

ANTITRUST: WIN OR WEAPON?

Alexander T. Sodini

* Alexander T. Sodini is an economics major in his junior year. Alex is a club Ultimate Frisbee player and a graduate of the Heritage Foundation's Academy Program with plans to pursue graduate studies down the line. His main research interests are economic history and public policy.

On December 4, 2021, several Democratic members of Congress sent a letter urging Attorney General Merrick Garland and the Department of Justice to review the impending merger between WarnerMedia and Discovery. These congressional appointees felt the “transaction raises significant antitrust concerns. In particular, the merger threatens to enhance the market power of the combined firm and substantially lessen competition in the media and entertainment industry, harming both consumers and American workers.”¹ In the wake of increasing mergers and acquisitions, economists, politicians, and laymen alike have become increasingly concerned about the potential for monopolistic practices that would harm consumers. Disney, Amazon, Microsoft, and various other corporations have similarly faced scrutiny by the DOJ. In each case, calls for antitrust have arisen to save markets by breaking up firms for fear of anti-competitive behavior. While the goal of antitrust is noble — to maintain competition and therefore protect consumers from monopolistic markets — economists take divisive positions on the usefulness of antitrust. Standard justification comes courtesy of neoclassical price theory, using abstract models to justify state intervention in markets. Austrian economists, however, argue the neoclassical framework — from which antitrust law is justified — suffers from several theoretical issues. Additionally, em-

1 Letter from Rep. David N. Cicilline et al., to Attorney General Garland & Assistant Attorney General Kanter (December 4, 2021), [https://castro.house.gov/imo/media/doc/Letter%20to%20DOJ%20\(Press\).pdf](https://castro.house.gov/imo/media/doc/Letter%20to%20DOJ%20(Press).pdf) [<https://perma.cc/3QCE-XQD6>].

pirical evidence suggests that antitrust laws have damaged markets more than protected them, as antitrust has historically been used as an anticompetitive weapon by firms as opposed to the government.

The name antitrust “originated in the United States in the late nineteenth century in response to the rise of trusts, a term that became a euphemism for big business.² Proponents argue it is “the central role of antitrust in protecting consumers against anticompetitive conduct that raises prices, reduces output, and hinders innovation and economic growth.”³ The U.S. federal government itself asserts that it “enforces three major federal antitrust laws, and most states also have their own. In short, these laws prohibit business practices that unreasonably deprive consumers of the benefits of competition, resulting in higher prices for products and services” (*Antitrust Laws and You*, 2015).⁴ The three primary antitrust laws are the Sherman Antitrust Act (1890), Clayton Act (1914), and Federal Trade Commission Act (1914). Each act covers various aspects of supposedly anticompetitive practices such as tying, cartel-

2 LAURA PHILLIPS SAWYER, *U.S. Antitrust Law and Policy in Historical Perspective* 1-35, 1-2 (HARVARD BUSINESS SCHOOL, WORKING PAPER NO. 19-110, September 2019), https://www.hbs.edu/ris/Publication%20Files/19-110_e21447ad-d98a-451f-8ef0-ba42209018e6.pdf [<https://perma.cc/UKS2-MSRW>].

3 Jonathan B. Baker, *The Case for Antitrust Enforcement*, 17 JOURNAL OF ECONOMIC PERSPECTIVES 27, 27-50 (2003).

4 THE UNITED STATES DEPARTMENT OF JUSTICE, *Antitrust Laws and You*, www.justice.gov/atr/antitrust-laws-and-you-0 [<https://perma.cc/8XLV-YWX2>].

ization, and “attempted monopolization” that would result in monopolistic markets. Despite the passing and enforcement of such laws, economists have long debated, and even opposed such measures. Economists originally opposed any amount of antitrust legislation starting from the late 1800s to the mid 1900s, viewing competition as “rivalrous activity.”⁵ In the 1940s, however, economists began to conventionally accept and justify the use of antitrust, with the emergence of the Industrial Organization field. Throughout the rest of the 20th century, antitrust support would waver and wane as economists like Murray Rothbard and Dominick Armentano expressed disinterest in neoclassical monopoly theory, while support continued through the 2000s to fight big tech companies and maximize consumer welfare.⁶

The Neoclassical perfect competition model provides the conventional justification for antitrust law. The perfect competition model posits a static equilibrium market state in which four main assumptions hold: (1) Perfect Information; (2) Homogenous Products; (3) Infinite Sellers; (4) Free Entry and Exit. Deviations from this model are deemed as determinants of monopoly power: single sellers of a good violate the infinite sellers’ assumption, sellers

5 In the 1920s, progressive institutionalists were far more open to the use (and necessity) of antitrust laws, but mainstream support among economists did not formalize until later.

6 Caleb S. Fuller, PUBLIC POLICY: FIRMS & ANTITRUST, GROVE CITY COLLEGE (Feb. 23, 2021).

with distinguished products violate the homogenous products assumption, and so forth. Monopoly power is a result of barriers to entry, including government regulation, economies of scale, and natural monopoly.⁷

Sources of monopoly power all exhibit deviations from the perfect competition model, and it is the rise of firms with monopoly power into a monopolistic market which results in inefficiency:

The difference between the outcomes in perfect competition and monopoly defines the

[Neoclassical Price Theory] concept of efficiency. In perfect competition, the price of the product represents not only the utility that consumers derive from the good, or value, as measured by their willingness to pay, that consumers place on the good. The price also represents the cost to suppliers, the societal cost, to produce the good. The net effect is that suppliers produce goods at the lowest cost to society, and all consumers who value the good at that cost and price can purchase it. Monopoly yields inefficiency because the monopolist operates at a price above marginal cost. At that output level, allocative inefficiency results because a subset of consumers would have been willing to purchase the product at marginal cost but now must buy other products valued less highly, whether from the mo-

