PS
668
.K25

# Department of Justice

FOR RELEASE ON DELIVERY

Address by

ATTORNEY GENERAL NICHOLAS deB. KATZENBACH

before the

NATIONAL INDUSTRIAL CONFERENCE BOARD

Waldorf-Astoria Hotel, New York City

12:30 p.m., Tuesday, September 20, 1966

Chairman Helm, Sir Thomas, Members of the National Industrial Conference Board:

I hope that none of you has come to this luncheon in anticipation of a great debate in either the traditions of the United States Senate or the Oxford Union. The harsh truth is that this fight is fixed. The terms of debate are collusive. And the restraint of competition between Sir Thomas and myself is deliberate.

The authorities are enviable stage-managers. In selecting Sir Thomas they have chosen a voice of reason as well as a man of exceptional foresight. Sir Thomas sent me his address six weeks ago. I hardly did as well by him, but my words will not come as complete surprise to him either. I doubt, therefore, that you will find any gladiatorial overtones in our remarks. Indeed the program announces this as a "colloquy."

I must depart in only one particular from the careful brief I was given by the management. Sir Thomas and I were cautioned not to be splenetic or antagonistic--advice easy to follow--but we were also entreated to cleanse our language and avoid as much as possible such emotive terms as "antitrust."

I fear that as Attorney General this would require excessive self-abnegation. For to discuss business size and national economic growth involves centrally an appraisal of our antitrust policy. I will, promise, however, to avoid legalisms which would only lose you--and me--in a trackless jungle.

## I.

I think it fair to say that a strong antitrust policy has not won universal acceptance among leaders of our business community. The President of the United States Chamber of Commerce has recently called the antitrust laws "outmoded" and added that present policy "works at cross purposes with economic objectives of maximum growth and efficiency." 1/

Fortune Magazine argues that our attempt to prevent undue concentration in a market "frustrates the natural tendency of business to adjust to changes in technology, merchandising, finance, and corporate organization by growing bigger and by merging." The net effect, according to Fortune, is to impede innovation and progress. 2/

Others have argued that to prevent mergers that unduly increase market shares of the merging firms may discourage firms from growing in size, and this may impede technological progress.

The editors of Fortune are heirs to a distinguished blood line of economic scholarship. I am sure, for example, that their views were bolstered by a magisterial text, Recent Economic Changes, by Professor David Wells of Harvard, who wrote:

> 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. 3/

Professor Wells likely would agree, too, with the observation by George Gunton that "the concentration of production capital" is "the most effective, if not the only means of remedying . . . [a] constant social calamity." 4/

What Professor Wells wrote--in 1889, and what Mr. Gunton wrote--in 1899, obviously lack no adherents today. But it must be admitted, at least, that the enforcement of our antitrust laws has been less than a "constant social calamity."

This enforcement has not prevented what, by any historical test, has been an astonishing record of economic progress. We may rightfully suspect that antitrust has made an affirmative contribution to this program.

To say this does not, of course, dispose of the argument. There have indeed been drastic changes in our economy since the Sherman Act was passed seventy-five years ago:

--Our national income in terms of current prices has grown twelve times.

--The businessman of today is far more perceptive, knowledgeable, and sensitive to the public interest than his predecessors.

--Throughout the managerial community, the economic role of innovation and the introduction of new processes and products is much more fully appreciated.

In short, the traditional arguments against a strong anti-concentration policy have been shown to be wrong when laid against economic patterns of the past. But surely it is rational now to ask whether the reincarnations of the old arguments might not have new relevance, against the greatly **changed economic** patterns of the present. Is it not possible that the arguments have thus acquired a new, persuasive, respectability?

Respectable they surely are. Persuasive, in my opinion, they are not. And I would like to spend a few minutes telling you why I believe concentration cannot be justified any better now than it was 70 years ago. Then I would like to explain why I believe not only that these positive justifications are false, but that concentration has a negative impact on economic growth.

II.

There seem to me to be five principal arguments in the modern case for concentration. Let me consider each of them.

