

## THE ORIGINS OF ANTITRUST: AN INTEREST-GROUP PERSPECTIVE

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### I. INTRODUCTION

Disenchantment with the antitrust laws has been growing in recent years, for it is now recognized that they often hinder rather than improve economic efficiency. Successful businesses have been sued for offering the best products at the lowest prices, thus being guilty of 'dominating' their industries; competitive price-cutting has been condemned as 'predatory' or as 'discrimination' or 'foreclosure' (of one's competitors); and ready-to-eat cereal producers catering to the diverse preferences of American consumers have been accused not of collusively raising prices, but of 'sharing' a monopoly through the dubious tactic of 'brand proliferation'. The list is almost endless, and several well-received books have now been written on the ill effects of antitrust.<sup>1</sup> In a recent treatise Yale Brozen provided evidence that the antitrust laws 'are themselves restraining output and the growth of productivity', and are 'contributing to a deterioration of the competitive position of the United States in competitive markets'.<sup>2</sup> Dominick Armentano offered even sharper criticism by concluding that, based on historical evidence, the antitrust laws are a major *source* of monopoly power—routinely used to protect inefficient firms.<sup>3</sup> And Harold Demsetz has admitted that if certain antitrust policies were continued, he would favor outright repeal of the Sherman Act.<sup>4</sup>

These criticisms are well taken and well grounded on sound empirical research. This research has given rise to what Brozen calls 'a revolution in economics—in that part of the field called industrial organization—which is nearly complete in the professional journals'.<sup>5</sup> But despite this, there still exists great faith among economists in the necessity of antitrust laws to ensure competition in a private enterprise system. It is true, most would concede, that mistakes have been made, but the antitrust laws in general and the Sherman Antitrust Act in particular are still widely held as the guarantors of a competitive economy. There is a strongly-held belief that there once was a 'golden age of antitrust', during the late nineteenth century, in which these laws were implemented to brush back a 'rising tide of monopoly power'. Thus, economists have great faith in the legitimacy, if not necessity, of the antitrust laws, despite all their past policy failures. Whenever a pattern of perverse economic behavior persists over several decades, economists usually ascribe it to something inherent in the decision-making structure. Antitrust, however, seems to be an exception. In one popular textbook F. M. Scherer proclaims:

In the United States . . . the enforcement of the antitrust laws is the main weapon wielded by government in its effort to harmonize the profit-seeking behavior of private enterprise with the public interest.<sup>6</sup>

Kenneth Clarkson and Roger Miller, in another well-known text, say that 'Antitrust laws have been legislated and enforced in order to keep business behavior and markets competitive',<sup>7</sup> while another textbook author, Marshall Howard, praises the Sherman Antitrust Act as the 'Magna Carta of free enterprise'.<sup>8</sup>

Statements such as these are found not only in the industrial organization textbooks but also appear to represent the opinions held by a strong majority of the economics profession. In a recent survey of a random sample of economists published in the *American Economic Review*,<sup>9</sup> 83 per cent of those surveyed agreed that 'antitrust laws should be used vigorously to reduce monopoly power from its current level'. Apparently, this attitude is even held by some of the staunchest 'free market' economists including some of the sharpest critics of antitrust enforcement. George Stigler, for instance, recently said of the Sherman Act: 'So far as I can tell, it's a public interest law . . . in the same sense in which I think having private property, enforcement of contracts, and suppression of crime are public-interest phenomena. . . . I like the Sherman Act'.<sup>10</sup> Similarly, Richard Posner contends, '. . . the Sherman Act was passed in 1890 against a background of rampant cartelization and monopolization of the American economy'.<sup>11</sup>

These observations portend a paradox of sorts. Namely, despite the widely-held view that antitrust is anticompetitive, at least as it has historically been practised, there is still strong sentiment in favor of wider application of the antitrust laws. I contend that this paradox can be explained by the fact that the Sherman Antitrust Act, considered by some to be the 'Magna Carta of free enterprise', is an example of one of the last uncovered vestiges of the 'public interest' theory of regulation. One of the accomplishments of research in law and economics has been to demonstrate that government regulation is rarely designed to protect the 'public interest', an undefinable term at best, but rather benefits private interests: the ICC was used to the advantage of railroads, trucking firms, and Teamsters; the CAB cartelized the airline industry; occupational licensure protects incumbent practitioners, and so on. Surprisingly, the one form of regulation that is arguably the most pervasive—antitrust—has been relatively ignored by students of the economics of regulation.<sup>12</sup> The basic question addressed in this paper is: was the Sherman Antitrust Act really aimed at protecting the public interest, as most economists seem to believe, or was it an example of special interest legislation designed more to redistribute wealth than to enhance efficiency? Is a competitive market really a public good, and therefore underproduced in the absence of antitrust legislation? To anticipate the conclusions of the analysis, there is evidence that the Sherman Antitrust Act may never have been intended to promote competition. It was basically a legislative response to the protectionist pressures of the late nineteenth century, much akin to the current clamor for an 'industrial policy' designed to protect inefficient businesses. If one accepts these conclusions, then it comes as no surprise that as William Baxter, former Director of the US Justice Department's Antitrust Division, stated: 'The antitrust laws consistently produce results which are antithetical to the goal of economic efficiency'.<sup>13</sup>

Section II discusses the role of interest-group politics in the passage of the Sherman Act. Section III offers some empirical evidence on whether the nineteenth-century trusts were in fact monopolizing industry, as the interest groups claimed they were. Section IV attempts to shed further light on this question by examining the views of the economics profession in the late nineteenth century. Section V contains a summary and conclusions.

## II. INTEREST-GROUP POLITICS AND PASSAGE OF THE SHERMAN ACT

Major political agitation for 'antimonopoly' laws such as the Sherman Act was first led by farmers' organizations such as the Grangers and the Farmers' Alliance,<sup>14</sup> who were among the most powerful political interests of the day. Two political objectives of the farm groups were:

1. The promotion and protection of relatively small farms that were having trouble competing with 'giant wheat farms' (which they called 'land monopolies').
2. The regulation of railroad rates.

