struggle; but, in the meantime and as a first step, we should demand that the jail-penalty provisions of these laws be abolished. It is bad enough if men have to suffer financial penalties, such as fines, under laws which everyone concedes to be non-objective, contradictory, and undefinable, since no two jurists can agree on their meaning and application; it is obscene to impose prison sentences under laws of so controversial a nature. We should put an end to the outrage of sending men to jail for breaking unintelligible laws which they cannot avoid breaking.

Businessmen are the one group that distinguishes capitalism and the American way of life from the totalitarian statism that is swallowing the rest of the world. All the other social groups—workers, farmers, professional men, scientists, soldiers—exist under dictatorships, even though they exist in chains, in terror, in misery, and in progressive self-destruction. *But there is no such group as businessmen under a dictatorship.* Their place is taken by armed thugs: by bureaucrats and commissars. Businessmen are the symbol of a free society—the symbol of America. If and when they perish, civilization will perish. But if you wish to fight for freedom, you must begin by fighting for its unrewarded, unrecognized, unacknowledged, yet best representatives—the American businessmen.

4. ANTITRUST

BY ALAN GREENSPAN

The world of antitrust is reminiscent of Alice's Wonderland: everything seemingly is, yet apparently isn't, simultaneously. It is a world in which competition is lauded as the basic axiom and guiding principle, yet "too much" competition is condemned as "cutthroat." It is a world in which actions designed to limit competition are branded as criminal when taken by businessmen, yet praised as "enlightened" when initiated by the government. It is a world in which the law is so vague that businessmen have no way of knowing whether specific actions will be declared illegal until they hear the judge's verdict—after the fact.

In view of the confusion, contradictions, and legalistic hairsplitting which characterize the realm of antitrust, I submit that the entire antitrust system must be opened for review. It is necessary to ascertain and to estimate: (a) the historical roots of the antitrust laws, and (b) the economic theories upon which these laws were based.

Americans have always feared the concentration of arbitrary power in the hands of politicians. Prior to the Civil War, few attributed such power to businessmen. It was recognized that government officials had the legal power to compel obedience by the use of physical force—and that businessmen had no such power. A businessman needed customers. He had to appeal to their self-interest.

This appraisal of the issue changed rapidly in the immediate aftermath of the Civil War, particularly with the coming of the railroad age. Outwardly, the railroads did not have the backing of legal force. But to the farmers of the West, the railroads seemed to hold the arbitrary power previously ascribed solely to the government. The railroads appeared

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unhampered by the laws of competition. They seemed able to charge rates calculated to keep the farmers in seed grain—no higher, no lower. The farmers' protest took the form of the National Grange movement, the organization responsible for the passage of the Interstate Commerce Act of 1887.

The industrial giants, such as Rockefeller's Standard Oil Trust, which were rising during this period, were also alleged to be immune from competition, from the law of supply and demand. The public reaction against the trusts culminated in the Sherman Act of 1890.

It was claimed then—as it is still claimed today—that business, if left free, would necessarily develop into an institution vested with arbitrary power. Is this assertion valid? Did the post-Civil War period give birth to a new form of arbitrary power? Or did the government remain the source of such power, with business merely providing a new avenue through which it could be exercised? This is the crucial historical question.

The railroads developed in the East, prior to the Civil War, in stiff competition with one another as well as with the older forms of transportation—barges, riverboats, and wagons. By the 1860's there arose a political clamor demanding that the railroads move west and tie California to the nation: national prestige was held to be at stake. But the traffic volume outside of the populous East was insufficient to draw commercial transportation westward. The potential profit did not warrant the heavy cost of investment in transportation facilities. In the name of "public policy" it was, therefore, decided to subsidize the railroads in their move to the West.

Between 1863 and 1867, close to one hundred million acres of public lands were granted to the railroads. Since these grants were made to individual roads, no competing railroads could vie for traffic in the same area in the West. Meanwhile, the alternative forms of competition (wagons, riverboats, etc.) could not afford to challenge the railroads in the West. Thus, with the aid of the federal government, a segment of the railroad industry was able to "break free" from the competitive bounds which had prevailed in the East.

