coincided with the peak of the merger wave.

sector increased the strength of managerial interests. It also thereby encouraged the financing of corporations from internal sources and the use of loans in place of equity as a source of funds.[76]

Simultaneously, in the 1950s and 1960s, the New Deal coalition evolved into a broader and more enduring social compromise:

1. The most radical reformist aspects of the New Deal were abandoned. Keynes himself had always objected to the reform program of the New Deal including both the NRA and attempts to raise wages. Instead, he had emphasized monetary and fiscal policies.
2. The direct relationship between finance and the managers of large corporations was basically preserved despite the political set back the finance sector experienced. Finance also maintained some influence on the management of the macroeconomy. Its traditional concern about government deficits and inflation was never completely abandoned.[77]
3. The favorable trends of technology and of the profit rate allowed for the growth of real wages and the development of welfare programs. This evolution provided a basis for an alliance between management and labor represented by the big labor unions (growing in importance as a result of the corporate-managerial revolution and the rise of state institutions).

Thus, a fragile balance was maintained between the interests of several social groups, state officials, managers, financiers, and middle classes.[78] It culminated during the 1960s in a new model

[76] Managerial theories bloomed during the 1960s (a famous example being the work of J.K. Galbraith). It is interesting to notice, however, that this emphasis on management also initiated concern and criticism. This is documented at length in Peritz's book for example: "The concern was regulatory capture—the power of business elites, the oligarchic results of process theories, and paralleling Berle and Means's anxiety about the break between corporate ownership and control, the gap between old theories about democratic majoritarianism and more recent findings of oligarchic rule in the halls of the bureaucratic government." PERITZ, *supra* note 1, at 189–90.

[77] During the 1950s, the Truman and Eisenhower administrations never fully accepted spending policies, and made several attempts at a return to "sound" public finance.

[78] It is sometimes described in a different terminology referring to "industrialists," labor leaders, and state officials.

of welfare and economic progress, although it was rapidly mired by the development of the Vietnam War and the early signs of the coming third structural crisis.

Overall, the character of competition policy in the 1950s and 1960s cannot be imputed to any single specific group, nor can it be merely attributed to the larger role played by government. Given the favorable economic conditions of the period up to the second half of the 1960s, competition policy is best understood as the expression of a very specific social compromise, in which finance suffered a setback relative to management, and management and unions mutually benefited.

F. The crisis of the 1970s and the merger wave of the 1980s

The most fascinating feature of competition policy after 1970 was its sudden transformation between the 1970s and 1980s. Competition policy during the 1970s was consistent with the previous decade, and even witnessed a number of legislative attempts at greater control of rising concentration. In stark contrast, the 1980s was a period of lax antitrust enforcement generally and virtually a per se legal approach to vertical restraints and vertical mergers.

A crucial element in the interpretation of these changes can be found in the reassertion of the unfavorable trends of technology and distribution at the end of the 1960s, and the corresponding crisis of the 1970s. The new crisis represented the end of a period dominated socially and politically by the experience of the Great Depression and World War II. The political power of finance was progressively restored as finance more clearly and directly asserted a leading position in political and policy circles. In the academic field of economics and the other social sciences, this evolution inspired greater confidence in market-based mechanisms, while monetary policy was given greater importance.

1. COMPETITION POLICY IN THE 1970s: FROM ANTITRUST TO A PRO-MERGER ATTITUDE The early antimerger attitude of the Nixon administration is well summarized by Peritz:

> The 1968 Merger Guidelines expressed the Antitrust Division's commitment to corporate deconcentration—that is to an evaluation of large mergers according to a market-share analysis founded on the tenets of oligopoly theory. . . . the Guidelines were consistent with the congressional intent to stem the tide of industrial concentration as well as recent court opinions' structural approach to competition.[79]

The Hart Bill of 1972 provides another clear illustration of the new concern about concentration. Senator Philip Hart himself described the bill as "the greatest effort which has been put forth to finding a solution for economic concentration."[80] Eventually the bill was defeated and the political environment shifted in favor of deregulation and limited government intervention. The intellectual foundation for the new laissez faire approaches to antitrust issues had been developed much earlier, primarily at the University of Chicago (in particular by George Stigler, Aaron Director, Robert Bork, and Richard Posner).

