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The Merits of Antimerger Policy— A Reply to Professor Galbraith

Donald F. Turner

Professor John Kenneth Galbraith has recently charged that American antimerger policy is out of date. He has argued that large size and high concentration lead to increases in planning efficiency; thus, since efficient planning is desirable, he asserts that large size and high concentration should be encouraged. Mr. Turner, in his reply to Professor Galbraith, feels that while their opinions about antitrust policy may be irreconcilable, their differences concerning American industry rest on questions of fact and may be debated as such. Mr. Turner therefore attacks each of Galbraith's two major premises in turn, and concludes that neither is supported by the factual data presently available. Mr. Turner argues that large size and high concentration lead instead to slack and inefficiency. The author concludes that, while criticism of present policy serves the worthwhile end of forcing reevaluation, present antimerger policy will remain unless its critics can point to persuasive factual support for their intellectual theorizations.

I. INTRODUCTION

I SHOULD LIKE to discuss American antimerger¹ policy — whether it appears to make sense, or, as an ample supply of critics maintain, it is antiquated or just plain foolish. American antimerger policy has since 1950² become rather strict. It is based

upon the traditional economic view that when a market becomes highly concentrated or oligopolistic in structure, the intensity and effectiveness of competition — particularly price competition — are likely to diminish. Each of the major sellers bulks so large in the

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market that a price cut by one cannot be ignored by the others, but must immediately be matched. Price cutting therefore does not pay and tends to be avoided; "parallel policies of mutual advantage, not competition . . . emerge."³

Our antimerger policy — which reflects our hostility to concentration — by and large does not allow two substantial viable com-

¹ Clayton Act § 7, 15 U.S.C. § 18 (1964), formerly 38 Stat. 731 (1914).

² Section 7 of the Clayton Act was amended in 1950 by the Celler-Kefauver Antimerger Act, 64 Stat. 1125 (1950).

³ United States v. Aluminum Co. of America, 377 U.S. 271, 280 (1964).

peting companies to merge. This position was recently upheld by the Supreme Court in *United States v. Von's Grocery Co.*,⁴ a case that involved a merger between two relatively substantial grocery chains in the Los Angeles market — Von's with approximately 4.7 percent of total retail sales in 1958 and Shopping Bag with approximately 4.2 percent. The aggregate market share of the eight largest chains in the Los Angeles market — a group which included Von's and Shopping Bag — had risen from 33.7 percent in 1948 to 40.9 percent 10 years later.

In the Supreme Court, the Government argued that a merger between direct competitors is presumptively unlawful, even in a market still relatively unconcentrated, if (1) the market is threatened with undue concentration and (2) the challenged merger substantially increases market concentration. The Government agreed that the precise impact of the increase in concentration effected by the merger upon the competitive health of the Los Angeles market could not be gauged. Indeed, we conceded, it might be negligible. We pointed out, however, that the merger moved a market tending toward undue concentration a pronounced step further in that direction, and that only a few more steps of comparable magnitude would be necessary to make concentration so great that competition would almost certainly be weakened. Antimerger policy would be ineffective, we urged, if we had to await such further changes. The Supreme Court agreed with our position, but not everybody else does.

The major argument against the strong antimerger/anticoncentration policy that I have described is based upon the proposition that technological and other economic developments make large size and industrial concentration not only necessary but also desirable. Professor John Kenneth Galbraith believes that antitrust enforcement is out of date.⁵ He supports his conclusion with two homonymic arguments. First, he contends that the larger a firm is, the more effectively it can plan; we must, therefore, tolerate giant sized firms in order to have efficient planning. Second, he believes that firms that can control prices can plan more effectively; we must, therefore, tolerate concentrated industries in order to produce efficient planning. There is nothing startlingly new in these propositions. As long ago as 1889 Professor David Wells of Harvard wrote:

⁴ 384 U.S. 270 (1966).

