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IN RESPONSE TO A REVISIT

John M. Kuhlman*

“There’s glory for you!” “I don’t know what you mean by ‘glory’ ”, Alice said. “I meant, ‘there’s a nice knock-down argument for you!’ ” “But ‘Glory’ doesn’t mean ‘a nice knock-down argument,’ ” Alice objected. “When I use a word,” Humpty Dumpty said in a rather scornful tone, “it means just what I choose it to mean,—neither more nor less.”—

L. Carroll, Through the Looking Glass

In an anti-trust case, for better or for worse—and, one is inclined to say, until death do they part—lawyers and economists represent a peculiar amalgamation of talent. The lawyers are representative of the legal institutions and rules within which and by which the issues are litigated. The economists are representative of the economic issues as well as the basic intellectual discipline which is used to analyze and rationalize those same issues. It is essential, then, that both learn something of the other discipline. The economist must appreciate the legal institutions and the rules within which the lawyer and the court function. And the lawyer must develop some understanding of the discipline of economics as well as the framework within which the economist operates. To these ends, it is imperative that the dialogue between the two professions be continued.

Over the past several years, Mr. Luther McKinney and I have carried on such a dialogue—as lawyer and economist on opposing sides in an antitrust case, as contributors to professional journals, and as *postprandial* speakers. This dialogue has certainly contributed to my appreciation and understanding of the law and, I hope, has made some contribution to Mr. McKinney’s understanding of economics. But, more than that, I hope that those who have participated as

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spectators in this dialogue have also gained some insight into one or the other of the two disciplines.

I

I am afraid that some of the differences between Mr. McKinney and myself may be semantic in nature. This arises from the fact that economists are prone to use common words in ways that are uncommon to the layman or non-economist. Further, the economist has been trained to speak in as precise a way as possible. But let me explain two such instances.

Mr. McKinney contends that I confuse the two issues in an anti-trust case: (1) the issue of the existence or non-existence of a conspiracy and (2) the issue of damage estimation.¹ I very carefully pointed out when referring to the estimation of damages that I was speaking to the basic economic issue rather than the basic legal issue. It is in regard to the basic economic issue that the economist has, I feel, a major role to play. That is, it is his task to make an estimate of the damages resulting from the alleged violation of the antitrust laws. It may well be that he can make a contribution to the determination of whether a conspiracy existed, and, in coming years, this role of the economist will become increasingly important as conspirators become more sophisticated and as the law makes more use of computers. As it stands right now, however, I suspect that few lawyers would be willing to base their case as to the existence of a conspiracy on the analysis of the economist and nothing else. Certainly since the electrical equipment cases of the middle 1960's, the economists' major contribution to antitrust cases has been that of estimating damages.

Mr. McKinney challenges my proposition that price-fixing arrangements have some effect on costs.² He points out that Professors Leftwich and Adelman take the position that there is "no immutable economic rule" to the effect that such a combination will significantly raise costs. I am confident that both Professors Leftwich and Adelman would agree that competition stimulates efficiency and yields a better pattern of resource usage than does monopoly or collusive oligopoly, but they were not asked that question. They were asked if there

1. McKinney, *Tainted Costs Revisited*, 1972 WASH. U.L.Q. 239, 240.

2. *Id.* at 242.

was an immutable economic rule that such conspiratorial combinations would increase costs. To that very narrow and technical question, most economists would probably answer in the negative. But if the same economist were asked to list the benefits of competition, most would include increased efficiency as one of their responses.

After all, competition has been our national policy since 1890. This has been repeated and reaffirmed in congressional debate and action, judicial decisions, and policy statements by governmental officials of every administration. Why do we have this deep belief in the efficacy of competition? It has never been better stated than by Judge Learned Hand in the *Alcoa* decision:

Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.³

If, indeed, economists, lawyers, and judges in any significant number believe that there is no relationship between the level of competition in an industry and the level of efficiency in that industry, then there is a very limited basis for the antitrust laws and a national policy of competition.

II

Mr. McKinney inquires whether there is anything more than a theoretical possibility that collusive agreements effect costs or "whether it always follows as night the day."⁴ I am sure that he expects a negative response but I am equally confident that the response has to be in the affirmative. In the electrical equipment price-fixing rings, there was an allocation system in which each member firm was awarded a share of the market. Each firm then received that portion of the market regardless of market conditions. In periods of declining sales, the less efficient plants produced the same percentage of a smaller total market. This would not happen if the industry were controlled by a single firm which operated several plants. In such an instance, the less efficient plant would not be operated during periods of declining sales. We can say without any doubt or equivocation, a price-fixing ring which

3. *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945).