The antitrust analysis of the 1980s cannot simply be understood as the discovery and application of microeconomics by the legal profession. Microeconomics is a neutral tool in this respect. For example, the basic microeconomic model of perfect competition could have been used to support a return to the Brandeisian nostalgia for smallness and deconcentration efforts. Instead, in the 1980s, Chicago school microeconomic theory became the basis for deregulation efforts. Several specific economic results were emphasized including efficiencies from scale and scope economics and vertical integration, and the difficulties in successfully maintaining cartel behavior. The new promerger attitude was also justified by new theories regarding the impact of mergers on the market for corporate control, e.g., that mergers could discipline managers and thereby improve corporate performance. The new policy concerning competition coincided, and certainly stimulated, the merger wave of the 1980s.

[79] Peritz, *supra* note 1, at 232–33.

[80] Student Note, *The Industrial Reorganization Act: An Antitrust Proposal to Restructure the American Economy*, 73 Colum. L. Rev. 635 (1973).

2. THE CRISIS OF THE 1970s AND THE NEW INTERNATIONAL FRAMEWORK Although the new unfavorable trends of technology and distribution in the late 1960s asserted themselves only gradually, their effects were felt suddenly at the end of the decade. Keynesian macro policies during the 1960s appeared to be effective in maintaining nearly full capacity utilization rates up to the 1970 recession. Thus, Keynesian policy may have delayed the effects of the new unfavorable trends for a few years. However, after 1970, the U.S. economy entered a period of strong instability, with a succession of sharp fluctuations up to the 1982 recession, the most serious since the World War. In addition, the foreign trade surplus shrunk gradually in the second half of the 1960s and then turned negative during the first half of the 1970s, triggering the crisis of the Bretton Woods international monetary system. There was also a slowdown in the growth of labor productivity and a decline of the productivity of capital. The fact that labor productivity was still booming in Japan added to the concern about the future competitiveness of the United States.

Although this new structural crisis differed considerably from the Great Depression, its impact on competition policy was reminiscent of the about-face between the first and second New Deals. In many respects, however, the change in the 1970s was different. In the 1930s, the planning experiment of the first New Deal gave way to a revival of antitrust, while the vigorous antitrust enforcement in the early 1970s was followed by a promerger and lax enforcement approach.

Several new policies in the early 1970s were devised to confront the problems of the period. The Economic Stabilization Act of 1970 temporarily gave the president new powers to control prices and wages in order to control inflation. The same was true of competition policy. Legislative attempts at deconcentration were part of the overall attack on inflation and slow growth.[81] Their defeat led to the rise of deregulation and faith in market outcomes. In the middle of 1971, a balance of payments crisis led to the suspension of the convertibility of the dollar with gold, and

[81] When Hart introduced his bill he sought to remedy inflation and unemployment. *Id.* at 637.

ushered in the new era of floating exchange rates. Finally, the decline of the U.S. hegemony in a world of transnational corporations also fostered increased concern. In this environment of international competition and failed efforts at deconcentration, limiting mergers and heavily regulating business practices seemed unnecessary at best.

It is still unclear whether the wave of mergers and takeovers of the 1980s will produce new favorable trends of technology and distribution like those that appeared during the transition between the 19th and 20th centuries. There is no doubt, however, that new economic transformations are occurring. Like one century ago, the leading actors in the process are finance and management, but this time in an international context.

3. MARKET BASED ECONOMICS IN ITS SOCIAL SETTING: THE NEW HEGEMONY OF FINANCE One striking feature in the transformation of economic policy during the 1970s and 1980s is its global character. Deregulation, macroeconomic (the priority given to the fight against inflation),[82] financial deregulation, new legislation concerning labor and welfare, as well as competition policy, all trumpet a return to a greater faith in market-based solutions.

The underlying political basis for the popularity of laissez-faire approaches is the reassertion of political power by the financial sector.[83] The new pattern of social relations that emerged in the 1980s should not be understood, however, as an autonomous rise of finance, but instead as part of broader social dynamic.[84] The alliance between finance and the upper fraction of manage-

[82] The development of Euromarkets in the late 1960s, in which finance operated more freely, was an important component of restoration. In spite of antitrust policies, the financial relations continued to evolve and progress during the 1950s and 1960s. These gradual developments were actually paving the way for the new hegemony of finance in the 1980s.

[83] By pointing out the social basis for an economic approach does not imply that such policies cannot be effective.

[84] The political struggle between finance and management is evident in the legislative history of the Williams Act, and the evolving common law concerning antitakeover devises.

ment was strengthened in the 1980s, simultaneously with the political defeat of the labor movement and the end of the compromise with middle classes.[85]

The new course of events in the 1980s provides a further illustration of the scope of what is actually at stake in the historical transformation of competition: the relationship between ownership and management, the ability of competing groups to organize and transform the economy, to influence the state, and control its institutions.

