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Commentary: Antitrust 1889

Frank H. Easterbrook*

I'm delighted to participate in this celebration of antitrust's centenary but puzzled about why I should have been invited. Federal judges have no insight into state antitrust laws, and my career as a scholar did not supply the omission. I accepted the assignment in the hope that I would learn something about a topic new to me.

My first discovery concerning early antitrust laws is that there isn't much history of state antitrust laws worth learning. After all, 1888 and 1889 were the years of the principal debates in Congress on the Sherman Act.[1] The law was enacted in 1890 almost as an afterthought; Congress was reaping what had been sown. States and Congress plunged into the abyss together, and as Professor Millon's paper demonstrates it is hard to tell them apart.

That we celebrate state law supposes, however, that there is a difference. What could it be? To the extent we can distinguish the genesis of the state and federal antitrust laws, what should we like to know about the states, or about Kansas, in 1889? Here is a list:

1. Why 1889, for Kansas and the United States together? If there were some national paroxysm, simultaneity is to be expected; if not, legislation strung through the years is more likely. What happened that caused so many jurisdictions to act at the same time?
2. Why the particular kind of law that ensued? That is, statutes based on common law, which refused to *enforce* cartel agreements and other *unreasonable* restraints, but did little to penalize them or to define them?
3. Why did nothing happen? Neither state nor federal laws led to significant numbers of prosecutions, public or private, for a long time.[2] The initial cases tended to concern railroads; think of the *Trans-Missouri* case,[3] which set the pattern for the federal antitrust law after the disastrous adventure of *E.C. Knight*.[4]
4. Many agricultural cooperatives are hard to distinguish from cartels. Yet none was prosecuted—and when the threat of prosecution appeared on the horizon, Congress quickly enacted the Capper-Volstead Act of 1920 to make

* Judge, United States Court of Appeals for the Seventh Circuit; Senior Lecturer, The University of Chicago.

1. *See* W. LETWIN, LAW AND ANTITRUST POLICY IN AMERICA 53-95 (1965).
2. *See* Posner, *A Statistical Study of Antitrust Enforcement*, 13 J.L. & ECON. 365 (1972).
3. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).
4. United States v. E.C. Knight Co., 156 U.S. 1 (1895).

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it go away.[5] This antitrust exemption retains almost sacred status although others, such as the exemption for insurance, have fallen into disfavor.

5. Why did the laws not deal with mergers? A cartel or trust is a loose assemblage of firms, and competition may break out again. The state and federal laws prohibited these cartel agreements. But they did not prohibit all mergers, a much longer-lasting form of aggregation. Although mergers can be called "combinations" in restraint of trade, not until the Clayton Act of 1914 did anyone treat the antitrust laws as addressing the subject.[6]

To understand what happened, we ought to ask what led to a set of laws with remarkable similarities. Here are the things one can say positively—the facts in need of explanation: the action took place in 1888-1890, not before; the laws largely followed the common law in committing to courts the definition of what would be prohibited; neither state nor federal executive branches acted to enforce the laws, and took after the railroads rather than the trusts first; until the Clayton Act was amended in 1950 to include sales of assets, antitrust law pretty much ignored mergers; and antitrust has never been applied to agricultural cooperatives.

I don't doubt for a second that the antitrust laws produced important benefits.[7] The question is why they were enacted when they were, in the form they were. No readily observable change in the late nineteenth century supplies an explanation. Surely laws didn't change because of Jefferson's views (which had been around for a century and so can't explain something unique to the 1880s) or to a burning bush seen by the economics profession on the way to Lawrence, Kansas, in 1889. Economists were hostile to antitrust laws in the nineteenth century—not until the 1930s did they work out a useful theory of imperfect competition.[8] Neither was it an outbreak of hostility to business in general. Survey data show that 1880-1892 was an unusually good time for public perceptions of business.[9] Just three months after passing the Sherman Act,

5. 7 U.S.C. § 291 (1920); *see also* National Broiler Marketing Ass'n v. United States, 436 U.S. 816 (1978).