In seeking government regulation to hinder the development of large-scale farming, farm organizations were apparently seeking protection from pressures of competition, despite the rhetoric about 'land monopolies'. That farmers simultaneously complained about *falling* farm prices belied the notion that the farm industry was becoming monopolized. Sanford D. Gordon, who conducted an extensive survey of public attitudes toward the trusts prior to the Sherman Act, concluded that:

Perhaps the most violent reaction [against industrial combinations] of any single special interest group came from farmers. Besides their active participation in the early anti-monopoly movement, (before the combination movement really got started) the Agricultural Alliance and Wheels regularly denounced trusts. They singled out the jute bagging and alleged binder twine trust, and sent petitions to both their state legislators and to Congress demanding some relief. Cotton was suggested as a good substitute for jute to cover their cotton bales. In Georgia, Mississippi, and Tennessee the Alliances passed resolutions condemning the jute bagging trust and recommended the use of cotton cloth.<sup>15</sup>

Thus it appears that one of the things that annoyed southern farmers was that cotton cloth, which they produced, was being replaced by jute. They sought legislation that would dissolve their competition. Gordon found this behavior to be characteristic of the farm lobby. During the 51st Congress, the Congress that passed the Sherman Act,

. . . 64 petitions and memorials were recorded in the *Congressional Record*, all calling for action against combinations. These were almost exclusively from farm groups . . . Not a single voice spoke up either in favor of, or expressing any neutrality toward trusts . . . The greatest vehemence was expressed by representatives from the Mid-West.<sup>16</sup>

Farmers also hoped to secure wealth transfers through the regulation of railroad rates, having accused the railroads of monopolistic pricing. But the view that the railroad industry prior to 1887 (when the ICC was created) was becoming monopolized is inaccurate, for the *fall* in railroad rates during that time is striking. The decline in railroad rates nationwide was even greater than the fall in the general price level from 1865 to 1900, so that farmers received substantial benefits from the competitiveness of that industry.<sup>17</sup> In seeking governmental price regulation they were apparently trying to secure additional benefits beyond what a competitive railroad market would give them. For instance, the railroads gave rebates to their large-volume customers, as most competitive businesses must do. It is likely that

smaller-scale farmers who did not receive rebates sought regulation to prohibit their competitors from receiving them.

In lobbying for antitrust legislation the farmers' organizations claimed that trusts and combinations were monopolies so that the things they bought (from the trusts) were becoming increasingly expensive relative to the prices of farm products. Thus the trusts were allegedly 'exploiting' the farm population. But the facts do not support this interpretation. From 1865 to 1900 agricultural terms of trade *improved* from the farmers' perspective.<sup>18</sup> While there was a declining general price level during much of this period, farm prices fell *less* than all other prices, producing real gains for farmers. Farm prices were, however, quite volatile which may explain why farmers became so politically active. A strong case can be made that such volatility explains why farm lobbyists have been among the most active (and effective) throughout history. Also, the quality of many manufactured goods was improving because of technological changes in the manufacturing sector so that the agricultural terms of trade were even better for farmers. Thus, it is difficult to fathom that the farm lobby was attempting to avoid rather than create monopoly rents by lobbying for 'anti-monopoly' or antitrust legislation.

Many other groups soon became part of the antitrust coalition—small business organizations, academics (although not economists), and especially 'progressive' journalists'.<sup>19</sup> The *Congressional Record* of the 51st Congress is replete with examples of congressmen voicing complaints of small businesses (especially agricultural businesses) in their districts who were allegedly being subjected to 'unfair' competition by the trusts. These groups all claimed that the 'giant monopolies' were creating a 'dangerous concentration of wealth' among the capitalists of the day. Even though the conspicuous wealth of entrepreneurs such as Rockefeller, Mellon and Morgan added fuel to this charge, it does not appear that this was generally true. As Gray and Peterson concluded:

In the period from 1840 to 1900, the division of national income between labor and property owners (capital and natural resource suppliers) remained in a 70–30 ratio. Over the same time span, both capital and developed natural resources increased faster than the labor force. This means that labor incomes per unit of labor rose compared with profits and interest per unit of property input.<sup>20</sup>

Although there was no *general* redistribution of wealth from labor to capital owners, dynamic, competitive markets always alter the distribution of income in ways that some do not like. There was no 'dangerous concentration of wealth' taking place, but many supporters of antitrust probably found their own incomes lower than they liked and sought to use the powers of the state to alter that situation.

Despite the facts regarding income distribution, it is relevant that perceptions are often more important than reality in politics. The news media and popular press of the 1880s successfully nurtured the notion that the wealth of a small handful of successful entrepreneurs (the 'robber barons') was coming at the expense of farmers, laborers and consumers, and was therefore the 'legitimate' domain of governmentally-imposed redistribution. In short, they denied that business activity and free-market exchange involving the 'trusts' was mutually advantageous, but was rather a zero-sum game, at best. As one historian concluded:

Trusts, it was said, threatened liberty, because they corrupted civil servants and bribed legislators; they enjoyed privileges such as protection by tariffs;

they drove out competitors by lowering prices, victimized consumers by raising prices, defrauded investors by watering stocks, and somehow or other abused everyone. The kind of remedy that the public desired was also clear enough: it wanted a law to destroy the power of the trusts.<sup>21</sup>

This statement of the standard account of the 'trust problem' is quite revealing. If trusts bribed legislators and were protected by tariffs, then the source of the problem is government itself and the solution is *less* government regulation and the enforcement of laws against bribery and fraud, not bans on industrial combinations. Further, *lowering* prices and closing unprofitable plants is perfectly consistent with competitive behavior and any laws prohibiting these actions must hinder, not help competition. Moreover, the statement that trusts simultaneously lowered prices and raised prices, victimizing both competitors and consumers, is nonsensical. In sum, one may object to lower prices and plant closings on arbitrary distributional grounds: They may temporarily hurt less efficient businesses and necessitate the movement of capital and labor—changes individuals may not wish to undertake. But to criticize these phenomena on the grounds that they are 'monopolistic' is misleading. Hayek noticed that the benefits of competitive markets

