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The Evolution of the Political Economic Foundations of Competition Policy

by

Ronald W. Cotterill

**Presented at the
Ankara Center for Research and Thought
Ankara, Turkey**

**Food Marketing Policy Center
University of Connecticut**

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The Evolution of the Political Economic Foundations of Competition Policy

by Ronald W. Cotterill

I. Introduction

I would like to thank you for inviting me to talk this evening. Turkey is a nation that has been at the center of the World for much of the past 2,000 years, and now it is again at the crossroads of world affairs. It is a dynamic and modern nation that is playing a leading role in the integration of Muslim countries into the world community. Such countries will not be copies of Western countries or, for that matter, each other. There is a creative element at play that ideally will engender social and cultural diversity while providing economic advancement.

Having said this, unfortunately I know very little about your country and this region of the World. Thus I can not talk to you about the political economy of Turkey, the Turkish hinterland to the East as far as China, or the entrance of Turkey into the European Union. These topics interest me; however, I must learn about them from you.

Tonight affords me another opportunity. I would like to look back into the development of political economy. This exercise will explain how competition policy has evolved. In the United States we call competition policy antitrust policy because it first took form as a government policy against the trusts that were created at the end of the 19th century; for example, Standard Oil, U.S. Steel, U.S. Sugar, and Armour Beef. Essentially, these combinations of smaller firms in an industry were monopolies.

The evolution of the political economic foundations of competition policy illustrate the role that markets and government have played for the social control of power in a society. If you compare what I say to the development of Turkish political economy, perhaps you will find useful insights. Please permit me to proceed as follows. First I will provide a workable definition of power and explain the challenge that is the social control of power. Then I will explain the evolution of Anglo-American political economy starting in the Enlightenment period of the 1700's, proceeding to the industrial age, most notably the rise of powerful corporations, neoclassical economics, and the first competition policies. Moving on in the 20th century I will focus upon the Depression Era and 1945-1980 which I label the golden age of government enforcement of competition policy. Next comes the 1980's with the conservative reaction and the relaxation, some would say dismantling of competition policy enforcement. This political movement in the Reagan and Thatcher era was based upon an ideological commitment to reducing the role of government in the economy. Intellectually, Chicago School economists argued for the relaxation of competition policy so that a new market for corporate control could be created. This increased market pressures upon corporate bureaucracies to manage their companies in a more efficient and progressive manner.

For 1990 to present I explain how the conservative retreat from U.S. Federal government agency enforcement gave rise to a second new market. Federal enforcement now "competes" with the enforcement activities of state attorneys general and class action lawsuits on behalf of disperse groups such as consumers, farmers, or numerous business buyers that claim damages due to violations of competition policies. One can also add the enforcement by other nations' competition agencies, especially the EU Directorate General for Competition.

II. A Working Definition of Power and the Social Control of Power by the Organization of Political Economy

For my purposes it is sufficient to define power as the leadership prerogatives that come from the organization of individuals into groups dedicated to a common task. A chief executive officer has power over the operations of a firm. A king or dictator can have absolute power over a nation's culture and its economy, yet we now know that this is not the most powerful political economic organization.

The challenge of social organization is to create a political economic system that diffuses power to a wide array of organizations that each specialize in the pursuit of fairly narrow goals. In the aggregate these can combine to produce more power, more wealth, and a progressive, dynamic society. I would define progressive and dynamic to include the efficient use of scarce resources, the encouragement of human talents and scientific innovation, and the distribution of income and wealth in a fashion that rewards effort, creative and scientific insight, and in a fashion that gives all members of society the opportunity to advance according to their abilities.

Today, the dominant model of political economy is the Anglo-American model which is based on liberal democratic political organization and an effectively competitive economy regulated in the first instance by decentralized markets and in a secondary fashion by government regulation and competition policies. There are, of course, alternatives. Swedish social democracy is a somewhat different but essentially similar approach. Singapore and China have non-democratic governments, limited political and personal freedoms, and growing capitalist economies. Saudi Arabia and some other

Muslim countries have kings or dictators and limited social, political, and economic freedoms. India is moving from a socialist to mixed capitalist economy.