⁵ See Six Reith Lectures by Professor Galbraith, BBC, London, England, Nov.-Dec. 1966, in 76 LISTENER & BBC TELEVISION REV. Nos. 1964-69 (1966); J.K. GAL-

Society has practically abandoned — and from the very necessity of the case has got to abandon, unless it proposes to war against progress and civilization — 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 the employment of great capital upon the most extensive scale.⁶

And, in 1899, George Gunton wrote that “the concentration of production capital” is “the most effective if not the only means of remedying . . . [a] constant social calamity.”⁷ The most recent source of this type of criticism, however, is not the United States, but England. For, like Ovid in exile at Tomi, Professor Galbraith has been writing in London. And last winter the BBC’s listeners heard the distinguished successor of Wells assert that “oligopoly is combined, in one of the more disconcerting contradictions of economic theory, with efficient production, expansive output, and prices that are generally thought rather favorable to the public.”⁸ Stating his belief that large size and concentration are needed to achieve planning efficiency, he concluded that “modern antimonopoly and antitrust laws are a charade.”⁹

I disagree with Professor Galbraith’s view that changes in the economy require us to accept giant firms and concentrated industries in order to achieve industrial efficiency. While I, too, believe that the industrial system is experiencing change, I do not think those changes so profound as to require abandonment of our traditional support for competition; and, in my view, the evidence today, as in the past, supports the proposition that giant size and concentration within an industry ordinarily lead to worse market performance rather than better — where market performance is viewed broadly to include efficiency in the production and marketing units, price-cost relations, and technical progress. Let me examine each of Professor Galbraith’s arguments in turn.

II. THE SIZE-EFFICIENCY CORRELATION — DOES IT EXIST?

Professor Galbraith first contends that changes in the structure of the economy have significantly increased the size that a firm must

BRAITH, *THE NEW INDUSTRIAL STATE* (1967). See also J.K. GALBRAITH, *AMERICAN CAPITALISM, THE CONCEPT OF COUNTERVAILING POWER* (1952).

⁶ D.A. WELLS, *RECENT ECONOMIC CHANGES* 74 (1889).

⁷ G. GUNTON, *TRUSTS AND THE PUBLIC* 77 (1899).

⁸ Lecture by Galbraith, *supra* note 5, *Control of Prices and People*, 76 *LISTENER & BBC TELEVISION REV.* 763 (1966).

⁹ *Id.* at 794.

achieve in order to plan and to operate efficiently. Since in a growing economy the standard for judging giant size must be periodically updated — so that what was regarded as giant size 10 years ago, much less the turn of the century, is probably inappropriate today — let me discuss this proposition in relation to both changes in the size of the economy and in the size of individual markets.

If such changes as Professor Galbraith alleges have occurred, they must have taken place in methods of production, marketing, finance, research and development, or in management operations. I am not aware, however, of changes in any of these areas that would support Professor Galbraith's conclusion that we must tolerate giant firms for the sake of efficiency.

Professor Galbraith does not identify any transformation of methods of production, marketing, or finance that have significantly increased the minimum size that a firm must obtain in order to be efficient. This is not to say that there have been no changes in these areas. To the contrary, there have been many changes in production, marketing, and finance that have affected the minimum efficient size of many firms. Indeed, many of these changes may have made it easier for small firms to be efficient. Moreover, almost 10 years ago Professor Bain, who studied the matters of production, marketing, and finance thoroughly, concluded: "*It is not true* that existing degrees of business concentration are adequately explained simply as the result of adjustments to attain maximum efficiency in production and distribution."¹⁰ Professor Bain's statement appears to be no less true of the economy today.

Thus, the major reason for believing that a strong anticoncentration policy is as appropriate today as it ever was is that there have been no evident economic changes in America over the past years in the direction of "natural monopoly" or "natural oligopoly." This is simply to say that there is no greater need to have industries composed of one or a few firms in order to have firms big enough to be efficient. It is, of course, important to allow firms of sufficient size to realize economies of scale, and it is clear that such economies have dictated larger sized companies in some industries than once were required. But the markets for most products have been growing as well — often at least as fast — so that by and large there has been no decline in the number of efficient competitors that industries have room to accommodate. What economic evidence we

¹⁰ J. BAIN, *INDUSTRIAL ORGANIZATION* 185 (1959). See also *id.* ch. 5; J. BAIN, *BARRIERS TO NEW COMPETITION* ch. 3 (1956).