. . . are the results of such changes, and will be maintained only if the changes are allowed to continue. But every change of this kind will hurt some organized interests; and the preservation of the market order will therefore depend on those interests not being able to prevent what they dislike. All the time it is thus the interest of most that some be placed under the necessity of doing something they dislike (such as changing their jobs or accepting a lower income), and this general interest will be satisfied only if the principle is recognized that each has to submit to changes when circumstances . . . determine that he is the one who is placed under such a necessity.<sup>22</sup>

Hayek pointed out another inherent difficulty in maintaining competitive markets in democratic societies: 'In a society in which . . . the majority has power to prohibit whatever it dislikes, it is most unlikely that it will allow competition to arise'.<sup>23</sup>

There is no doubt that economic conditions were changing very rapidly in the latter part of the nineteenth century. Rapid expansion of the railroad and inland shipping industries greatly reduced the cost, both pecuniary and non-pecuniary, of transportation. Technological developments in the latter part of the century led to large-scale (and lower cost) production of steel, cement, and many other goods; communications technology rapidly expanded, especially with the use of the telegraph; and the capital markets became much more sophisticated. In addition, the nation underwent a rapid transition from a predominantly agrarian to an industrial society. In 1810 the ratio of farm to non-farm labor was approximately 4.0. This ratio fell to 1.6 by 1840 and by 1880 the labor force was about equally divided.<sup>24</sup> It is also apparent that individuals and groups uncomfortable in an atmosphere of rapid change were becoming increasingly adept at using the regulatory powers of the state to their own advantage, to slow or eliminate such change. It is in this atmosphere that the Sherman Antitrust Act was passed in 1890.<sup>25</sup>

### III. THE EVIDENCE

The Sherman Act was passed after 13 states had already instituted their own antitrust laws. The essential claim made by Senator John Sherman and his colleagues was that

Table I. Growth of output in 'monopolized' industries: 1880-1900\*

Industry	1880	81	82	83	84	85	86	87	88
Salt (nominal Q) (\$ millions)	5.0	4.0	4.0	4.0	4.0	5.0	5.0	4.0	4.0
Petroleum (bill. gal.)	0.84	1.1	1.2	1.3	1.0	1.0	0.9	1.2	1.2
Zinc (thous. ton)	25	31	34	37	39	41	43	50	56
Steel (mill. ton)	1.2	1.6	1.7	1.7	1.5	1.7	2.6	3.3	2.9
Bituminous coal (mill. ton)	34	38	48	61	69	74	65	67	79
Steel rails (mill. ton)	0.6	0.9	1.2	1.3	1.2	1.0	1.0	1.6	2.1
Sugar (mill. lb.)	285	171	319	303	276	303	191	376	345
Lead (thous. ton)	96	115	130	140	136	126	132	157	156
Liquor (mill. gal.)	64	71	74	78	81	71	72	71	75
Twine (nominal Q) (\$ millions)	12.5								
Iron nuts and washers (mill. lb.)	10.0								
Jute (\$ millions)	0.7								
Castor oil (\$ millions)	0.7								
Cotton seed oil (\$ millions)	7.7								
Leather (\$ millions)	2.7								
Linseed oil (\$ millions)	15.4								
Matches (\$ millions)	4.7								

\* Source: Compiled from US Bureau of the Census, *Statistical Abstract of the U.S.*, various years (Washington, DC: Government Printing Office); and US Bureau of the Census, *Historical Statistics of the U.S.* In some industries data are only available for 1880, 1890, and 1900.

combinations or trusts tended to restrict output which drove up prices. As Robert Bork concluded in an exhaustive review of the *Congressional Record* of the 51st Congress:

Sherman demonstrated more than once that he understood that higher prices were brought about by a restriction of output . . . Sherman and his colleagues identified the phrase 'restraint of commerce' or 'restraint of trade' with 'restriction of output'.<sup>26</sup>

If this is true, then one would expect to have observed restrictions of output in those industries that were allegedly being monopolized by the trusts and combinations. By contrast, if the trust movement was part of the evolutionary process of competitive

89	90	91	92	93	94	95	96	97	98	99	1900
4.0	5.0	5.0	6.0	4.0	5.0	4.0	4.0	5.0	6.0	7.0	7.0
1.2	1.9	1.5	2.3	2.1	2.0	2.1	2.2	2.6	2.6	2.3	2.4
59	64	81	87	79	75	90	81	99	115	129	123
3.4	4.3	3.9	4.9	4.0	4.1	6.1	5.3	7.2	8.9	10.6	10.2
91	85	99	105	113	115	106	121	123	132	149	173
1.4	1.5	1.9	1.3	1.5	1.1	1.0	1.3	1.1	1.6	2.0	2.3
306	497	371	463	611	729	544	644	708	558	334	622
178	158	198	208	224	214	236	257	282	302	298	367
81	88	91	98	101	91	78	71	73	81	87	97
	33.3										37.9
	12.4										13.9
	1.1										5.4
	0.6										0.4
	19.3										58.7
	6.3										11.8
	23.5										27.4
	2.2										6.0

markets responding to technological change, one would expect an expansion of trade or output. The data offer no support for the contention that in the 1880s trusts were restricting output and thereby increasing prices. From the *Congressional Record* of the 51st Congress a list of industries that were accused of being monopolized by the trusts was compiled. Those industries for which data were available are listed in Table 1 which shows output growth from 1880 to 1900. The available data are incomplete, but one striking feature of Table 1 is that of the 17 industries listed, there were *increases* in output not only from 1880 to 1890, but also to the turn of the century in all but two industries, matches and castor oil. These are hardly items that would cause a national furor, even if they were monopolized.