Here I will only address the development of the liberal democratic Anglo-American model and even then focus primarily upon the evolution of competition policies. Liberalism means different things for different persons so I will clarify. Adolf A. Berle, Jr., a leading political economist in the mid 20th century, provides a workable definition:

> If liberalism means anything, it means adherence to two propositions. First, you get the facts and draw the conclusions objective survey of the facts requires. Second, you steer steadily for the greatest freedom and self-realization of individuals-which means that an economic system is judged by its content and results, not by its form.[1]

III. The 18th Century Conceptual Foundations: The Great Separation of Religion and Political Economy

During the 1700's after several hundred years of wars that mixed religion and nation state motives, John Locke, Thomas Hobbes, and other natural rights philosophers separated church and state in their thinking and focused on more narrow goals that became political economy. Mark Lilla, a Columbia University humanities professor, calls this the great separation. He provides a very readable and insightful explanation of this move and relates it to current church/state issues in Muslim nations that would pursue theocratic states.[2]

In the 18th century the Anglican Church in England was a moribund institution that had little impact on the general population, and as such was a relatively easy target

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[1] Berle, Adolf A., Jr., *Power Without Property.* Harcourt, Brace & World, Inc., New York, 1959, p. 12.
[2] Lilla, Mark. 2007. *The Stillborn God: Religion, Politics, and the Modern West.* Alfred A. Knopf. September 16.
Lilla, Mark, 2007. *The New York Times.* "The Politics of God." August 19. http://www.nytimes.com/2007/08/19/magazine.

for separation from political economic issues.[3] Curiously, as political philosophers moved away from religion, John Wesley, a Cambridge trained Anglican minister and his followers, crusaded for most of the 18th century to revive Protestantism by refocusing it upon personal moral beliefs and a personal commitment to an upright, moral life style. C.E. Vulliamy, the definitive biographer of Wesley writes,

> …the preaching of Wesley was mostly directed towards the new industrial classes, it had a great and increasing influence upon the economic history of England.
>
> Methodism taught people to be industrious, clean, efficient and trustworthy; Wesley, eminently practical as he was, always laid stress upon the importance of order, regularity and cheerfulness in the normal occupations of life. He taught a code of inflexible honesty. He denounced in the most emphatic manner the crimes of defrauding the revenue and receiving bribes.[4]

In New England, Jonathan Edwards preached a similar message of personal responsibility in what was called, "the great awakening." George Whitfield, Wesley's peer in the Methodist movement in the British Isles, actually joined Edwards in New England and is buried in Boston after an unexpected death.

On the other side of the great separation, 1776 saw the drafting of the American Declaration of Independence with its open commitment to political democracy and the statement that all men are created equal with the inalienable right to life, liberty, and the pursuit of happiness. Adam Smith's, *Wealth of Nations*, also appeared in 1776 with its argument that markets (the invisible hand) and the economic specialization that they permit, not royal monopolies and mercantile policies, are the source of economic progress and wealth.

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[3] After all, Henry VIII created the Anglican Church to resolve his marriage problems, expropriate church wealth, and to advance his control of England.
[4] C.E. Vulliamy, *John Wesley* Lowe and Brydone Printers Ltd., London, 1933, p. 268.

Thus the separation of church and state allowed intellectual leaders on both sides of the separation to focus on the development of institutions and organizations that led to social and economic progress. Without Wesley and his Methodist revival the emerging working and middle classes so necessary for the advance of industry and science would not have been in place and as effective. Even in his old age Wesley was still critical of English society. In 1782, after over 50 years of evangelical effort, for many years riding by horse from town to town to preach revival, Wesley still found fault with English society:

> If sloth and luxury are not, what is the present characteristic of the English nation? It is ungodliness. This is at present the characteristic of the English nation. Ungodliness is our universal, our constant, our peculiar character.[5]

IV. 1865 to 1914: The Rise of the Modern Industrial State and the Advent of Competition Policies

The social control of power in the modern industrial state was the question that dominated political economy during the 19th century. As science and industrial technology progressed it was clear that great economic progress was imminent. How to organize such societies was an open question. The answers advanced included grand social schemes: communism, socialism, capitalism, and many blends thereof. Alongside the grand ideologies a pragmatic and empirical approach evolved in Great Britain and the United States. Although little noticed at the time, in 1837 Great Britain passed the first Limited Liability Act. It and its successors at the state level in the United States created the modern corporation.