1. Efficiency.

First, it is argued that mergers, by producing bigger companies, produce more efficient companies. "Remember Henry Ford and the assembly line" one hears. A merger, it is claimed, like a marriage, allows two to live more cheaply than one. Thus, by preventing mergers when they increase concentration substantially, the antitrust laws obstruct the provision of cheaper goods to the American public.

The trouble with this argument is that it does not square with the facts. What economic evidence there is on the subject 5/ suggests that many firms in concentrated industries are far larger than necessary to produce goods at the lowest possible costs.

In other words, most industries can easily sustain many competing firms, each using assembly-line production techniques. American markets tend to be large enough to allow firms to enjoy all important efficiencies of size, without dangerously restricting the number of competitors.

If economies of scale ascended in proportion to size, one would expect to find large firms enjoying higher profits. And yet, one study shows that, in general, profit rates of medium-sized firms are as large as those of giant firms. 6/ There is little, if any, evidence justifying concentrated markets on the grounds of economic efficiency.

Moreover, we should keep in mind that while the antitrust laws do indeed prohibit some mergers, they do not prohibit any firms from growing internally. This route is explicity left open to insure that firms can achieve those economies and efficiencies they may find in large size. It is difficult to believe that significant economies will long go unrealized because a particular merger has been prohibited.

2. Research and Development.

A second argument for concentration is the freqent plausible claim that large firm size and monopoly are necessary to support creative and efficient research.

We are told that today's inventor no longer lives in a basement or wears a green eye shade. Rather, he is the well-trained, efficient scientist--a member of a research team working in the laboratory of a large corporation.

Paying him and his colleagues to look for new plastics or electronic devices, or to turn a drawing board idea into a marketed product, is an expensive business. Thus a corporation must be large indeed, it is added, to pay for the steady research underlying Schumpeter's "gale of creative destruction" which represents the pinnacle of modern capitalism's achievement.

Statistical evidence supports the view that small firms are less likely to engage in research than large firms, 7/ but most markets in this country are big enough to support many large competing firms--they can even support several giants. Since markets are likely to become concentrated only when large firms are replaced by giants--or giants by super-giants--the crucial question is not whether large firms conduct more or better research than small firms, but how large firms compare with giants and with super-giants. 8/

The best evidence strongly suggests that firms simply do not need to be immense to support an adequate research establishment.

When Edwin Land developed his revolutionary camera, the Polaroid Corporation was not an industrial giant with vast research facilities. It was a million-and-a-half dollar firm specializing in sunglasses.

The Xerox Corporation is not founded on the products of extensive laboratories. Rather, its success began with a gamble made in 1955 by a small Rochester, New York firm on the invention developed by Frank Carlson in his New York City apartment.

And the oxygen converter--a pathbreaking advance in steel manufacturing was not promoted by one of the steel giants. It was first put to use in a very small company and then adopted in two of the smaller steel corporations.

Indeed, it has been found in repeated studies that among firms which undertake research, the laboratories of the smaller firms tend to be as large and productive as those of their larger rivals. 9/ In fact, a recent study of the drug industry concludes that once drug firms grow past a moderate size, their research techniques seem to become more cumbersome, for their research and development has proved less efficient and fruitful. 10/

In the chemical, petroleum, and steel industries, too, there is great evidence that the inventive output per dollar of R&D expenditure generally is lower in the largest firms than in large and medium-sized firms. 11/

The popular belief that we must pay the price of increased concentration and reduced competition in order to buy effective and efficient research appears to be almost weightless.

3. Managerial Scarcity.

A third modern justification for concentration is the claim that mergers put to their most efficient use at least one very important ingredient in the production of each and every product--managerial brains.

As you gentlemen well know, talent is scarce, and a talented manager should not go unused. The large size of this audience, however, which itself is only representative of a much larger array of talent, strengthens the view that good management is not so scarce. Surely it is not so scarce that it can only be achieved by permitting levels of concentration well beyond what other economies of scale would dictate.