In addition, output in these industries generally expanded more rapidly than output in all other industries during the ten years preceding the Sherman Act. Data

are available for some industries only in terms of nominal output, while measures of real output are available in others. In the nine industries for which nominal output data were available, output increased on average by 62 per cent compared to an increase in nominal GNP of 16 per cent during that time period—almost four times greater. Several of the industries expanded output by more than *ten times* the overall increase in nominal GNP. Some of the more rapidly expanding industries were cotton seed oil (151 per cent), leather goods (133 per cent), cordage and twine (166 per cent), and jute (57 per cent).

Real GNP increased by approximately 24 per cent from 1880 to 1890, while those allegedly monopolized industries for which some measure of real output is available grew on average by 175 per cent—seven times the rate of growth of the economy as a whole. Again, some of the industries grew more than ten times faster than real GNP. These included steel (258 per cent), zinc (156 per cent), coal (153 per cent), steel rails (142 per cent), petroleum (79 per cent) and sugar (75 per cent).

These trends continued to the turn of the century. Output expanded in each industry except castor oil, and, on average, output in these industries grew at a faster rate than the rest of the economy. Those industries for which nominal output data were available expanded by 99 per cent compared to a 43 per cent increase in nominal GNP, while the other industries increased real output by 76 per cent compared to a 46 per cent rise in real GNP from 1890 to 1900.

In sum, the data call into question the notion that those industries singled out by Senator Sherman and his colleagues were creating a 'rising tide of monopoly power', if one judges by Senator Sherman's own measuring rod of monopoly power, output restriction. These industries were expanding much faster than the economy as a whole, a phenomenon that has been overlooked by those who adhere to the standard account of the origins of antitrust. To my knowledge this fact has not been revealed previously: It is usually *assumed*, without evidence, that the trusts were restricting output.

It is possible that even though the trusts were actually expanding output, they were doing so less rapidly than if such combinations did not exist, thereby increasing prices and profits. The data, however, do not support this interpretation. Prices in these industries were generally *falling*, not rising, even when compared to the declining general price level. Price data on these items are very scattered and some are simply unavailable. But the data that are available indicate that falling prices accompanied the rapid output growth in these industries. For example, the average price of steel rails fell from \$68 to \$32 between 1880 and 1890, or by 53 per cent. The price of refined sugar fell by 22 per cent, from 9 cents per pound in 1880 to 7 cents in 1890. It fell further to 4.5 cents by 1900. The price of lead dropped by 12 per cent, from \$5.04 per pound in 1880 to \$4.41 in 1890. The price of zinc declined by 20 per cent, from \$5.51 to \$4.40 per pound from 1880 to 1890, and the price of bituminous coal remained steady at about \$3.10 per pound, although it fell by 29 per cent, to \$2.20 from 1890 to 1900. Although the consumer price index fell by 7 per cent from 1880 to 1890 this was proportionately less than all of these items except coal.<sup>27</sup>

Perhaps the most widely-attacked trusts were those that existed in the sugar and petroleum industries. But there is evidence that the *effect* of these combinations or mergers was to *reduce* the prices of sugar and petroleum. Moreover, Congress clearly recognized this. Congressman William Mason stated during the House debates over the Sherman Act:

. . . trusts have made products cheaper, have reduced prices; but if the price of oil, for instance, were reduced to one cent a barrel, it would not right the



wrong done to the people of this country by the 'trusts' which have destroyed legitimate competition and driven honest men from legitimate business enterprises.<sup>28</sup>

Senator Edwards, who played a key role in the debate, added:

Although for the time being the sugar trust has perhaps reduced the price of sugar, and the oil trust certainly has reduced the price of oil immensely, that does not alter the wrong of the principle of any trust.<sup>29</sup>

Thus the Congress acknowledged that combinations were actually responsible for improving the lot of the consumer by dropping prices 'immensely'. They objected, however, to the fact that less efficient (smaller) businessmen ('honest men') were driven out of business. The fact that these and other businessmen voted and contributed in other ways to political campaigns surely helps to explain this stance taken by the Republican-controlled Congress. At the time nearly every Congressional district had large numbers of small businesses (and farmers) so that one would have expected them to carry considerable political clout compared to the trusts which were far fewer in number and whose ownership was more dispersed.<sup>30</sup> Senator Edwards' statement reveals that he knew the sugar and oil trusts were in the true interests of consumers, but was probably afraid of the political backlash that would follow any announcement of support for these organizations or for the likes of John D. Rockefeller. It was generally recognized that, despite the facts, the strong emotional opposition to the trusts fostered by journalists, politicians, and others meant that speaking in favor of them could mean political suicide.<sup>31</sup>

In summary, the Sherman Act may possibly be viewed as special-interest legislation, the purpose of which was at least two-fold. First, to isolate certain groups, especially small businesses, from the rigors of competition. *If the trusts were restricting output (or slowing its expansion) and raising prices, small businesses would not have objected, for they would have benefited from the (higher) price umbrella.* This point is of considerable importance. It is widely acknowledged that small businesses have always initiated antitrust cases against their larger (and often more efficient) competitors. As Armentano,<sup>32</sup> Demsetz,<sup>33</sup> and others have shown these actions typically protect small businesses from competition and inevitably lead to higher prices. If the larger businesses in these cases were colluding and *raising* industry prices, it stands to reason that smaller businesses would also benefit and would not have brought antitrust suits against them. The point is, just as small businesses have often benefited from the *enforcement* of the antitrust laws over the years (at the expense of larger businesses and consumers) they are likely to have been a major force behind the *creation* of the laws in the first place. By this interpretation their interest was not to prohibit monopoly from occurring but to protect themselves from competition. In short, they wanted an 'antimonopoly' law to reduce competitive pressures in their industries.