[5] Vulliamy, p. v.

The English law was the first to regulate the organization of joint-stock companies and limit the personal liability of each shareholder to the amount of his share. Previously, if a company went bankrupt, the entire property of each individual shareholder could be used to pay the company's creditors. The new Act caused a flood of wealth to pour into limited liability companies, which provided much of the capital for new British industries, and London became the financial capital of the world. [6]

In 1886 in Santa Clara County v. Southern Pacific Railway, 118 US 394, the U. S. Supreme Court declared that a corporation is a "person" and entitled to protection as a person before the law. In jest one might note that the modern corporation is truly a vehicle that both political economist and evangelical minister can admire. It is an organization, a superman, that assembles and harnesses the skills of many individuals to undertake an economic activity. Men and women die, but their work lives on in the corporation because it has eternal life. In practice, corporations, of course, may fail and disappear, yet their good works can give them eternal life. John Wesley would have to approve.

In the United States the rise of large corporations that dominated some industries, especially railroads, banks, and manufacturing industries, led to public outcry by Western farmers and workers. This populist movement demanded and received government regulation of railroads and competition (antitrust) policies.[7] In 1887, the Interstate Commerce Commission was established to regulate railroads that had local monopolies in many regions of the U.S. In 1890, the Sherman Antitrust Act declared price fixing, cartels, and trusts that would enact such policies to be illegal.

[6] Charlot, M. 1991. *Victoria, The Young Queen.* Cambridge, MA:Basil Blackwell Inc. p. 337.
[7] Goodwyn, Lawrence. 1978. *The Populist Moment: A Short History of the Agrarian Revolt in America.* Galaxy Books, p. 7.

These laws actually created the need for economic theory and analysis. It is more than coincidence that the American Economic Association was founded in 1885. One now had need to define markets and to analyze pricing in a market to determine whether prices were being manipulated or fixed or whether a particular corporation had intent to monopolize or actually had monopolized a market.

Also, rather than being based on political theory this expansion of government to the social control of economic power was by popular demand.

Both economics and political philosophy, which soon became political science, had to play catch up with the real world economy and government oversight obligations. Fortunately, Alfred Marshall's, *Principles of Economics*, appeared in 1890 with its new neoclassical approach to economic analysis. One now had the mathematical and economic tools to analyze pricing, competition and monopoly.

For my purposes the 19th century will spill over until 1914 and the progressive political movement that finished the populist parties' reform agenda from the 1880 and 1890's.[8] In 1914 the Federal Reserve banking system was established, and as such represented the first modern intrusion of the central government into capital markets with the intent of regulating and stabilizing them to avoid financial panics and depressions.[9] The Clayton Antitrust Act (1914) seeks to prevent the development of monopoly by declaring any merger or acquisition to be illegal if it may tend to substantially lessen competition or create a monopoly. Also, in 1914 the Federal Trade Commission was established to enforce the Sherman and Clayton Acts.

[8] Goodwyn, L. 1978.

[9] Alexander Hamilton, our first and most brilliant Secretary of the Treasury, created the U.S. public debt and used it through the Bank of New York, which he founded, to stabilize financial markets, which he also helped to found, in the 1790s. [Chenow, Ron. 2004. *Alexander Hamilton*. The Penguin Group, New York.]

On the political philosophy front legal scholar, Louis Brandeis, ultimately a U.S. Supreme Court Justice, attacked the "curse of bigness".