IV. Conclusion

In this article we have tried to argue that the history of competition policy can only be understood as a part of the overall economic history of the American economy since the late 19th century. We have focused on the influence of (1) the trends in technology and distribution, (2) institutional changes, and (3) class and power relationships to describe the evolution of antitrust policy in the U.S. We can summarize our contentions as follows:

THE SHERMAN ACT We explain the enactment of the Sherman Act as the result of a combination of the rise of large firms utilizing new technological developments (a progressive mechanization of production) and the impact of several unfavorable economic trends in the economy, in particular a serious decline of the rate of profit. These trends led to the development of anticompetitive practices by firms. There was a growing heterogeneity between the new sector of large progressive firms and the smaller traditional sector. The Sherman Act was an attempt to curb such practices, and to protect the traditional sector. However, the ultimate statute, as well as its early enforcement, expressed a social compromise. It influenced the direction of concentration without effecting the overall trend.

THE MERGER WAVE AT THE TURN OF THE CENTURY The unfavorable tendencies of the late 19th century culminated in a crisis in the

[85] The underlying conditions and the features of the transformations of social relationships at the turn of the century and in the recent decades were, therefore, quite different.

1890s. In this context, the restraint imposed by the new antitrust act, and the transformation of the corporate laws, set the stage for a wave of "tight consolidations" or mergers at the turn of the century. A new framework of social relationships emerged ("corporate capitalism"), in which finance and management shared control of the most advanced segment of industry, and existed side by side with the traditional sector.

COMPETITION IN THE EARLY 20TH CENTURY The first decades of the 20th century were marked by the emergence of the "rule of reason" interpretation of the Sherman Act, the enactment of Clayton Act, the creation of the Federal Trade Commission, and the rise of trade associations. During these years, the trends of technology and distribution improved, and big business consolidated its political power over the smaller traditional firms. As a result, the leaders of the modern segment of industry, financiers and managers, were successful in channeling antitrust from a condemnation of bigness per se, into a clarification of the rules of the competitive game, thereby implementing a new framework of "cooperative competition." These achievements helped facilitate a new merger wave during the 1920s.

THE GREAT DEPRESSION The New Deal opened with the NRA codes implementing central planning of production and prices in each industry, and ended with a sudden reversal and return to antitrust enforcement. The strong heterogeneity within industry, with a still large obsolete traditional sector, was crucial in the development of the Depression. The weakness of American monetary and fiscal policy was also critical. During the Depression, many scholars and business people attributed the problem to excess competition. A competing intellectual tradition blamed the Depression on concentration and rigid prices. The collapse of the economy during the first phase of the Depression led to the creation of the NRA, finding its intellectual foundations in the first tradition. In the wake of this first emergency situation, there was a prompt return to the previous intellectual stand. The Depression eliminated large fractions of the obsolete sector of industry, and considerably facilitated the dominance of big business. In addition, the failures of financial institutions led to greater government regulation of banking. In this respect, the Depression facilitated the "New Deal coalition" between managers and state officials. Macroeconomic Keynesian policy emerged in this context and became even more important than competition policy.

ANTITRUST IN THE 1950s AND 1960s The benefits of the new trends of technology and distribution due to the efficiency of the new framework of corporate management became evident after World War II. In relation to the development of Keynesian macroeconomic policy, excess competition was no longer a threat to the stability of the economy. As expected, large corporations gained complete dominance after the war. The revival of antitrust enforcement, under the Celler-Kefauver amendment can be interpreted as part of the relative setback of finance in the wake of the Depression and the new social compromise. It did not lead, however, to deconcentration, but rather channeled mergers toward diversification. This movement culminated in the conglomerate merger wave of the late 1960s. During these years, finance was, however, gradually regaining its position both in domestic and international spheres (in particular in the development of Euromarkets).

THE 1970s AND THE MERGER WAVE OF THE 1980s A return to new unfavorable trends of technology and distribution at the end of the 1960s provoked a new structural crisis in the 1970s. The first reaction to the deterioration of the performances of the U.S. economy was the strengthening of antimerger policy and of its enforcement. However, the failure of demand policy to ameliorate the structural crisis discredited Keynesianism. The new power of finance—in relation to the new transnational scope of corporations—emerged suddenly to the fore, triggering a dramatic switch toward laissez-faire policies. This change in policy was evident in many fields, including the fight against inflation and for deregulation. This was the basis for the rise of the Chicago school to policy prominence. The pressure to reduce concentration was relaxed, and mergers were no longer discouraged. A new framework of social relationships emerged in which the hegemony of finance was restored, and a new alliance formed between finance and the upper fraction of management