6. One of the ironies of early antitrust enforcement is that the *Addyston Pipe* case, United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898) (Taft, J.), *modified & aff'd*, 175 U.S. 211 (1899), did away with the cast iron pipe cartel only to induce an industry-wide merger, which no one challenged. *See* Bittlingmayer, *Decreasing Average Cost and Competition: A New Look at the Addyston Pipe Case*, 25 J.L. & ECON. 201 (1982).

7. Some meager data may be found in Stigler, *The Economic Effects of the Antitrust Laws*, in THE ORGANIZATION OF INDUSTRY 259 (1968). Other, more recent data show that the antitrust laws reduce the incidence of cartels. *E.g.*, Block, Nold & Sidak, *The Deterrent Effect of Antitrust Enforcement*, 89 J. POL. ECON. 429 (1981).

8. *See* Stigler, *The Economists and the Problem of Monopoly*, in THE ECONOMIST AS PREACHER 38 (1982).

9. L. GALAMBOS, THE PUBLIC IMAGE OF BIG BUSINESS IN AMERICA, 1880-1940 (1975).

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Congress enacted the McKinley Tariff Act, a monstrously anti-consumer piece of legislation that fed the trusts (by curtailing the power of foreign competition) and led to a recession in 1892. Antitrust predated that downturn. So how is one to understand its adoption?

Although there were "great trusts" at the time, these were thought to be problems of corporate law. "Do we allow holding companies?" was the question Ohio and New Jersey had to resolve in dealing with Standard Oil Company. Standard Oil was an umbrella for firms already under common control. Its organization did not eliminate competition that otherwise existed.[10] Real trusts, such as the Sugar Trust, comprised independent businesses and so could in principle increase prices. Yet consumers' prices were falling rapidly in the decade before 1889. Efficiencies in production, whether or not made possible by the trusts, were swamping monopoly effects.[11]

The booming economy does offer clues about some of the pattern, however. Mergers allow coordination of production in a way that trusts do not. They also avoid the holding of excess capacity, a common phenomenon because cartels allocate quotas by reference to capacity. Thus mergers, with the greatest potential for efficient production, might sensibly be left alone even though trusts hold the greater potential for sudden increases in competition if they break down.

A booming economy and the exclusion of mergers also lead me to doubt some of Professor Millon's explanation. He says that the aggregation of economic power threatened American ideals and led to the statutes. Yet there was no upsurge in economic concentration in the 1880s, and the exception for mergers allowed economic concentration to continue unabated. The upsurge of concentration came later, in the Great Merger Wave of 1897-1904.[12] Moreover, one can't readily understand antitrust laws by reference to concern for small dealers. Cartels yield manna for small dealers, which can charge the cartel price without curtailing their output. Small dealers are the greatest proportional gainers from trusts—if they don't get the higher price, they'll get the privilege of being bought out.[13]

10. Standard Oil was a very large company, and much of its profitability lay in managerial innovations that decreased the cost of coordinating production from exploration through delivery. Large enterprises may benefit from multidivisional rather than pyramidal organization. *See* O. WILLIAMSON, MARKETS AND HIERARCHIES (1975); A. CHANDLER, JR., THE VISIBLE HAND 321-27, 416-31 (1977) (discussing Standard Oil in particular). The holding company structure (one corporation owning stock in subsidiaries) may be valuable in organizing the firm. Yet until the late 1890s, when New Jersey changed its law to allow one corporation to own stock in another, holding companies were not possible in the United States. Thus the "trust" form, and several variations, for Standard Oil.

11. L. TELSER, A THEORY OF EFFICIENT COOPERATION AND COMPETITION 25-47 (1987).

12. *See* Bittlingmayer, *Did Antitrust Policy Cause the Great Merger Wave?*, 28 J.L. & ECON. 77 (1985).

13. "Predatory pricing" is much talked about and little proved. In the years before 1914, it was much more profitable to purchase a rival than to try to drive it under by reducing one's own prices.