> Brandeis wanted honest and socially minded business. He disliked bigness because he considered, rightly, that the men creating and operating it did not understand what they were doing and, because they pretended to understand what they were doing, turned themselves into pious frauds.[10]

Walter Lippman, perhaps the greatest U.S. political philosopher since Thomas Jefferson, wrote incisively about the fundamental values that underpin a liberal democratic society.[11] Adolf Berle, summarizes Lippmann's contribution as follows:

> Checks (not "balances") appeared in the form of periodic political interventions demanded by American public opinion. To explain this it becomes necessary to import a political conception–the 'public consensus'–familiar to the political scientists and brilliantly explained a few years ago by Mr. Walter Lippmann. So, it seems, the ultimate protection of individuals lies not in the play of economic forces in free markets, but in a set of value judgments so widely accepted and deeply held in the United States that public opinion can energize political action when needed to prevent power from violating these values.[12]

This conforms with my earlier conclusion that the rise of competition policies came not from social science. They came from the demands of the general population to "do something."

V. The 20th Century: The Great Depression and the Post World War II Era of Rigorous Government Enforcement 1945–1980

To this day no one is sure why the great depression occurred worldwide in the 1930's. Nonetheless it ushered in a great deal of economic regulation that sought to avoid its recurrence. Capital markets and the power of large banks and industrial

[10] Berle, Adolf A., p. 14.
[11] John F. Kennedy, at a state dinner for Nobel Laureates, quipped that there probably has not been so much talent assembled in the White House since Thomas Jefferson dined alone. See W. Lippmann, *A Preface to Politics* (1914), *The Good Society* (1937).
[12] Berle, Adolf A., p. 22.

corporations were main targets. Adolf A. Berle, Jr., and Gardiner C. Means in their classic, *The Modern Corporation and Private Power*, (1932) maintained that the separation of managerial control from stock ownership in large corporations created conditions that encouraged speculation and unwise investments.[13] As stock became available in the 1920's it was dispersed over thousands of relatively small investors, who had no incentive to discipline (control) management. A. A. Berle has explained this problem as follows:

> …while the stockholdings were diffused, widely separated, scattered into all manner of relatively small holdings, the stockholder in the main could not use his fractional power save in very rare instances. For practical purposes, he could vote a paper proxy for a slate commonly put up by the management or occasionally put up by some powerful contesting group. In net effect the result was that the various units of American industrial production (five hundred or at most six hundred administer approximately two-thirds of American industry) were in the main controlled by their boards of directors. The power location in stockholders was for practical purposes a fiction.[14]

Investors that lost everything in the crash of 1929 understandably felt defrauded by firms that issued stock, and firms that promoted the trading of stock. They also felt defrauded by the ensuing bank failures and the loss of their savings. The Banking Act of 1933 (Glass Steagall Act) sought to restore confidence by insuring savings deposits in local banks, and by forcing separate companies to provide insurance, commercial banking (savings and loans) and investment banking (the design, issue, and trading of bonds and stock).[15] The intent was to protect consumers of the first two from the vagaries of securities markets. Recently the walls between financial industries in Glass

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[13] Berle, A.A. and G.C. Means. 1932. *The Modern Corporation and Private Property,* revised ed. 1968. New York:Harcourt, Brace & World, Inc.
[14] Berle, pp. 52-53.
[15] Glass-Steagall Act. Available at http://en.wikipedia.org/wiki/Glass-Steagall_Act.
Gotlieb, Andy. 2001. *Philadelphia Business Journal*, "With Glass-Steagel gone, have things changed?" August 3. Available at http://www.bizjournals.com/philadelphia/stories/2001/08/06/newscolumn7.html.

Steagell were repealed. The merger between Citi Corp. and the Travelers Insurance Company in 1999 required this change. The industry successfully argued that today's capital markets are deeper and more resilient than in the 1930s. Given the recent credit and mortgage crisis, and the current dire financial situation of Citi Corp, one hopes that they were correct.

In 1934 the Securities and Exchange Commission also was created to enforce federal securities laws and regulate the securities industry/stock market. The SEC to this day requires extensive reporting on a quarterly or annual basis by all publicly traded corporations.[16]

The Franklin D. Roosevelt presidency also saw a complete turnover in the U.S. Supreme Court. F.D.R. created a liberal court that supported his move from unregulated open market capitalism to a mixed capitalist economy where government played a major role by regulating business, and enforcing competition policy as well as providing direct services.