4. McKinney, *supra* note 1, at 242-43.

allocates markets on some basis other than costs of production will have the inevitable effect of raising the cost of production. On this point, all economists including Professors Adelman and Leftwich will be in hearty agreement.⁵

That raises the next question. Do most (or all) price-fixing agreements contain market sharing provisions? There is really no way of saying for certain, but it would appear that few firms would be willing to enter a price-fixing agreement without some assurance that they would receive a portion of the industry's sales regardless of the level of demand. This issue is sufficiently complex that the reader would do well to read my analysis of this problem published elsewhere.⁶

When the question of entry is introduced, a host of new issues are raised. A price-fixing ring must do what it can to impede entry and it might under certain circumstances even hasten the exit of some resources presently in the industry. Certainly the great threat to a price-fixing ring is an influx of resources which would so alter the supply situation that the ring could no longer exist. If it is successful and does impede the flow of resources into or out of the industry in question, there can simply be no question whatsoever that the costs of that industry are affected. A movement of resources into an industry will, on the whole, result in increased efficiency and to the extent that a price-fixing ring impedes this flow of resources, industry costs will be higher. In sum, there are, it would seem, relatively few instances in which a price-fixing ring would have no effect on the costs of production. The reasoning does not depend upon restriction of output and a resultant higher average cost. It results only from an allocation of resources which is different than that which would occur under noncollusive conditions. An industry organized as a monopoly would actually yield superior results in terms of resource utilization than would the same industry made up of independent firms but engaged in price fixing.

III.

In addition to the problems discussed above, there is also a con-

5. R. LEFTWICH, *THE PRICE SYSTEM AND RESOURCE ALLOCATION* 219 (3d ed. 1966).

6. Kuhlman, *The Nature and Significance of Price-Fixing Rings*, 2 *ANTITRUST L. AND ECON. REV.* 69 (1969); Kuhlman, *Theoretical Issues In the Estimation of Damages In a Private Antitrust Action*, 33 *SOUTHERN ECON. J.* 548 (1967).

ceptual problem. In certain theoretical market structures, economists know the relationship between costs and price with a great deal of certainty. In the real world some businesses have unsophisticated pricing rules such as a 20% markup. With the exception of these few cases, it is not all clear what the relationship is between cost and price. As a matter of fact, there are instances in which the relationship goes from price back to costs. In some instances, overhead costs are assigned on the basis of what the product line will bear. Some products may be assigned a great deal of the common costs of the firm.

This means in an antitrust case, then, that the defendant firm would not have the choice of bringing in some of its cost data and excluding other, but would, in the interest of complete analysis, be required to bring in all of its cost data including cost data pertaining to product lines not involved in the litigation. It would have to be established that costs were assigned without any consideration of the existence or non-existence of a conspiracy.

Surely Mr. McKinney must have had his tongue in cheek when he suggested that the plaintiff should assume the burden of showing that the costs would have been in the absence of the alleged (or proven) conspiracy. This would be a monumental, if not impossible, chore for the accounting staff of the defendant's firm itself with its unimpeded access to the company records.

I am sure that the contemporaneous records of the typical defendant in a treble damage action were not made up with that action in mind. They are, at best, a rationalization of the company's activities for either the stockholders, the management, or the Internal Revenue Service.

IV.

In conclusion, let me point out that the offense, alleged or otherwise, of a price-fixing ring is the fixing of prices. The evidence of this offense, if it is to be found, will be in the behavior of prices. That is, the prices behaved differently than would have been the case but for the alleged violation of the antitrust laws.

In the case of the electrical equipment trials, the price behavior was such that no economist could possibly have explained that behavior on the basis of anything other than a conspiracy and a breakdown of that conspiracy. For example, in the case of power transformers, prices fell

by a factor of one-half over a period of only a few weeks and recovered by about the same amount in an equally short period of time. Certainly no economist is going to argue that this kind of abrupt change in price reflects equally abrupt changes in costs.

My case can be summed up in the following brief propositions. First, it is impossible to state what the exact relationship between price and cost is in markets in which we find price-fixing. Second, any action by a price-fixing ring which restricts entry, hastens exit, or allocates production on some basis other than efficiency will, in and of itself, cause prices to be different than would have been the case had the ring never existed. Third, the evidence of a price-fixing conspiracy and the measure of its impact must be in the prices that the ring was alleged to have fixed and not in the relationship between the cost and price of the member firms. And fourth, although there are no generally accepted immutable laws to the effect that competition lessens incentive for increased efficiency, this is a widely held belief and it is a basis for all antitrust legislation.