As might be expected, the subsidies attracted the kind of promoters who always exist on the fringe of the business community and who are constantly seeking an "easy deal." Many of the new western railroads were shabbily built: they were not constructed to carry traffic, but to acquire land grants.

The western railroads were true monopolies in the textbook sense of the word. They could, and did, behave with an aura of arbitrary power. But that power was not derived from a free market. It stemmed from governmental subsidies and governmental restrictions.[1]

When, ultimately, western traffic increased to levels which could support other profit-making transportation carriers, the railroads' monopolistic power was soon undercut. In spite of their initial privileges, they were unable to withstand the pressure of free competition.

In the meantime, however, an ominous turning point had taken place in our economic history: the Interstate Commerce Act of 1887.

That Act was not necessitated by the "evils" of the free market. Like subsequent legislation controlling business, the Act was an attempt to remedy the economic distortions which prior government interventions had created, but which were blamed on the free market. The Interstate Commerce Act, in turn, produced new distortions in the structure and finances of the railroads. Today, it is proposed that these distortions be corrected by means of further subsidies. The railroads are on the verge of final collapse, yet no one challenges the original misdiagnosis to discover—and correct—the actual cause of their illness.

To interpret the railroad history of the nineteenth century as "proof" of the failure of a free market, is a disastrous error. The same error—which persists to this day—was the nineteenth century's fear of the "trusts."

The most formidable of the "trusts" was Standard Oil. Nevertheless, at the time of the passage of the Sherman Act, a pre-automotive period, the entire petroleum industry amounted to less than one percent of the Gross National Product and was barely one-third as large as the shoe industry. It was not the absolute size of the trusts, but their dominance within their own industries that gave rise to apprehension. What the observers failed to grasp, however, was the fact that the control by Standard Oil, at the turn of the century, of more than eighty percent of refining capacity made economic sense and accelerated the growth of the American economy.

Such control yielded obvious gains in efficiency, through the integration of divergent refining, marketing, and pipeline operations; it also made the raising of capital easier and

[1] I am indebted to Ayn Rand for her identification of this principle. See her "Notes on the History of American Free Enterprise" (chapter 7).

cheaper. Trusts came into existence because they were the most efficient units in those industries which, being relatively new, were too small to support more than one large company.

Historically, the general development of industry has taken the following course: an industry begins with a few small firms; in time, many of them merge; this increases efficiency and augments profits. As the market expands, new firms enter the field, thus cutting down the share of the market held by the dominant firm. This has been the pattern in steel, oil, aluminum, containers, and numerous other major industries.

The observable tendency of an industry's dominant companies eventually to lose part of their share of the market, is not caused by antitrust legislation, but by the fact that it is difficult to prevent new firms from entering the field when the demand for a certain product increases. Texaco and Gulf, for example, would have grown into large firms even if the original Standard Oil Trust had not been dissolved. Similarly, the United States Steel Corporation's dominance of the steel industry half a century ago would have been eroded with or without the Sherman Act.

It takes extraordinary skill to hold more than fifty percent of a large industry's market in a free economy. It requires unusual productive ability, unfailing business judgment, unrelenting effort at the continuous improvement of one's product and technique. The rare company which is able to retain its share of the market year after year and decade after decade does so by means of productive efficiency—and deserves praise, not condemnation.

The Sherman Act may be understandable when viewed as a projection of the nineteenth century's fear and economic ignorance. But it is utter nonsense in the context of today's economic knowledge. The seventy additional years of observing industrial development should have taught us something.

If the attempts to justify our antitrust statutes on historical grounds are erroneous and rest on a misinterpretation of history, the attempts to justify them on theoretical grounds come from a still more fundamental misconception.