If one of the firms in a proposed merger has bad management, its salvation most obviously lies in seeking new executives. I suspect it is the rare situation in which the only way to buy good management is to buy a competing company. The Yankees, for example, didn't merge with the Twins; they fired Johnny Keane (and discovered their problem wasn't management at all).

Even if there were shortages in managerial talent, we have plainly entered into a generation of superb managerial training, not only in the splendid schools of business administration, but also in the growing array of sabbatical and mid-career programs being conducted around the country. (Indeed, some businessmen are even willing to concede the educational benefits that accrue from working for a time in the government.)

4. Improved Competition.

As the fourth argument on behalf of concentration, we often hear two companies contend that if they are allowed to merge they will be able to compete better with the industry leader.

This argument is frequently made and sometimes it has merit. There are occasions, for example, when a manufacturer can demonstrate overriding advantages of a conglomerate merger with a large enterprise.

It is not the policy of the Department of Justice to oppose all mergers. Indeed, we go to court to oppose only about 20 of the 1,000 mergers consummated each year, some of them involving very large companies indeed.

Generally, however, when the major justification raised by merging companies is that they would be able to compete better against an industry leader if they merge does not withstand analysis.

If the two firms are basically inefficient, it is difficult to see how a merger can cure their problems. Second, as I have already suggested, if the merger is so substantial as to be anti-competitive, it also would exceed economies of scale, and only rarely would it be necessary to achieve savings in production costs.

Third, if we allowed the second and third firms in an industry to combine in order to compete better with the largest firm, we should also have to allow the fourth, fifth and sixth largest firms to combine to do the same, and so on. We might soon discover that a competitive industry containing twenty firms had been turned into a non-competitive one containing only two or three.

5. Saving the Community.

The fifth and final argument on behalf of concentration is that a merger with competitors will bring great benefits to the community concerned. The argument usually takes the following form:

Company A, which is in a weak or failing condition, would like to sell out to a large competitor, B. Company A, and the community in which A is located, argue that the sale should be allowed, even if it lessens competition, for sale to B provides the strongest possibility that A will not be shut down with a consequent loss of jobs and general hardship to the community.

I believe that we should reject this argument for several reasons. First, if A is actually failing, the antitrust laws do not forbid its sale, though they might require A's owner to try to sell to other firms before he sells to A's largest competitor.

Second, the sale of a weak but not failing company to a large firm in the same industry might not, after all, save the jobs of A's employees. If A were in such rocky condition, the buying company might well decide to close down the plant.

Finally, if fear of unemployment justifies an anticompetitive merger in one community it justifies such mergers in all similar communities. To accept such a justification therefore may well reduce competition--and employment--throughout the country.

In the short run as well as in the long run, a reduction in competition tends to produce higher prices, lower sales, and thus lower employment for the industries concerned. It makes little sense to pay so high a price for so uncertain and unlikely reward.

To summarize my response to all five arguments, then, in the United States an easy acquiescence in mergers which significantly increase concentration is not necessary to economic efficiency or to a lively rate of technological innovation and progress.

III.

A harder test of antitrust policy is the specific one raised by the title of this colloquy. Does a strong policy against concentration in fact actively promote economic growth and progress?

There are traditional reasons for believing that this is so. There are also, I suggest, some newer patterns in our economy which suggest the continued, perhaps even increased validity of the type of anticoncentration policy we are pursuing.

The traditional premise of our policy is that competition leads to an economic system more efficient and productive than any other. Both theory and experience teach us that when a market becomes highly concentrated, the intensity and effectiveness of competition are reduced. 12/ Thus, by preventing the development of concentrated markets, we expect by and large to achieve better market performance.

The fact that lack of competition produces lazy industries, just as lack of exercise produces flabby executives, can be easily observed.