have on the subject shows that in America many firms in concentrated industries are far larger than necessary to produce goods at the lowest possible cost. If there were continuing economies of scale, one would expect the largest firms in industries to have higher profit rates than their smaller brothers. But the evidence shows that while average profit rates increase as the size of firms grows to approximately \$5 million in assets, there is no correlation between size and profit rates beyond that point.¹¹

Nor do we have any reason to believe, though it is repeatedly asserted as if it were obvious gospel truth, that there is any relation between size and technological progress as would warrant any significant constraints on antimerger policy. Several empirical studies have tested the validity and dimensions of the proposition that both the amount and the efficiency of research directly correlates to size of firm. These studies tend to show that many more large firms (with 5000 or more employees) do research than do small firms (with less than 500 employees). But once we get a firm large enough to do organized research at all, there are no evident economies of scale either in research for size of firm or in research productivity for any given amount spent.¹²

It is of course true that large firms are more likely to have research operations than small firms. Nevertheless, among firms which do have research organizations, smaller firms tend to spend proportionately as much as their larger counterparts, as is true in the petroleum and glass industries, and in some instances they spend more. In a study of the patent behavior of 448 firms selected from *Fortune's* list of the largest 500 industrial corporations in 1955, the author concluded that "the evidence does *not* support the hypothesis that corporate bigness is especially favorable to high inventive output."¹³ As for the efficiency of the research done, another author concluded that "[i]n most industries the productivity of an R&D [research and development] program of given scale seems to be lower in the largest firms than in somewhat smaller firms;"¹⁴ and

¹¹ Alexander, *The Effect of Size of Manufacturing Corporation on the Distribution of the Rate of Return*, 31 REV. OF ECON. & STATISTICS 229 (1949). See also C. FERGUSON, *A MACROECONOMIC THEORY OF WORKABLE COMPETITION* 172-75 (1964).

¹² Worley, *Industrial Research and the New Competition*, 69 J. POL. ECON. 183 (1961).

¹³ Scherer, *Firm Size, Market Structure, Opportunity, and the Output of Patented Inventions*, 55 AM. ECON. REV. 1097, 1114 (1965).

¹⁴ Mansfield, *Industrial Research and Development Expenditures: Determinants, Prospects, and Relation to Size of Firm and Inventive Output*, 72 J. POL. ECON. 319, 338 (1964).

in a further study it was found that diseconomies of scale in the pharmaceutical industry were encountered in even moderate firm sizes.¹⁵ These studies support the conclusion that for efficient research and development we may need large firms — ranging perhaps from \$10 million to \$100 million in assets depending on the industry — but they cast doubt, to say the least, upon the need for giants and supergiants.

Finally, I do not believe that changes in the area of management control require us to allow larger firms in order to achieve that efficiency in planning that Professor Galbraith desires. Normally one would expect that after a certain minimum size is reached, firms become less rather than more efficient in terms of management. The reasons for this were well stated by Professor Kenneth Boulding, who is now president-elect of the American Economic Association. He stated:

There is a great deal of evidence that almost all organizational structures tend to produce false images in the decision-maker, and that the larger and more authoritarian the organization, the better the chance that its top decision-makers will be operating in purely imaginary worlds. This perhaps is the most fundamental reason for supposing that there are ultimately diminishing returns to scale.¹⁶

Professor Oliver Williamson, who served as my Special Economics Assistant, has developed analytical support for this argument that problems of maintaining control in hierarchical organizations become progressively more difficult as size increases.¹⁷ He goes on to point out, however, that as the ability of a firm to process data increases, the size of the most efficient managerial unit also increases. Since the digital computer has vastly increased the amount of data that a firm can process, it may be that Professor Galbraith relies on advances in the computer field as the basis for the changes in efficient firm size that he alleges. But, while the digital computer indeed has by and large increased the efficient size of the managerial unit, a large number of complex decisions far beyond the present reach of the computer remain. Top management must continue to rely extensively on the organization below it for the information it obtains and for the execution of its plans. In sum,

¹⁵ Comanor, *Research and Technical Change in the Pharmaceutical Industry*, 47 REV. OF ECON. & STATISTICS 182 (1965).

