ADDRESS

by

DONALD F. TURNER
Assistant Attorney General
in Charge of the
Antitrust Division
U. S. Department of Justice

Prepared for Delivery

Before the

INSTITUTE OF ADVANCED LEGAL STUDIES

London, England

Monday, June 5, 1967

I should like to discuss with you this evening American antimerger policy -- whether it appears to make sense, or as an ample supply of critics maintain, it is antiquated or just plain foolish. American antimerger policy, as you may be aware, has become rather strict. It is based upon the traditional economic view that when a market becomes highly concentrated or oligopolistic in structure, the intensity and effectiveness of competition -- and in particular price competition -- are likely to diminish. Each of the major sellers bulks so large in the market that a price cut by one cannot be ignored by the others, but must immediately be matched. Price cutting therefore does not pay, and tends to be avoided; "parallel policies of mutual advantage, not competition * * * emerge."

Our antimerger policy - which reflects our hostility to concentration, - by and large does not allow two substantial viable competing companies to merge. This position was recently upheld by our Supreme Court in the Von's Grocery case, a case that involved a merger between two relatively substantial grocery chains in the Los Angeles market -- Von's with approximately 4.7% of total retail sales in 1958 and Shopping Bag with approximately 4.2%. The aggregate market share of the eight largest chains in the Los Angeles market -- a group which included Von's and Shopping Bag -- has risen from 33.7% in 1948 to 40.9% ten years later.

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

The major attack upon the strong antimerger/anti-concentration-policy that I have described is based upon the proposition that technological and other economic developments make large size and industrial concentration not only necessary but desirable. There is nothing startingly new in this proposition. As long ago as 1889 Professor David Wells of Harvard 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.

And, in 1899, George Gunton wrote that "the concentration of production capital" is "the most effective if not the only means of remedying . . . [a] constant social calamity." The most recent source of this type of criticism is not the United States, however, but England. For, like Ovid in exile at Tomi, Professor Galbraith has been writing in London. And last winter the BBC's listeners heard the distinguished successor of Wells assert that

> Oligopoly is combined in one of the more disconcerting contradictions of economic theory with efficient production, expansive output and prices that are generally thought rather favorable to the public.

Stating his belief that large size and concentration are needed to achieve planning efficiency, he concluded that

> Modern antimonopoly and antitrust laws are a charade.

I shall not burden you with a detailed treatment of Professor Galbraith's comments, but it seems to me that he is as wrong today as his predecessor was 70 odd years ago and I should like to take advantage of this visit here to restate the reasons why I think so. My conclusions on this question rest largely upon economic studies of American industry and they thus may not be directly applicable to the British situation. You may, therefore -- thanks to the BBC --

find yourselves witnessing an extraterritorial debate about what is basically American policy. Nevertheless, I am convinced that the arguments in the debate -- if not the exact figures and statistics -- may have considerable relevance for British economic planning.

The major reason for believing that a strong anti-concentration policy is as appropriate today as it ever was is that there has been no evident shift in America over the past years in the direction of "natural monopoly" or "natural oligopoly." This is simply to say that there is no greater need to have industries composed of one or a few firms in order to have firms big enough to be efficient. It is, of course, important to allow firms of sufficient size to realize economies of scale, and it is clear that such economies have dictated larger sized companies in some industries than once were required. But the markets for most products have been growing as well -- often at least as fast -- so that by and large there has been no decline in the number of efficient competitors that industries have room for. What economic evidence we have on the subject shows that in America many firms in concentrated industries are far larger than necessary to produce goods at the lowest possible cost. If there were continuing economies of scale, one would expect the largest firms in industries to have higher profit rates than their smaller brothers. But the evidence shows that while average profit rates increase as the size of firms grow to

approximately $5 million, there is no correlation between size and profit rates beyond that point. 1/

Nor do we have any reason to believe, though it is repeatedly asserted as if it were obvious gospel truth, that there is any such relation between size and technological progress as would warrant any significant constraints on antimerger policy. We have had several empirical studies testing the validity and dimensions of the proposition that both the amount of research and the efficiency of research is correlated with size of firm. They tend to show that many more large firms (with 5,000 or more employees) do research than small firms (with less than 500 employees) do. But once we get a firm large enough to do organized research at all there are no evident economies of scale either in research for size of firm or in research productivity for any given amount spent. 1a/

It is of course true that large firms are more likely to have research operations than small firms. Nevertheless, among firms which do have research organizations, smaller firms tend to spend proportionately as much as their larger counterparts, as is true in the petroleum and glass industries, and in some instances they spend more. In a study of the patent behavior of 448 firms selected from Fortune's list of the largest 500 industrial corporations in 1955, the author concluded that the evidence does not support the hypothesis that "corporate bigness is especially favorable to high inventive output." 2/ As for the

efficiency of the research done, another author concluded that "in most industries the productivity of an R&D program in a given scale seems to be lower in the largest firms than in somewhat smaller firms" 3/; and in a further study it was found that diseconomies of scale in the pharmaceutical industry were encountered in even moderate firm sizes. 4/ These studies support the conclusion that for efficient research and development we may need large firms -- ranging perhaps from $10 million to $100 million depending on the industry -- but they cast doubt, to say the least, upon the need for giants and super giants.