A second purpose of the Sherman Act was to satisfy voters who had become increasingly envious of the economic success earned by nineteenth-century entrepreneurs and who were upset over rapidly-changing relative prices and wages. As mentioned in the above quotation of Hayek, changing relative prices are often characteristic of a dynamic, competitive market economy. But groups whose relative wages and incomes fall (at least temporarily) often protest to the government by lobbying for protectionist measures of various sorts, including antitrust laws. It is not

unusual for economic instability (i.e., deflation) caused largely by the government's monetary policies to be blamed on a small handful of private corporations.

One objection to this interpretation may be that even though the trusts were dropping prices, couldn't they have been engaging in predatory pricing? This is possible, but not probable. Studies of predatory pricing over the past several decades have found that it is not likely to be a profitable practice and that there is no evidence that Standard Oil, which was sued for predatory pricing in the famous 1911 decision, was actually engaged in any such practice.<sup>34</sup> This has led George Stigler to conclude, 'Today it would be embarrassing to encounter this argument [that predatory pricing is a monopolizing device] in professional discourse'.<sup>35</sup> Moreover, with respect to the trusts of the late nineteenth century, it is inconceivable that they would have allowed prices to fall for more than an entire decade, as they did, to 'temporarily' undercut the competition. That would have been irrational.

These statements are not meant to imply that there was no monopoly power in American industry during the late nineteenth century. It appears that one function of the Sherman Act was to divert public attention away from a more certain *source* of monopoly power, the state. It is well known that the Interstate Commerce Commission, established three years before the Sherman Act in 1887, served as the mechanism for the legal cartelization of the railroad industry. Here, and in many other instances, it was government regulation itself that was the source of monopoly power. Tariffs imposed by Congress were probably the major source of restraints of trade in the late nineteenth century, but the Sherman Act made no provision for them or for any other form of government-sanctioned monopoly. Nor should one expect vote-maximizing politicians to have done so, for they are major beneficiaries of such legislative privileges. In bestowing them, they win votes and campaign contributions from the beneficiaries. The political costs, on the other hand, are rather hidden, for the average voter has little or no financial incentive to discover the true costs of protectionism. Moreover, even though the aggregate costs of protectionism may be large, they are relatively small to each individual voter.

In a particularly revealing statement Senator Sherman attacked the trusts during the Senate debates over his bill on the grounds that they

. . . subverted the tariff system; they undermined the policy of government to protect . . . American industries by levying duties on imported goods.<sup>36</sup>

This is certainly an odd statement by the man who has been called the champion of free enterprise. However, the evidence cited above is consistent with the Senator's political fears. Increased output and reduced prices in these industries apparently dissipated the monopoly rents previously procured by protective tariffs. This worked against the objectives of some in the protected industries and of their legislative allies such as Senator Sherman. Further, just three months after the Sherman Act was passed Senator Sherman, as Chairman of the Senate Finance Committee, sponsored a bill popularly known as the 'Campaign Contributors' Tariff Bill'. As reported in the *New York Times* on 1 October 1890:

The Campaign Contributors' Tariff Bill now goes to the president for his signature, which will speedily be affixed to it, and the favored manufacturers, many of whom . . . proposed and made the [tariff] rates which affect their products, will begin to enjoy the profits of this legislation.<sup>37</sup>

The *New York Times* further reported that ‘the speech of Mr Sherman on Monday [29 September 1890] should not be overlooked, for it was one of confession’. Apparently, Senator Sherman withdrew his speech from the *Congressional Record* for ‘revision’, but a *New York Times* reporter obtained an unabridged copy of the original. As reported in the *New York Times*:

. . . we direct attention to those passages [of Sherman’s speech] relating to combinations of protected manufacturers designed to take full advantage of high tariff duties by exacting from consumers prices fixed by agreement after competition has been suppressed. . . . Mr Sherman closed his speech with some words of warning and advice to the beneficiaries of the new tariff. He was earnest enough in his manner to indicate that he is not at all confident as to the outcome of the law. The great thing that stood in the way of the success of the bill, he said, was whether or not the manufacturers of this country would permit free competition in the American market. The danger was that the beneficiaries of the bill would combine and cheat the people out of the benefits of the law. They were now given reasonable and ample protection, and if they would resist the temptation attaching to great aggregations of capital to combine and advance prices, they might hope for a season of great prosperity. . . . He did hope, the Senator concluded, that the manufacturers would open the doors to fair competition and give its benefits to the people. . . . He hoped the manufacturers would agree to compete one with another and would refuse to take the high prices that are so easily obtained.<sup>38</sup>

For Senator Sherman to say that a protective tariff would not harm consumers or would actually help them if only manufacturers could be trusted to refrain from raising prices is contradictory, to put it mildly. It led to a complete reversal of the views of the *New York Times* which had for years been one of the foremost proponents of antitrust legislation. After observing the behavior of Senator Sherman and his colleagues during the months following the passage of the Sherman Act the *New York Times* concluded:

That so-called Anti-Trust law was passed to deceive the people and to clear the way for the enactment of this . . . law relating to the tariff. It was projected in order that the party organs might say to the opponents of tariff extortion and protected combinations, ‘Behold! We have attacked the Trusts. The Republican party is the enemy of all such rings.’ And now the author of it can only ‘hope’ that the rings will dissolve of their own accord.<sup>39</sup>

These suspicions are certainly justified. Monopoly has long been associated with governmental entry restrictions such as tariffs, quotas, licenses, monopoly franchises, and grandfather clauses, but this type of activity has been immune from antitrust law. It is not unlikely that the Sherman Act was passed to help draw public attention away from the actual process of monopolization in the economy, among the major beneficiaries of which have always been the legislators themselves.<sup>40</sup> The Sherman Act won votes and campaign contributions from small businesses, while the tariff bill was supported by *all* manufacturers, large and small. Tollison and McCormick<sup>41</sup> argue that the essential role of legislators is precisely this: to act as ‘brokers’ of legislation. By interfering with the competitive process the Congress became perhaps the chief interest group benefiting from the Sherman Act. Similar views were also voiced by many economists during that time, although they were almost completely ignored by the legislature.