Economic theory and analysis of competition policy also had a significant advance. In 1933 Edwin Chamberlain's Theory of Monopolistic Competition introduced the term "oligopoly," a market supplied by few firms – a structural condition that lies between an effectively competitive and monopolistic market.[17] Moreover he provided an economic foundation for the Clayton Act's requirement to determine if mergers short of monopoly, i.e. mergers that create oligopolies, lessen competition and allow prices to rise above effectively competitive levels. Chamberlain's small numbers model (tight

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[16] The recent tech stock bubble has led to increased reporting requirements for U.S. stock exchanges that have led many new ventures to go public on European exchanges. Again, there is a market for the trading of stock that have many exchanges competing for the business.

[17] Chamberlain, E. 1933. *The Theory of Monopolistic Competition.* Cambridge: Harvard University Press.

oligopoly) demonstrates that if oligopolists have symmetric cost conditions and if they follow each other's price change (follow a price leader) then they will price at the same level as a monopolist. He called this conduct tacit collusion because it does not require explicit communication between firms as in price fixing and cartelization. Today there are more advanced game theoretic models of oligopoly pricing that demonstrate price elevation. Mergers that enable such "coordinated effects" are now illegal not only in the U.S. and E.U. but in many other countries worldwide.[18]

After World War II competition policy enticed an era of rigorous enforcement that lasted into the 1960's and limped forward to 1980. Several conditions were in place that guaranteed this. First, in the U.S. one had a liberal Supreme Court that broadly construed the laws in fashion that made it relatively easy for the federal enforcement agencies (FTC and the U.S. Department of Justice) to win cases. Economic theory had advanced to a level that provided models for monopoly pricing, dominant firm pricing, tacitly collusive pricing, price discrimination, vertical pricing, and barriers to entry. The use of econometrics and computers enabled empirical analysis of business conduct that provided evidence in courts of law.

Second, the securities and banking laws of the 1930's aided in revival of capital markets. In 1959, A.A. Berle, Jr. in a very powerful small classic, *Power Without Property*, explained the new mixed economy's division of power among regulated security firms, stockholders, industrial corporation managers, government regulatory and competition agencies, and a new oversight class "fiduciary agents." Writing in 1959 he

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[18] U.S. Department of Justice 1992 Federal Horizontal Merger Guidelines, Revised 1997. Available at http://www.usdoj.gov/atr/public/guidelines/hmg.pdf.
E.U. Merger Guidelines. Available at http://ec.europa.eu/comm/competition/mergers/legislation/regulations.html.

envisioned that fiduciary agents for small stockholders would monitor corporations to ensure the best performance from management. Berle writes,

> We have noted that the financial power to determine who shall manage a corporation and, within limits, to influence the policy of such management rests with the holders of the common stock. We have seen that the holdings of common stock are gradually–or perhaps rather rapidly–beginning to be concentrated in the professional managers of the pension trust funds and mutual funds. To a somewhat less extent, the same is true of the great insurance companies. Power over the management is power over the accumulation and handling of risk capital. We thus dimly discern the outline of a permanently concentrated group of officials, holding a paramount and virtually unchallenged power position over American industrial economy. There is little need to argue the fact that this will be a substantial change.[19]

Given this newly efficient capital market, competition policy, especially the enforcement of merger policy, need not be concerned about the need for mergers to discipline management. Merger policy could and did in this era focus narrowly on the possibility that the merger would elevate prices due to a transition to noncompetitive pricing.

Finally, during this post World War II era competition policy expanded in other countries, sometimes by U.S. insistence (Japan and Germany). In 1948 the U.K. created its Monopolies and Restrictive Trade Practices Commission, what is now the U.K. Competition Commission. By 1964, twenty four countries had created similar legislation and agencies.[20] In the Treaties of Paris (1951) and the Treaty of Rome (1957) the European Union created legislation similar to the U.S. Sherman Act.

VI. The Conservative Backlash in the 1980's

[19] Berle, p. 52.

[20] Corin Edwards, 1966. Statement before U.S. Senate Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, 89th Congress, 2nd Session, Washington, D.C., U.S. G.P.O.