¹⁶ Boulding, *The Economics of Knowledge and the Knowledge of Economics*, 56 AMER. ECON. REV. 1, 8 (1966).

¹⁷ Williamson, *Hierarchical Control and Optimum Firm Size*, 75 J. POL. ECON. 123 (1967).

while computers may be responsible for important changes in management, there is no indication that these changes have been of such magnitude as to necessitate giant sized firms.

Thus, in every area — production, finance, marketing, research and development, and management — we are unable to detect changes of a sort that would require us to accept the proposition that giant size can typically be justified on efficiency grounds. We do not see any indication that giant size is now necessary to achieve efficiency in planning. We continue to believe therefore, that anti-trust policy does not deprive the economy of any significant benefits when it prevents the creation of giant size firms. Surely in the face of all this the least that can be said is that the burden of proof is on those who claim that there is a sufficiently important relation between size on the one hand and progressiveness or efficiency in planning on the other to warrant a drastic cutback in antimerger policy. I see no indication that Professor Galbraith has sustained this burden.

III. THE CONCENTRATION-EFFICIENCY CORRELATION — DOES IT EXIST?

I have been talking about the relation of efficiency and progressiveness to the size of business firms. Professor Galbraith also appears to suggest that not only size, but high concentration of firms within an industry — a concentration high enough to give them some control over price — is beneficial, and perhaps essential, to efficient mass production, and, in particular, to efficient planning. Here too, however, the evidence available shows no correlation between high concentration and the principal elements of economic performance — price, cost, and progressiveness. To the contrary, a recent review of all previous studies in this area suggests that, in the United States at least, there is a direct correlation not with lower prices but with higher prices: the gap between prices and costs is greater in concentrated industries.

While there is no decisive evidence on the question of the relation of concentration to efficiency at any given time, there is nothing substantial to refute the strong a priori case that high concentration will tend to produce slack and inefficiency. I will only cite a study which showed that between 1899 and 1937 the industries in which labor productivity increased most sharply were those characterized by declining concentration.¹⁸ Moreover, industries of low

¹⁸ See Stigler, *Industrial Organization and Economic Progress*, in *THE STATE OF THE SOCIAL SCIENCES* 269 (L. White ed. 1956). *But cf. id.* at 278.

concentration showed better performance than those with high. Since much research and innovation is directed at lowering costs, thus leading to higher levels of output per man-hour, these studies suggest that increased concentration leads to less innovation rather than more. Thus, I repeat, there is no reason for us to believe that our traditional concern for market structure — our traditional effort to prevent undue concentration — deserves to be discarded.

In any event, Professor Galbraith does not make clear just how increased concentration and control over price are meant to improve planning efficiency. Since the prices which a firm would receive in a market with unchanging demand would remain constant whether or not that firm had market control, the type of price control for which Galbraith argues would only be necessary in a market where demand for a product changes. However, if prices in such a market are held constant, shifting demand will lead to shifts in the *amount* of the product produced. Thus, if prices are held steady in the manner that Galbraith seems to think desirable, output would bear the entire burden of shifts in demand. This result has disturbing implications for employment, efficient use of plant facilities, planning of production, and so forth. Most economists would prefer that prices also be made to bear some of the burden of shifts in demand by being adjusted in accordance with changing demand conditions. And I might add that most businessmen also seem reluctant to maintain price stability at all costs. Thus, even in industries in which list prices are unchanging, we often find that the prices of actual transactions do reflect variations in demand. This fact indicates that price shares some of the burden of adapting to market variability.

If Professor Galbraith is arguing that increased concentration allows both prices and output to remain steady despite shifting demand, I doubt very much that he is correct. He claims that when sales begin to fall, firms can respond by increasing promotional activities; that is to say, they can spend more money on advertising and thus keep demand for their products high. But, if the strategy that Professor Galbraith suggests works in an industry in which giant size exists, it should presumably display the stability that Professor Galbraith has in mind. Yet even in the automobile industry we have recently seen considerable change in industry output and effective auto prices. Moreover, since advertising and similar promotional efforts work well only with consumer goods, Professor Galbraith's argument does not apply to the producer goods sector

at all. In any event, it is not clear why it is desirable to pursue so singlemindedly the goal of output and price stability.