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So if not concern for small dealers and worthy men, what underlies the stampede to antitrust law? You may have noticed from Professor Millon's paper that the states first to enter this fray were agricultural—Kansas, Illinois, Minnesota, Wisconsin, and so on. New York did not pass an antitrust law until 1897, and other industrial states such as Pennsylvania and Massachusetts waited until after the Depression of the 1930s.[14] Several other things were happening in the early antitrust states in the 1880s, most of them related to the railroads rather than to the oil and sugar trusts.[15]

Agricultural states had begun to enact price regulations for grain elevators, leading to the famous *Munn v. Illinois.*[16] The Granger Movement was under way. States also wanted desperately to regulate the railroads, and in particular to end the price discrimination practiced by those railroads. They prevailed on Congress to enact the Interstate Commerce Act in 1887, and several states tried to regulate interstate movements on their own.

Railroads provided fabulous benefits for the agricultural states, for transportation made their product available more widely. These were boom years. But there was a vicious fight over the sharing of the gains to be had from transportation. Would they go to the farmers or to the railroads? Competition would allocate the gains to the farmers. More than that, competition would end the hated price discrimination—particularly the fact that it might cost more to ship grain east from a small town than from a larger city farther west along the same line.[17]

Some of the objection to the railroads was justified. Some of it was self-destructive, because some lines were natural monopolies, and price discrimination was necessary to allow operation of the lines in the first place. For farmers seeing the track in place, however, it made sense to try to appropriate as much of the gain as possible. By 1889 the main lines had been finished, which made it opportune to start turning the screws on the railroads.

The Interstate Commerce Act of 1887 did not do the trick. The

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Standard Oil bought out its rivals at premium prices. McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case,* 1 J.L. & ECON. 137 (1958); Telser, *Cutthroat Competition and the Long Purse,* 9 J.L. & ECON. 137 (1966).

14. *See* H. SEAGER & C. GULICK, JR., TRUST AND CORPORATION PROBLEMS ch. 17 (1929); H. THORELLI, THE FEDERAL ANTITRUST POLICY 79-84, 155-56 (1955).

15. This is not to say that a special agricultural preference for antitrust laws can be "proved." George Stigler tried to do that and was unable to confirm the hypothesis—or for that matter any rival hypothesis. *See* Stigler, *The Origin of the Sherman Act,* 14 J. LEGAL STUD. 1 (1985); *see also* Telser, *Genesis of the Sherman Act,* in MANAGEMENT UNDER GOVERNMENT INTERVENTION: THE VIEW FROM MT SCOPUS (Lanzilotti ed. 1984).

16. *See* Kitch & Bowler, *The Facts of Munn v. Illinois,* 1978 SUP. CT. REV. 313. Regulation did not end the problem of monopoly in the purchase and storage of grain. *See* Pashigian, *Why Have Some Farmers Opposed Futures Markets?,* 96 J. POL. ECON. 371 (1988).

17. Hovenkamp, *Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem,* 97 YALE L.J. 1017 (1988); *see also* Hovenkamp, *The Political Economy of Substantive Due Process,* 40 STAN. L. REV. 379 (1988).

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railroads persuaded Congress not to ban long-and-short-haul discrimination. States knew that any attempt to regulate interstate transportation directly would fail under the Commerce Clause. Thus the upsurge after 1887 of antitrust regulation, both at the state level and in Congress. And thus the fact that the principal initial prosecutions under these statutes were against railroads rather than trusts. Mergers were not the problem. Cartels and discrimination were. The emphasis on cartels and monopolistic practices was a shorthand for discrimination. Enforcers could disregard the bulk of the economy, because this was not the source of the agitation for antitrust.

My hypothesis, then, is that we are in Kansas because antitrust is part of the Granger Movement. It is related to the Interstate Commerce Act and the regulation of grain elevators. Its impetus came from farmers' belief that by 1889 they could gain from curtailing railroads' cartels and price discrimination. The failure of the Interstate Commerce Act of 1887, and the substantial completion of the interstate rail system, explains the genesis of antitrust in the midwest, the timing of antitrust when prices were falling and the economy booming, and why there was little enforcement at the start. This is a regrettably mundane explanation. It might even be called the standard explanation of civics texts, which does not make it wrong.

Antitrust law has far o'erleaped its starting place. But it helps, I think, to avoid attributing to the legislators of the time a prescience about the theory of monopoly that economists would not develop for another forty-five years.

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