## IV. ECONOMISTS AND THE EMERGENCE OF ANTITRUST

One historian has written: ‘. . . the Congressional debates indicated that no influence whatever was exercised by [economists] upon the development of the national legislative policy’ regarding antitrust.<sup>42</sup> That is, no economists were even called in to testify about the proposed Sherman Act. However, there was some writing on the subject in the newly-established *American Economic Review*, other social science journals, and in the popular press. Sanford D. Gordon<sup>43</sup> surveyed all professional journals in the social sciences, and all articles and books written in other outlets by economists regarding their opinions of the trusts prior to the Sherman Act. He concluded that:

. . . a big majority of the economists conceded that the combination movement was to be expected, that high fixed costs made large scale enterprises economical, that competition under these new circumstances frequently resulted in cutthroat competition, that agreements among producers was a natural consequence, and the stability of prices usually brought more benefit than harm to the society. They seemed to reject the idea that competition was declining, or showed no fear of decline.<sup>44</sup>

One of the best younger economists, John Bates Clark, had this to say of the trusts:

Combinations have their roots in the nature of social industry and are normal in their origin, their development, and their practical working. They are neither to be deprecated by scientists nor suppressed by legislators. They are the result of an evolution, and are the happy outcome of the competition so abnormal that the continuance of it would have meant widespread ruin. A successful attempt to suppress them by law would involve the reversion of industrial systems to a cast-off type, the renewal of abuses from which society has escaped by a step in development.<sup>45</sup>

Other economists shared this dynamic view of the competitive process. George Gunton, for example, wrote:

Strictly speaking, concentration of capital does not drive small capitalists out of business, but simply integrates them into a larger and more complex system of production, in which they are enabled to produce wealth more cheaply for the community and obtain a larger income for themselves . . . The competition between trusts naturally tends to reduce the profits to a closer margin than would the competition between corporations for the reason that the larger the business transacted, the smaller the percentage of profit necessary to its success. Thus, instead of concentration of capital tending to destroy competition, the reverse is true. . . . By the use of large capital, improved machinery and better facilities, the trust can and does undersell the corporation.<sup>46</sup>

Simon N. Patten of the Wharton School also defended the trusts:

The concentration of capital does not cause any economic disadvantages to the community. Those producers who seek protection through combinations are much more efficient than were the small producers whom they displaced.<sup>47</sup>

And David A. Wells voiced similar sentiments:

Society . . . has got to abandon . . . the prohibition of industrial concentrations and combinations. The world demands abundance of commodities, and demands them cheaply; and experience shows that it can have them only by employment of great capital upon the extensive scale.<sup>48</sup>

There was some opposition to these views but Gordon, in his survey, found them to be a very small minority. So universal was the favorable attitude toward the trusts by economists that antitrust laws were opposed by even the harshest critics of *laissez faire*. Perhaps the most prominent critic of the private enterprise system was Richard T. Ely, who in 1885 organized the American Economic Association. Ely did not share the evolutionary view of the market held by most others in the profession at that time and favored much greater government intervention into economic affairs. In the 'first principle' upon which he thought an American Economic Association should be based he stated:

We regard the state as an educational and ethical agency whose positive aid is an indispensable condition of human progress. While we recognize the necessity of individual initiative in industrial life, we hold that the doctrine of laissez-faire is unsafe in politics and unsound in morals; and that it suggests an inadequate explanation of the relations between the state and the citizens.<sup>49</sup>

Having developed this perspective Ely was highly critical of the trusts but not because he thought they were monopolies. Rather, he believed they 'exploited' the working class and recommended two policy approaches to the 'trust problem'. One was the nationalization of certain industries. Government ownership, thought Ely, would allow them to be run on a more 'morally sound' basis. The second approach involved governmental regulation in the form of the abolition of child labor, restrictions on working hours for women, government inspection of factories, and limits on the number of hours worked per day. Ely hoped these measures would ' . . . do more to moralize industry and purify politics than all the restrictive legislation against capital [i.e., an antitrust law] ever enacted'.<sup>50</sup> Thus, even though Ely was perhaps the harshest critic of the trusts in particular and of *laissez-faire* in general (at least among US economists) he still did not advocate antitrust legislation. Instead, he favored the nationalization of industry and the regulation of labor relations.

In summary, Gordon found that a 'big majority' of economists at the time held a dynamic view of the competitive process, much like Adam Smith's conception of competition. As McNulty<sup>51</sup> stated, 'the Smithian concept of competition is essentially one of business behavior that might reasonably be associated with the verb 'to compete''. This is very different from the more contemporary perfect competition model (and its variants) which, as McNulty says, is

not a definition of a *behavioral process* of competing but, rather, a definition of competition as a *state* in which that process had run its limits. . . . The two concepts . . . are fundamentally incompatible. Competition came to mean [with the perfect competition model] a hypothetically realized situation in which business rivalry, for competition in the Smithian sense, was ruled out by definition.<sup>52</sup>

From this perspective the nineteenth-century economists thought of combinations as competitive devices aimed at capitalizing on the newly-advanced technologies of large-scale production. Merger waves were also viewed as competitive, for those firms failing to act to achieve efficiencies of large-scale production would be put at a competitive disadvantage. Furthermore, they also recognized that legislative restrictions on combinations would mean a step backwards in economic development, as John Bates Clark insisted. The empirical evidence cited above supports these views, and Gordon found that of the two empirical studies of trusts done by economists prior to the Sherman Act (the salt and whiskey trusts) both found them to cause output expansion and lower costs and prices.<sup>53</sup> It is not surprising that economists exerted 'no influence whatever' on the Congressional debates over the Sherman Act, for they would not have advised Congress to do what it was obviously intent upon doing—passing an antitrust bill by near unanimous consent.<sup>54</sup> This has changed dramatically over the years for as George Stigler has pointed out, economists are now deeply involved (and well paid, says Professor Stigler) in antitrust litigation and enforcement. The way in which economists view competition is likely to be one reason for this change. One can imagine that if John Bates Clark and his colleagues had thought of competition in terms of the static equilibrium conditions of perfect competition rather than the dynamic, rivalrous process of 'Smithian' competition, they would have roundly condemned the trusts. The trusts were, after all, causing a greater divergence from the ideal of perfect or atomistic competition. Had the nineteenth-century economists taken this former view they would probably have been called in to testify during the debates over the Sherman Act and would have provided intellectual support for antitrust legislation. It is doubtful, however, that their contributions would then have been socially productive. It is hard to argue that by focusing on 'perfect' competition as a normative ideal rather than on the actual process of competition modern economists have not done more harm than good in their approach to the study of antitrust.<sup>55</sup> Some economists are realizing this and are revising the way in which they think about competition and the implications of this revision for antitrust economics. For example, M. Bruce Johnson concluded his 1983 presidential address to the Western Economic Association by saying:

. . . the [perfectly] competitive model of economic theory not only offers little guidance [to the analysis of antitrust], but actually points us in the wrong direction. The confusion arises because not many economists fail to realize that the 'competitive model' is silent on the subject of competition.<sup>56</sup>

Thus, in addition to the evidence garnered in Section III, I believe that economists' changing views of the nature of competition also help explain the paradox mentioned at the beginning of this paper. By focusing on the static competitive model modern economists are inclined to think of nineteenth-century trusts as monopolizing devices since they reduced the degree of atomistic competition. On this basis alone, and ignoring price and output data, this was indeed a time of 'rampant cartelization and monopolization', as Richard Posner describes it. But if one accepts the alternative view that competition is a dynamic, rivalrous process, then the mere number of firms in an industry does not necessarily have anything at all to do with competitiveness. Accordingly, the trusts of the late nineteenth century may be viewed just as the economics profession then viewed them: as part of the normal evolutionary process of competitive markets.

## V. SUMMARY AND CONCLUSIONS

It is held as an article of faith by most economists that the Sherman Antitrust Act is a guarantor of competitive markets. Even though it is now widely held that the enforcement of the Sherman Act over the past 95 years has probably reduced industrial competitiveness, there is faith that the original intent of the Sherman Act was to promote competition in an increasingly monopolized economy. The evidence, however, indicates otherwise. The trusts of the late nineteenth century caused output to expand even faster than the rest of the economy—in some cases more than ten times faster for decades at a time. As a result, prices in the allegedly monopolized industries were *falling*. This was even acknowledged by the critics of the trusts in the Congress, who complained that falling prices drove less efficient ‘honest men’ out of business. There was relatively little enforcement of the Sherman Act for at least ten years after it was passed, but it did serve to immediately divert attention from a more certain source of monopoly, tariffs, which were sharply increased just three months after passage of the Sherman Act by a bill sponsored by Senator Sherman himself.

Interestingly, the great majority of economists of the day viewed competition as a dynamic process and thought that mergers (formal or informal) facilitated social coordination. There was no substantial support among economists for the Sherman Act, even from the most severe critics of *laissez-faire* such as Richard T. Ely. A law to prohibit mergers and combinations was thought to inhibit social coordination and to retard economic development. There is growing evidence that John Bates Clark and his nineteenth-century colleagues were right. Although they did not share the economic sophistication of their modern counterparts they understood what, ironically, industrial organization economists now call ‘the new learning’: that industrial concentration is most often the source of efficiency, not monopolization. Accordingly, it is not surprising that after 95 years of experience with the Sherman Act so many economists have concluded that the Act’s enforcement has hindered rather than helped competition.

Even though modern economics embodies an ‘efficiency’ rationale for the Sherman Act, that rationale was never used to make a case for the original enactment of the law. Rather, it was constructed, *ex post*, as a rationalization for a law that already existed. Moreover, it appears that the efficiency rationale for antitrust has often been used by legislators as a justification for protectionist policies. Legislators have always had incentives to enact protectionist legislation, and the economics of antitrust has sometimes provided intellectual support for these objectives.<sup>57</sup>

## REFERENCES AND NOTES

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2. Y. Brozen, *supra*, note 1, p. 14.
3. D. Armentano, *supra*, note 1.
4. H. Goldschmidt *et al.*, *supra*, note 1, p. 235.
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9. B. Frey, W. Pommerehne, F. Schneider and G. Gilbert, 'Consensus and Dissention Among Economists,' (1984) 74 *American Economic Review* 986–994. These authors find similar opinions among French, German, Swiss and Austrian economists (from Austria). Their results are nearly identical to a 1979 survey by J. Kearl, C. Pope, G. Whiting and L. Wimmer, 'A Confusion of Economists?' (1979) 69 *American Economic Review* 30.
10. T. Hazlett, 'Interview With George Stigler,' (January 1984) *Reason* 46. Also see George Stigler, 'The Origin of the Sherman Act' (forthcoming) *Journal of Legal Studies*.
11. R. Posner, *supra*, note 1, p. 23.
12. There has been some preliminary work. See W. Shughart and R. D. Tollison, 'The Positive Economics of Antitrust Policy: A Survey Article,' (1985) 5 *Int. Rev. Law and Econ.* 39.
13. W. Baxter, 'The Political Economy of Antitrust,' in R. D. Tollison (ed.), *The Political Economy of Antitrust*, Lexington Books (1980), p. 4.
14. See W. Letwin, *Law and Economic Policy in America: The Evolution of the Sherman Antitrust Law*, University of Chicago Press (1965), p. 67.
15. S. D. Gordon, 'Attitudes Toward Trusts Prior to the Sherman Act,' (1963) 20 *Southern Economic Journal* 158.
16. *Ibid.*, p. 162.
17. D. North, *Growth and Welfare in the American Past: A New Economic History*, Prentice Hall (1966), p. 139.
18. *Ibid.*
19. S. D. Gordon, *supra*, note 15.
20. R. Gray and J. Peterson, *Economic Development in the United States*, Irwin (1965), p. 57.
21. As cited in W. Letwin, *supra*, note 14.
22. F. Hayek, *Law, Legislation, and Liberty*, vol. 3, *The Political Order of a Free People*, University of Chicago Press (1979), p. 94.
23. *Ibid.*, p. 77.
24. T. Anderson and P. Hill, *The Birth of a Transfer Society*, Hoover Institution Press (1980), p. 50.
25. T. Anderson and P. Hill, *ibid.*, demonstrate that during the 19th century there was a steady erosion of constitutional safeguards of economic liberties such as those embodied in the commerce, contract and due process clauses of the US Constitution. Prior to this constitutional erosion, say Anderson and Hill, it was much less likely that an attempt to redistribute income through governmental regulation of business behavior would be held as constitutional by the courts. The 'rent-seeking society' was relatively held in check by the constitution. A watershed case was *Munn v Illinois*, where the courts held that it was legitimate for a group of farmers to lobby the Illinois legislature to pass a law dropping (and then controlling) the price of grain storage (charged by a man named Munn). This was a blatant political attempt by the farmers to redistribute income to themselves at Mr Munn's expense because, they argued, that was 'in the public interest'. In short, Munn was not a monopolist: the farmers simply wanted the government to force him to charge lower prices. This case established the precedent that those dissatisfied with the functional distribution of income could seek governmental regulation as a means of altering that distribution in their favor. In sum, the Sherman Act, passed 13 years after the Munn decision, was put into place during a time of growing regulatory redistribution veiled in the rhetoric of 'protecting the public interest'.
26. R. Bork, 'Legislative Intent and the Policy of the Sherman Act,' (1966) 9 *J. Law and Econ.* 16.
27. Data were obtained from US Bureau of the Census, *Statistical Abstract of the U.S.*, US Government Printing Office (various years).
28. *Congressional Record*, 51st Congress, 1st Session, House, 20 June (1890) 4100.
29. *Ibid.*, p. 2558.
30. To my knowledge data on political contributions during this time are unavailable with the