A recent study has examined the popularly held belief that American firms are more productive than their European counterparts because they enjoy better technology. It concludes, however, that "in most industries the best British firms equal the best American in efficiency. The real difference between the two nations' industries is in the average firm. The average American firm is usually much closer to the best commercial practice than is the average British firm." 13/

The author of this study goes on to suggest that a major reason for this difference may be that American firms are likely to be more competitive than those in Britain, and inefficient American firms are more likely to get pushed to the wall. He concludes that "in America the prevalence of competitive behavior tends to make industrial research compulsory for all once it gets a foothold in an industry. In consequence, corporate research is far more common in America." 14/

I do not mean to suggest that all unconcentrated industries are more competitive than all concentrated industries. Some industries remain competitive despite the presence of only a handful of firms. I do mean to suggest that, as a general rule, increased concentration tends to remove the competitive goad to industrial vitality.

Antitrust law, like all law, to be workable and tolerable must operate by means of general rules. The benefits of a general rule prohibiting mergers that significantly increase concentration heavily outweight, in my opinion, any inhibitions, any injuries that such a rule might impose in exceptional cases.

So much for the traditional appraisal of the evils of concentration. There is, in addition, a less traditional argument for a strong antitrust policy against concentration--that such a policy helps to promote economic growth by making inflation easier to control.

In essence, the argument is, first, that concentration may add to inflationary pressures because of the power of concentrated industries to set prices relatively independent of market factors and second, that by making inflation more difficult to control, concentration can interfere with full employment and rapid economic growth.

If industries in our economy are concentrated or tend to become concentrated, inflationary pressures may be increased in several ways. Firms in concentrated industries tend to cooperate in exercising shared monopoly power, and this enables them to push up prices even when costs are stable and demand does not exceed supply. 15/ Increasing concentration in an industry thus may well be accompanied by increasing prices even when excess demand does not generally exist.

Further, the fact that an industry is concentrated can act as a brake on any tendency for prices to fall. For example, increased productivity or other factors may well lead to lower costs. But these do not then as readily result in lowered prices as in non-concentrated firms.

There is, finally, some reason to believe that the higher profits earned by firms in concentrated industries becomes a target for labor wage demands higher than increases in productivity may justify. It is easier, at the same time, for firms in concentrated industries to pass on the costs of wage increases to the public. 16/ And these wage increases have a broader effect because of the pressures they create for the leaders of other unions, in non-concentrated industries, to seek parallel gains.

Concentrated markets are not the major factor responsible for inflation in the American economy. I do believe, however, that they play a significant, if complex, role in almost all modern inflations--a role that promises to become increasingly important.

Insofar as concentration contributes to inflation, it tends to retard economic growth. Costly experience has taught us that the environment most conducive to rapid economic progress is not characterized either as inflationary or deflationary--it is one free of both significant unemployment and rapidly rising prices. The dislocations caused by inflation and any excessively deflationary reactions that it may provoke can well restrict the rate at which our economy expands.

There is then no question but that inflation must be controlled. As President Johnson observed in his recent message to Congress, "Inflation imposes a cruel and unjust tax on all the people . . . When total spending rises more rapidly than the economy can accommodate--when business investment creates undue pressures--when armed conflict overseas imposes new burdens on government--then we must be willing to shift into lower gear and reduce inflationary pressures."

The President's recommendations to defer and to reduce federal expenditures and to suspend temporarily the investment tax credit are designed to distribute the burden of anti-inflationary measures more equitably. And they are designed to control inflation while at the same time maintaining an economy which operates at full capacity. In short, these recommendations seek to combat the harm that inflation can cause individual Americans and the nation as a whole in our search for rapid and orderly economic progress.

The case I am making today is the case for antitrust and for our attentive policy concerning mergers. I submit that the task of controlling inflations is easier and will be easier in the future if, through persistent efforts to deal with the problems of market power in the Antitrust Division, we continue to contribute to the reduction of conditions of concentration.

My conclusion is simply that as our nation's economy expands and as technological progress becomes increasingly important, we have need more than ever to adhere to the 75 year-old still salutary, principles embodied in our antitrust laws.