In the early days of the United States, Americans enjoyed a large measure of economic freedom. Each individual was free to produce what he chose, and sell to whomever he chose, at a price mutually agreed upon. If two competitors concluded that it was to their mutual self-interest to set joint price policies, they were free to do so. If a customer re-

quested a rebate in exchange for his business, a firm (usually a railroad) could comply or deny as it saw fit. According to classical economics, which had a profound influence on the nineteenth century, competition would keep the economy in balance.

But while many theories of the classical economists—such as their description of the working of a free economy—were valid, their concept of competition was ambiguous and led to confusion in the minds of their followers. It was understood to mean that competition consists merely of producing and selling the maximum possible, like a robot, passively accepting the market price as a law of nature, never making any attempt to influence the conditions of the market.

The businessmen of the latter half of the nineteenth century, however, aggressively attempted to affect the conditions of their markets by advertising, varying production rates, and bargaining on price with suppliers and customers.

Many observers assumed that these activities were incompatible with the classical theory. They concluded that competition was no longer working effectively. In the sense in which they understood competition, it had never worked or existed, except possibly in some isolated agricultural markets. But in a meaningful sense of the word, competition did, and does, exist—in the nineteenth century as well as today.

"Competition" is an active, not a passive, noun. It applies to the entire sphere of economic activity, not merely to production, but also to trade; it implies the necessity of taking action to affect the conditions of the market in one's own favor.

The error of the nineteenth-century observers was that they restricted a wide abstraction—competition—to a narrow set of particulars, to the "passive" competition projected by their own interpretation of classical economics. As a result, they concluded that the alleged "failure" of this fictitious "passive competition" negated the entire theoretical structure of classical economics, including the demonstration of the fact that laissez-faire is the most efficient and productive of all possible economic systems. They concluded that a free market, by its nature, leads to its own destruction—and they came to the grotesque contradiction of attempting to preserve the freedom of the market by government controls, *i.e.*, to preserve the benefits of laissez-faire by abrogating it.

The crucial question which they failed to ask is whether "active" competition does inevitably lead to the establishment of coercive monopolies, as they supposed—or whether a laissez-faire economy of "active" competition has a built-in regulator that protects and preserves it. That is the question which we must now examine.

A "coercive monopoly" is a business concern that can set its prices and production policies independent of the market, with immunity from competition, from the law of supply and demand. An economy dominated by such monopolies would be rigid and stagnant.

The necessary precondition of a coercive monopoly is closed entry—the barring of all competing producers from a given field. This can be accomplished only by an act of government intervention, in the form of special regulations, subsidies, or franchises. Without government assistance, it is impossible for a would-be monopolist to set and maintain his prices and production policies independent of the rest of the economy. For if he attempted to set his prices and production at a level that would yield profits to new entrants significantly above those available in other fields, competitors would be sure to invade his industry.

The ultimate regulator of competition in a free economy is *the capital market*. So long as capital is free to flow, it will tend to seek those areas which offer the maximum rate of return.

The potential investor of capital does not merely consider the actual rate of return earned by companies within a specific industry. His decision concerning where to invest depends on what he himself could earn in that particular line. The existing profit rates within an industry are calculated in terms of existing costs. He has to consider the fact that a new entrant might not be able to achieve at once as low a cost structure as that of experienced producers.

Therefore, the existence of a free capital market does not guarantee that a monopolist who enjoys high profits will necessarily and immediately find himself confronted by competition. What it does guarantee is that a monopolist whose high profits are caused by *high prices*, rather than *low costs*, will soon meet competition originated by the capital market.

The capital market acts as a regulator of prices, not necessarily of profits. It leaves an individual producer free to earn as much as he can by lowering his costs and by increasing his efficiency relative to others. Thus, it constitutes the mechanism that generates greater incentives to increased productivity and leads, as a consequence, to a rising standard of living.