By 1980 the FDR liberal democratic model of mixed capitalism with active government oversight had aged and was crumbling under new forces. The Reagan presidency in the U.S. and the Margaret Thatcher era in the U.K. created a conservative shift that, in retrospect now seems entirely appropriate. In the U.S. the development of the economy, new technologies, and the growth of very large corporations had created complexity that demanded deregulation and reformulation of competition policy enforcement.

Henry Manne, a Chicago School economist wrote a seminal article in 1965 that challenged the efficiency of capital markets and called for the relaxation of merger enforcement to create a market for corporate control to discipline bad managers.[21] Manne argued that boards of directors and fiduciary agents could not provide adequate discipline to ensure corporations performed up to their abilities. He reasoned that firms in an industry had the specialized knowledge necessary to evaluate each other's performance. Therefore mergers, more specifically hostile takeovers, could improve management and shareholder value.

To go down Manne's avenue the Reagan administration adopted a new theory of competition, Contestable Market Theory, and the Chicago School position that there were no significant barriers to entry in most industries. Free entry and exit under Contestable Market Theory guarantees that even a monopoly prices competitively. Ergo no worry. Virtually all mergers do not reduce competition.[22]

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[21] Mann, Henry, 1965. Mergers and the Market for Corporate Control. *Journal of Political Economy* 73, 110-120.

[22] For a rebuttal is my testimony before the House Judiciary Committee in 1989, FMPC Research Report No. 2 at http://www.fmpc.uconn.edu.

To fuel this new market for corporate control the Reagan administration relaxed securities regulation so that investment banks including new upstarts such as Kohlberg Kravis and Roberts (KKR) could issue junk bonds to finance hostile takeovers and leveraged buyouts (LBOs). Junk bonds are high risk and pay a high interest rate because they are not backed by collateral and are used in a fashion where default is a distinct possibility. LBOs use junk bonds to finance as much as 98-99% of a takeover thereby promising huge gains to shareholders if in fact the new owners can improve management and profits.

During the 1980's and 1990's many relatively staid large U.S. corporations were "attacked" and forced to merge, go LBO under the control of someone such as KKR, or do a defensive leveraged recapitalization. For example, the Walt Disney Company suddenly found itself under attack by an outside buyer who had realized the company was severely undervalued given the advent of the VCR. Disney had dozens of "old" classic films locked away in its storage vaults. The outsider was the first to see the value to Disney of the home video retail market.

In food retailing nearly all of the top twenty supermarket chains in the U.S. were taken over by LBO firms or did a leveraged recap in defense during the 1980's or early 1990's. Only two failed. The rest made huge returns for their leveraged investors because the firms used their precarious financial position to renegotiate labor union contracts and to demand price reductions from suppliers, otherwise no jobs and no sale.

At the height of this unleashed frenzy, a frenzy that created a new wealthy class, Professor Michael Porter published a study commissioned by the Corporate Roundtable– the leaders of the top U.S. corporations–that questioned the wisdom of such "short term" focus on earnings and value.[23] He argued that the more administered systems in Japan and Europe that shielded corporations from LBOs and hostile takeovers allowed corporations to undertake long term strategies whose pay offs were higher. However, by 1995 U.S. corporations had adapted to the new tough love and one no longer read stories claiming that Japan Inc., France Inc. or bank dominated boards of German corporations were the future for business organization.[24] The new market for corporate control was clearly driving increased capital market efficiency, and offering investors higher returns. Competition policy accommodated this conservative invigoration of capital markets.[25]

VII. 1990 to Present: The Liberal Resurgence

Until about 1990 in the USA the primary enforcement agencies for competition policy were in the Federal government (the Dept. of Justice and the Federal Trade Commission). The conservative Ronald Reagan presidency (1981-1988) and the increasingly conservative US Supreme Court sought to and in fact did limit the scope and effectiveness of these federal agencies with the goal of allowing markets and competition unfettered by government intervention to run the economy. The ultimate effect, however, was not to limit the enforcement of competition (antitrust) policy. Rather it gave rise to new enforcement avenues–in fact one could even say it created a market for competition policy enforcement where before we had only 2 bureaucratic federal government agencies. Those government agencies did not have the creative and intellectual

[23] Porter, Michael E. 1992. *The Harvard Business Review*, "Capital Disadvantage: America's Failing Capital Investment System." September-October.