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

> There is a great deal of evidence that almost all organizational structures tend to produce false images in the decision-maker, and that the larger and more authoritarian the organization, the better the chance that its top decision-makers will be operating in purely imaginary worlds. This perhaps is the most fundamental reason for supposing that there are ultimately diminishing returns to scale. 5/

Although the ability to handle great masses of information has been increased by use of the computer, there is no indication that changes resulting from the introduction of the computer have been so important

as to require giant sized firms. Surely in the face of all this the least that can be said is that the burden of proof is on those who claim that there is a sufficiently important relation between size on the one hand and progressiveness or efficiency in planning on the other to warrant a drastic cut-back in antimerger policy. I see no indication that Professor Galbraith has sustained this burden.

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

While there is no decisive evidence on the question of the relation of concentration to efficiency at any given time, there is nothing substantial to refute the strong a priori case that high concentration will tend to produce slack and inefficiency. I will only cite a study

which showed that between 1899 and 1937 the industries in which labor productivity increased most sharply were those characterized by declining concentration. 6/ Not only that, industries of low concentration showed better performance than those with high. Since much research and innovation is directed at lowering costs, thus leading to higher levels of output per man-hour, these studies suggest that increasing concentration leads to less innovation rather than more. Thus, I repeat again that there is no reason for us to believe that our traditional concern for market structure -- our traditional effort to prevent undue concentration -- deserves to be discarded.

In any event, Professor Galbraith does not make clear just how increased concentration is meant to improve planning efficiency. If concentration allows firms to keep their prices steady, and if demand for their products changes, their output will vacillate radically. And, if output continually vacillates, firms are not able to plan any better than if their prices shift. In fact, because of its disturbing implications for employment, radical shifts in output are probably less desirable than shifts in price.

If Professor Galbraith is arguing that increased concentration allows both prices and output to remain steady despite shifting demand, I doubt very much that he is correct. He claims that when sales begin to fall, firms can respond by increasing promotional activities; that is to say, they can spend more money on advertising and thus keep

demand for their products high. But, whether the strategy that Professor Galbraith suggests works in practice is dubious. Since American automobile manufacturing is an industry in which giant size exists, it should presumably display the stability that Professor Galbraith has in mind. Yet even in the automobile industry over the past six months we have seen considerable change in industry output and effective auto prices. Moreover, since advertising and similar promotional efforts work well only with consumer goods, Professor Galbraith's argument does not apply to the producer goods sector at all. In any event, it is not clear why it is desirable to pursue single-mindedly a single goal of output and price stability.

Of course Professor Galbraith may only be saying that concentrated industries are less subject to the vagaries of the market place than industries with a large number of smaller firms. Even if this is true, however, no one is proposing that all industry structure should consist of a large number of small firms. Most economies, including efficiencies in planning, can ordinarily be achieved by firms that are large but not giant size. High concentration is rarely needed. However, even if Galbraith were right in believing that giant size and concentration helps firms plan more efficiently, he does not indicate the extent to which planning efficiency is improved, and therefore, he does not make clear whether the game is worth the candle. I have no reason to believe that any increase in planning efficiency that great size and concentration

may create could outweigh the considerable harm caused by their effect in limiting competition -- harm which may take the form of higher prices, diseconomies of control, and a lower rate of innovation.

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

In concluding, I should like to remind you once again that what I have said is more obviously applicable to the American economy than to any other. Markets and firm size in the United States are already so large that it is rare that additional mergers are needed to create efficient production. In smaller economies with smaller firms mergers may be desirable in order to lay the groundwork for creating efficient production size. I express no views on that question. I do believe strongly, however, that Europeans should not take the fact that America has many giant sized firms as demonstrating that they should encourage increases in firm size to that point. Many American firms are larger, some much larger, than any good economic reason would compel. I respectfully suggest that any European program of permitting or promoting mergers would do well to take this into account.

FOOTNOTES

1/ 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.

1a/ J. S. Worley, "Industrial Research and the New Competition," Journal of Political Economy, April 1961.

2/ F. M. Scherer, "Firm Size and Patented Inventions," American Economic Review, December 1965, pp. 1097-1125.

3/ Edwin Mansfield, "Industrial Research and Development Expenditures: Determinants, Prospects, and Relation to Size of Firm and Inventive Output," Journal of Political Economy, August 1964, 72, p. 338.

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

5/ Kenneth E. Boulding, Richard T. Ely Lecture, Seventy-eighth Annual Meeting of the American Economic Association.

6/ George J. Stigler, "Industrial Organization and Economic Progress," as reprinted in Harry J. Levin, Editor, Business Organization and Public Policy, pp. 131-133.