The history of the Aluminum Company of America prior

to World War II illustrates the process. Envisaging its self-interest and long-term profitability in terms of a growing market, ALCOA kept the price of primary aluminum at a level compatible with the maximum expansion of its market. At such a price level, however, profits were forthcoming only by means of tremendous efforts to step up efficiency and productivity.

ALCOA was a monopoly—the only producer of primary aluminum—but it was not a coercive monopoly, *i.e.*, it could not set its price and production policies independent of the competitive world. In fact, only because the company stressed cost-cutting and efficiency, rather than raising prices, was it able to maintain its position as sole producer of primary aluminum for so long. Had ALCOA attempted to increase its profits by raising prices, it soon would have found itself competing with new entrants in the primary aluminum business.

In analyzing the competitive processes of a laissez-faire economy, one must recognize that capital outlays (investments in new plant and equipment either by existing producers or new entrants) are not determined solely by current profits. An investment is made or not made depending upon the estimated *discounted* present worth of expected future profits. Consequently, the issue of whether or not a new competitor will enter a hitherto monopolistic industry, is determined by his expected future returns.

The present worth of the discounted expected future profits of a given industry is represented by the market price of the common stock of the companies in that industry.[2] If the price of a particular company's stock (or an average for a particular industry) rises, the move implies a higher present worth for expected future earnings.

Statistical evidence demonstrates the correlation between stock prices and capital outlays, not only for industry as a whole, but also within major industry groups.[3] Moreover, the time between the fluctuations of stock prices and the corresponding fluctuations of capital expenditures is rather short, a fact which implies that the process of relating new capital investments to profit expectations is relatively fast. If

[2] Alan Greenspan, "Stock Prices and Capital Evaluation." Paper delivered before a joint session of the American Statistical Association and the American Finance Association on December 27, 1959.

[3] For a detailed analysis of this correlation, see Alan Greenspan, "Business Investment Decisions and Full Employment Models," American Statistical Association, 1961 Proceedings of the Business and Economic Statistics Section.

such a correlation works as well as it does, considering today's governmental impediments to the free movement of capital, one must conclude that in a completely free market the process would be much more efficient.

The churning of a nation's capital, in a fully free economy, would be continuously pushing capital into profitable areas— and this would effectively control the competitive price and production policies of business firms, making a coercive monopoly impossible to maintain. It is only in a so-called mixed economy that a coercive monopoly can flourish, protected from the discipline of the capital markets by franchises, subsidies, and special privileges from governmental regulators.

To sum up: The entire structure of antitrust statutes in this country is a jumble of economic irrationality and ignorance. It is the product: (a) of a gross misinterpretation of history, and (b) of rather naive, and certainly unrealistic, economic theories.

As a last resort, some people argue that at least the antitrust laws haven't done any harm. They assert that even though the competitive process itself inhibits coercive monopolies, there is no harm in making doubly sure by declaring certain economic actions to be illegal.

But the very existence of those undefinable statutes and contradictory case law inhibits businessmen from undertaking what would otherwise be sound productive ventures. No one will ever know what new products, processes, machines, and cost-saving mergers failed to come into existence, killed by the Sherman Act before they were born. No one can ever compute the price that all of us have paid for that Act which, by inducing less effective use of capital, has kept our standard of living lower than would otherwise have been possible.

No speculation, however, is required to assess the injustice and the damage to the careers, reputations, and lives of business executives jailed under the antitrust laws.

Those who allege that the purpose of the antitrust laws is to protect competition, enterprise, and efficiency, need to be reminded of the following quotation from Judge Learned Hand's indictment of ALCOA's so-called monopolistic practices.

> It was not inevitable that it should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel.

ALCOA is being condemned for being too successful, too efficient, and too good a competitor. Whatever damage the antitrust laws may have done to our economy, whatever distortions of the structure of the nation's capital they may have created, these are less disastrous than the fact that the effective purpose, the hidden intent, and the actual practice of the antitrust laws in the United States have led to the condemnation of the productive and efficient members of our society *because* they are productive and efficient.