## NOTES

1. New York Times, Sept. 9 1966, p. 65.

2. Fortune, March 1966, p. 128.

3. Wells, "Recent Economic Changes," 74 (1889)

4. Gunton, "Large Aggregations of Capital," Trusts and the Public, 78-79, (1899)

5. Among the most significant of these studies is one done by Professor Bain. He measured the extent of scale economies within 20 leading manufacturing industries. In this manner he attempted to determine the minimum plant size which is sufficiently large to realize all plant size which is sufficiently large to realize all of the cost savings associated with mass production. On the basis of this analysis, he examined whether the extent of existing concentration was greater or less than the level which was required for economic efficiency. He concluded that "referring to the first four firms in each of our industries, it appears that concentration by the large firms is, in every case but one, greater than required by single-plant economies, and in more than half of the cases very substantially greater." Joe S. Bain, Barriers to New Competition, p. 111. See also J. Johnston, Statistical Cost Analysis.

6. Sidney S. Alexander, "The Effect of Size of Manufacturing Corporation on the Distribution of the Rate of Return," Review of Economics and Statistics, Vol. XXXI, No. 3, August 1949, pp. 229-235.

7. Jacob Schmookler, "Technological Progress and the Modern American Corporation" in Mason, The Corporation in Modern Society, 162 (1960).

8. Carl Kaysen and Donald F. Turner, Antitrust Policy, (1959) pp. 84-85.

9. In a recent study Professor Worley found that among firms which support research establishments smaller firms tend to spend proportionately as much as their larger rivals. J.S. Worley, "Industrial Research and the New Competition," Journal of Political Economy, April, 1961. Another interesting study shows that between 1899 and 1937 industries in which labor productivity increased most sharply were those in which concentration declined. George J. Stigler, "Industrial Organization and Economic Progress," as reprinted in Harry J. Levin, Editor, Business Organization and Public Policy pp. 131-133. A third study examined the rate of innovation within manufacturing industries

## NOTES

9. (continued) as measured by the number of patents issued to firms within these industries. This study concludes that "Inventive output (as measured by patents granted) increased with firm sales but generally at less than a proportionate rate." F.M. Scherer, "Firm Size and Patented Inventions," American Economic Review, December 1965, pp. 1097-1125. A fourth study examined the relative efficiency of large and small research laboratories in the pharmaceutical industry. On the basis of a statistical investigation the author included that "in the pharmaceutical industry, there are substantial diseconomies of scale in research and development; and that these disadvantages are encountered even by moderately sized firms." W.S. Comanor, "Research and Technical Change in the Pharmaceutical Industry," Review of Economics and Statistics, May 1965, p. 190.

10. Comanor, "Research and Technical Change in the Pharmaceutical Industry," Review of Economics and Statistics, May 1965, p. 190.

11. Edwin Mansfield, "Industrial Research and Development Expenditures: Determinants, Prospects, and Relation to Size of Firm and Inventive Output," Journal of Political Economy, August 1964, Vol. 72, p. 336.

12. That significant increases in concentration in the production of particular products will normally lead to less competition is strongly supported by empirical evidence. Professor Caves has pointed out: "We would expect from economic theory that high concentration . . . would tend to produce high profit rates . . . by giving firms a chance to garner some of the potential monopoly profits . . ." "This prediction," adds Professor Caves, "turn[s] out to be accurate." Richard Caves, American Industry: Structure, Conduct, Performance, (1964) p. 104. A study by Professor Bain on the relation of profit rates to industry concentration in 40 industries defined more or less along traditional product lines shows a significant correlation between higher than average profits and high concentration. Joe S. Bain, "Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-1940," in the Quarterly Journal of Economics, Vol. LXV (August, 1951) pp. 293-324. A more recent study shows that among industries with medium entry barriers (again defined along traditional product lines), the industry that is more highly concentrated shows higher profits. Joe S. Bain, Barriers to New Competition, ch. 7, pp. 182-204.

13. Schmookler, op. cit. supra at 148.

14. Ibid.

NOTES

15. The Annual Report of the Council of Economic Advisors January 1965, p. 107

16. Segal, "The Relation Between Union Wage Impact and Market Structure, in Quarterly Journal of Economics, February 1964; Eckstein & Wilson, "The Determination of Money Wages in American Industry," in Quarterly Journal of Economics, August 1962.