[24] An example of France Inc. is the hostile takeover of Aventis by a much smaller rival that the French government backed to create a "national champion" rather than allow a foreign company to acquire Aventis. [*Wall Street Journal*, April 26, 2004, p. A8.]

[25] For example, Judith Chevalier documented that LBO and recapitalized firms in food retailing tacitly coordinated pricing and elevated prices in U.S. cities where they dominated the market. [Chevalier, J.A., 1995. Do LBO Supermarkets Charge More? An Empirical Analysis of the Effects of LBOs on Supermarket Pricing. *The Journal of Finance* 50: 4, pp. 1095-1112.]

firepower, nor did they have the financial resources to effectively prosecute large competition policy cases in the US court system. In effect the size and power of large US corporations had outrun the ability of antitrust regulation by government agency as envisioned in the first half of the 20th century. Our political economy needed to advance beyond that simple model to create new markets that in fact perform the regulatory function in the larger more diverse and more powerful economy.

Here is what happened when the federal government activities were cut back during the 1980's. The states began to enforce the federal antitrust laws (In 1989 the now conservative US Supreme Court in its drive to limit the liberal agenda and powers of the federal government affirmed that each state had the right to enforce the federal antitrust laws.

Also, and perhaps more radical, the private bar (private lawyers) were given access to antitrust enforcement via the legitimization of "class action" lawsuits. If a lawyer could locate some consumers who felt that the antitrust laws had been violated and the result was that they paid higher prices or suffered other damages such as reduced product quality, that lawyer could sue on behalf of the consumers under the antitrust laws. It is important to realize that corporations and private businesses that buy from such sellers that may be in violation of the competition laws are also "consumers" and have access to this private enforcement vehicle. Similarly, farmers also have access if the believe that the prices they receive are depressed below competitive levels or cartelized (monopsony oligopsony).

In effect the class action lawsuit makes every lawyer in the USA an enforcement agent of the competition laws. For example, the huge lawsuit against the cigarette companies that proved that they did not tell consumers that cigarettes cause cancer was initiated and prosecuted under the price fixing and restraint of trade provisions of the antitrust laws by a private attorney, one Richard Scruggs in Mississippi. Not only did Mr. Scruggs win the case, he collected over 100 billion dollars in damages for consumers and made several billion dollars in legal fees for himself.[26]

Thus one can see that competition policy enforcement in the USA has been to a certain extent “privatized” in a fashion that attracts the best legal talent to enter the “market for antitrust enforcement” not only on the side of the large corporations that have the ability to pay high fees for the best legal talent. Such high quality legal talent also now enters on the other side of the case thereby assuring more–shall we say effective and equitable–enforcement of the laws.

Continuing the cigarette/cancer issue further, the next legal team to enter the courts on behalf of damaged consumers (smokers) was a joint antitrust effort by several states. They too obtained a multibillion dollar judgment that is now being paid back to the states in compensation for the increased medical and health expenditures due to the collusive actions of the cigarette companies to suppress information on the unhealthiness of cigarettes. The last agencies to enter the fray were the federal antitrust authorities at the US Dept. of Justice. The courts have ruled that they are too late and that the prior cases have punished the industry enough. This is an example of how the conservative shift to reduce the role of the federal government actually increased the effectiveness of competition policy enforcement by creating a market for such activities and structuring it in a fashion to insure the deployment of legal talent to both sides of the market.

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[26] Treaster, Joseph B. 2007. *The New York Times.* “A Lawyer Like a Hurricane.” March 16. http://www.nytimes.com/2007/03/16/business/16scruggs.html.