Of course, Professor Galbraith may only be saying that concentrated industries are less subject to the vagaries of the market place than are industries with a large number of smaller firms. Even if this is true, however, no one is proposing that all industry structures should consist of a large number of small firms. Most efficiencies, including efficiencies in planning, can ordinarily be achieved by firms that are large but not giant size. High concentration of the order proposed by Professor Galbraith is rarely needed.

IV. CONCLUSION

Even if Galbraith were right in believing that giant size and high concentration help firms plan more efficiently, he does not indicate the extent to which planning efficiency is improved, and therefore, he does not make clear whether the game is worth the candle. I have no reason to believe that any increase in planning efficiency that great size and concentration may create could outweigh the considerable harm caused by their effect in limiting competition — harm which may take the form of higher prices, diseconomies of control, and lower rates of innovation.

To summarize, Professor Galbraith's basic argument is that both large size and industrial concentration are needed for greater efficiency. My criticism of that argument is that, at least as applied to the American economy, it not only seems unsupported but what evidence we have points in the opposite direction.

Finally, Professor Galbraith's statement that antitrust enforcement is a "charade" implies that the antitrust laws are enforced primarily against small firms while the large ones are left alone. As I pointed out in my testimony,¹⁹ it is more difficult under present law to bring a case attacking existing concentration in an industry than to bring one seeking to prevent further concentration via merger. This difficulty stems in part from the fact that most existing concentration would have to be attacked as a form of "monopolization" made illegal by section 2 of the Sherman Act,²⁰ and it has not yet been held that this section applies in industries which are dominated by several firms rather than only one. On the other

¹⁹ *Hearings Before the Subcomm. of the Senate Select Comm. on Small Business*, 90th Cong., 1st Sess. 27, 28-30 (June 29, 1967).

²⁰ 15 U.S.C. § 2 (1964).

hand, there is no such limitation on the application of the Clayton Act, which prevents mergers that may substantially lessen competition.²¹ However, the fact that it is more difficult to attack existing concentration than it is to prevent future concentration obviously provides no justification for allowing firms to make anticompetitive mergers and to turn industries that are not now concentrated into industries that are concentrated.

I am not aware of any other way in which antitrust policy might be said to discriminate in favor of large firms. It is possible that Professor Galbraith believes that large firms can more easily withstand antitrust enforcement because it may be easier for a large firm which enjoys a substantial profit advantage over its smaller rivals to expand internally rather than through merger. The economic evidence, however, does not support the proposition that internal expansion is easier for a large firm than a small one. Ability to generate or attract capital for expansion depends primarily on profits, yet there is no indication that large firms enjoy a profit advantage. Professor Sidney Alexander's 1949 study revealed that large firms do not earn a higher rate of profit than their medium-sized rivals.²² He found that average profit rates increased as firm size grew to approximately the \$5 million total asset mark, but that once this level was reached profit rates were constant or even tended slightly downward. Professor C. E. Ferguson reports that this lack of correlation between firm size and profit rate has continued to hold since then.²³ Thus, although large firms ordinarily have larger absolute profits than their medium-sized rivals, they possess no relative advantage.

Obviously my reading of the changing industrial scene and my understanding of antitrust policy differ from those of Professor Galbraith. Our differences about antitrust policy may be irreconcilable. Our differences about the industrial scene, however, rest upon questions of fact. Unless evidence is forthcoming that strongly controverts that which I have reviewed above, I shall hold to my judgment that the benefits of reconstructing American industry in terms of giant sized firms are largely imaginary, while the costs of such a policy are very real. Thus, although the Antitrust Division is sensitive to the importance of reexamining periodically whether our

²¹ § 7, 15 U.S.C. § 18 (1964).

²² Alexander, *supra* note 11.

²³ C. FERGUSON, *supra* note 11.

ideas about the shape of the economy are accurate — and observations such as those of Professor Galbraith perform the useful function of making us do this sooner rather than later — at the present time we have no intention of accepting his view that giant size is beneficial, nor of accepting his implication that antitrust policy is out of date.