- exception of scattered anecdotes.
31. This would be similar to saying the US oil companies were not responsible for the Arab oil embargo and the shortages of the mid-1970s. A few did speak the truth and say this, but their views were muffled for years. S. D. Gordon, *supra*, note 15, p. 160, describes how any statement favorable to the trusts was used to great advantage by a politician's opponents. James Blaine, the unsuccessful Republican candidate for President in 1884, declared that trusts were 'private matters and not the public's concern'. The *Detroit Free Press* evaluated Blaine's statement by saying, 'If Mr Blaine had tried his best to do or say something good for the Democratic candidates, he could not have done better. His speech will do him infinite damage'.
  32. D. Armentano, *supra*, note 1.
  33. H. Demsetz, 'Two Systems of Belief About Monopoly,' in H. Goldschmidt *et al.*, *supra*, note 1.
  34. J. McGee, 'Predatory Price Cutting: The Standard Oil (N.J.) Case,' (1958) 1 J. Law and Econ. 137.
  35. G. Stigler, 'Economists and the Problem of Monopoly,' (1982) 72 Am. Econ. Rev. 9. *Review* 9.
  36. *Congressional Record*, 51st Congress, 1st Session, House, 20 June (1890) 4100.
  37. *New York Times*, 1 October 1890, p. 2.
  38. *Ibid.*
  39. *Ibid.*
  40. For historical discussions of government-sanctioned monopoly see Y. Brozen, *Is Government the Source of Monopoly?* Cato Institute (1980); William Letwin, *supra*, note 14; and Harold Demsetz, *supra*, note 33.
  41. R. D. Tollison and R. McCormick, *Politicians, Legislation, and the Economy: An Inquiry Into the Interest-Group Theory of Government*, Martinus Nijhoff (1981).
  42. J. D. Clark, *The Federal Antitrust Policy*, Johns Hopkins University Press (1931).
  43. S. D. Gordon, *supra*, note 15.
  44. *Ibid.*, p. 166.
  45. *Ibid.*, p. 164.
  46. *Ibid.*, p. 165.
  47. *Ibid.*, p. 166.
  48. As cited in W. Letwin, *supra*, note 14, p. 72.
  49. R. T. Ely, 'The Future of Corporations,' July (1887) Harpers 265.
  50. *Ibid.*
  51. P. McNulty, 'A Note on the History of Perfect Competition,' (1967) 10 J. Pol. Econ. 396. *Political Economy* 396.
  52. *Ibid.*
  53. S. D. Gordon, *supra*, note 15.
  54. The Sherman Act passed 242 to 0 in the house and 52 to 1 in the Senate. The lone dissenter, Senator Blodgett of New Jersey, is reported to have 'taken no part in the debate and did not explain his vote.'
  55. In a devastating but, until recently, largely ignored critique of the perfect competition model (and by implication the structure-conduct-performance model of industrial organization) Hayek explains how 'in perfect competition there is no competition'. Many of the competitive practices or ordinary life—price undercutting, product differentiation, advertising, mergers—have no place in static conceptions of 'perfectly' competitive markets. The idea of perfect competition *assumes* that state of affairs already to exist which, according to the dynamic Smithian theory, the *process* of competition tends to bring about. See F. A. Hayek, 'The Meaning of Competition,' in F. A. Hayek (ed.), *Individualism and Economic Order*, University of Chicago Press (1948).
  56. M. B. Johnson, 'Can Economic Analysis Give Better Guidance to Antitrust Policy?' (1983) *Economic Inquiry* 10.
  57. R. Tollison, R. Faith, and D. Leavens provide evidence that antitrust enforcement is often used by federal politicians to protect businesses in their districts from competition. See

R. Tollison *et al.*, 'The Antitrust Pork Barrel,' (1982) 25 J. Law and Econ. 329. Politicians have used antitrust economics as a source of intellectual support for laws they then use to create monopoly power. Economists surely never intended this, but they unknowingly contribute toward it when failing to acknowledge in their analysis the fact that economic policy-making does not take place in an apolitical vacuum.