Since 1990 the economic analysis that supports competition policy has also changed. In the U.S. the contestable market era ended when James Rill, Assistant Attorney General for Antitrust, announced that the federal agencies no longer accepted the Chicago School Theory that counseled there were no entry barriers but for government imposed ones.[27] The new federal merger guidelines, ultimately issued in 1992, reinstated the need for an empirical assessment as to whether entry would be "timely, likely, and sufficient" to defeat a noncompetitive price increase.[28] The merger guidelines in the U.S. and other countries, including the E.U., also reflect a global convergence on the way to define markets and analyze the competitive effects of a merger. This reflects the fact that economics as a social science and as a profession is now global. Specialists in industrial organization and competition policy routinely communicate, meet, and collaborate on a global basis.

Merger policy in the USA until around 1990 focused on the potential for increased collusion after the combination of two firms in a market whereas in the E.U. the focus until about the same time was on the possible creation of a dominant firm that could unilaterally elevate prices. Since 1992 merger authorities on both sides of the Atlantic have recognized both possible effects and call them "coordinated effects" and "unilateral effects". Unilateral effects analysis moreover has been extended from the large dominant firm situation in a homogeneous product industry to consider mergers in differentiated product industries where the merging parties may have very small market

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[27] *Antitrust Law Journal* Vol. 59, Issue 1, 1990. Interview with James F. Rill, Assistant Attorney General, Antitrust Division, U.S. Department of Justice.
[28] USDOJ Merger Guidelines.

shares.[29] In fact some leading economists are now calling for the complete abandonment of the use of market shares as a measure of market power. According to this new view the key factors are, irrespective of large or small market share the existence of substitute products and the lack of barriers to entry so that the merged firms can not raise price. Dennis Carlton, a recent chief economist at the Antitrust Division of the US Dept. of Justice, now a member of the President's Council of Economic Advisors, and a professor of economics at the University of Chicago has a recent paper that suggests moving this way. He would even apply this focus on substitutes and entry barriers to monopolization cases[30].

VIII. Conclusions

This review of the development of competition policies and the underlying political economy of markets and government intervention in markets provide support for the following propositions. First, in a democratic state the mandate for change in the role of markets and government agencies for the social control of power comes from the general populace via the political process. It does not come from advances in political science and economics. Positive social sciences follow rather than lead normative change in the agenda. Second, the rule of law and the development of legal precedents over time check politically motivated changes. Judicial review within the context of legal

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[29] Ivaldi, Marc, Bruno Jullien, Patrick Rey, Paul Seabright, and Jean Tirole. "The Economics of Tacit Collusion." Final Report for DG Competition, European Commission, IDEI, Toulouse, March 2003. http://europa.eu.int/comm/competition/mergers/others/#study.
Ivaldi, Marc, Bruno Jullien, Patrick Rey, Paul Seabright, and Jean Tirole. "The Economics of Unilateral Effects." Interim Report for DG Competition, European Commission, IDEI, Toulouse, November 2003. http://europa.eu.int/comm/competition/mergers/others/#study.

[30] Carlton, Dennis W. "Does Antitrust Need to be Modernized?" *The Journal of Economic Perspectives* 21(3), Summer 2007, p. 155.

proceedings that introduce evidence to weigh the facts and apply the law is the central component of competition policy enforcement.[31]

Perhaps the most basic insight that I will offer tonight is that as a nation's economy and the world economy develops, the role for markets expands. Yet unfettered markets run into trouble, and government regulation and competition policies improve economic performance. Then as corporations become even larger their complexity, the need for information, and the specialized skills to interpret business conditions and the political power of these corporations outpace the ability of investors and government agencies to constrain and channel their power. Markets come to the rescue. A market for corporate control aids investors, and a market for the enforcement of competition policy supplements central government enforcement efforts. This ongoing decentralization of power to markets, while preserving intervention based on law and economic analysis, provides the flexibility to grow without the aggregation of power in the government or in particular corporations. Thank you for listening to me.

[31] After 30 years of participating in this process I would observe that the access to company documents provides economists and lawyers unrivaled access to how firms actually operate. I would also note that the judicial process can sometimes be flawed. Individual judges can err, and appeal to a higher tribunal for various reasons is not always forthcoming. Nonetheless, over time the judicial system does identify the central truths as delimited by the law.