7 EDGAR K. BROWNING & MARK A. ZUPAN, *MICROECONOMICS: THEORY AND APPLICATIONS* 331 (J. Wiley & Sons Inc. 11th ed. 2011).

nopolist or from suppliers in other markets.⁸

Neoclassical price theory asserts that the optimal level of production within perfect competition is the quantity and price where the marginal cost curve intersects with marginal revenue (price). In a monopoly market, however, firms can charge a price above their own marginal costs, which results in an inefficient outcome for society: firms charging a higher “monopoly price” while restricting output⁹. The distinction between a perfectly competitive price and a monopolistic price is what necessitates the use of antitrust: “under competitive equilibrium conditions, production occurs at the most “efficient” point in the market. In a natural monopoly, the monopolist’s demand function is necessarily tilted downward, and the monopolist has total control of demand. The monopolist can charge prices higher than the marginal cost, producing a smaller amount than would be offered to the market in ‘perfectly’ competitive conditions.”¹⁰ Firms charging a monopoly price at a lower output thus results in deadweight loss, or in neoclassical terms, a loss in consumer welfare. Antitrust is thus neces-

8 Jay M. Strader, *The Impact of Neoclassical Price Theory on Monopolization Law: A Transatlantic Perspective* 13 (2015) (unpublished Ph.D. diss., University College London).

9 The monopolist cannot simply charge *any* price, as they are still constrained by the downward-sloping demand curve they are facing.

10 João F. R. Lanza, *The Myth of Natural Monopoly: The Case of Railroads*, 24 *THE QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS* 566, 567-568 (2021).

sary to regulate monopolistic markets to perform closer to the efficiency level possible under perfectly competitive conditions. So, “state intervention ensures efficient allocation in the market by fixing the price so that the monopolist behaves like a competitive firm, producing the ‘optimal’ quantity at which the marginal cost is equal to the selling price, emulating a market in ‘competitive equilibrium.’”¹¹

To begin the critique of neoclassical monopoly theory, it is important to recognize that the models of perfect competition and monopoly fail to resonate with economic reality. These models are no more than an abstract ideal: a timeless, theoretical model. Since the models fail to account for reality, their distinction becomes meaningless and illusory. Murray Rothbard notes that “there is no such thing as a monopoly price or competitive price on the market. There is only, the ‘free-market price.’”¹² The state, therefore, has no way of knowing or distinguishing between the monopoly and perfectly competitive price to effectively engage in antitrust. In the real economy, firms do not sell homogenous goods, market participants do not have perfect information, firms do not have free entry and exit and lastly, there is no infinite number of sellers. As such, “The neoclassical habit of confusing competitive process with a final, static equilibrium condition makes for gross errors

11 *Id.*

12 1 MURRAY N. ROTHBARD, *MAN, ECONOMY, AND STATE: A TREATISE ON ECONOMIC PRINCIPLES* 614-615 (Nash Publishing 2d ed. 1970).

in economic analysis. For instance, product differentiation, advertising, price competition (including price discrimination), and innovation are rather routinely condemned as ‘monopolistic’ and, thus, as resource misallocating and socially undesirable.”¹³ Practices like advertising and product differentiation are necessary in a competitive market yet are shunned by neoclassicals. This oversight is due to their faulty view of the economy through the lens of perfect competition: “by comparing the real-world competitive process to a yardstick of perfect knowledge, one quite naturally concludes that such expenditures are wasteful. But what appears from the viewpoint of omniscience to be waste is precisely the instrument employed by the competitive process to eliminate imperfections in knowledge, imperfections that hinder market exchange.”¹⁴ The perfect competition model is therefore “a highly unrealistic model that can play little or no role in an understanding or explanation of economic reality,” so utilizing antitrust laws to strive for an ideal incongruent with reality is irresponsible at best and destructive at worst.¹⁵

13 Dominick T. Armentano, *A Critique of Neoclassical and Austrian Monopoly Theory*, in *NEW DIRECTIONS IN AUSTRIAN ECONOMICS* 94, 96 (Louis M. Spadaro ed., Sheed Andrews and McMeel 1978).

14 Thomas J. DiLorenzo, *Chapter 55: Industrial Organization and the Austrian School*, in *THE ELGAR COMPANION TO AUSTRIAN ECONOMICS* 384-387 (Peter J. Boettke ed., Edward Elgar Publishing 1994).

15 William Barnett II et al., *Austrian Economics, Neoclassical Economics, Marketing, and Finance*, 5 *THE QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS* 51, 52 (2002).

Perfect competition, however, does not account for all justification for antitrust. During the 1950s, economists shifted into the growing industrial organization field: “The theoretical foundations of antitrust policy developed generally from neoclassical microeconomics and were refined by scholars specializing in industrial organization.”¹⁶ In an attempt to “formulate empirically testable hypotheses, the industrial organization field bypassed the neoclassical notions of perfect competition or workable competition, in favor of the structure-conduct-performance paradigm.”¹⁷ The structure-conduct-performance paradigm, much like perfect competition, is an analytical tool in which neoclassical economists derive the necessity for antitrust laws. This paradigm asserts that the structure of the market will affect the conduct of the firm, which in turn determines the performance. More specifically, “The main predictions of the structure-conduct-performance paradigm are: (1) that concentration will facilitate collusion, whether tacit or explicit, and (2) that as barriers to entry rise, the optimal price-cost margin of the leading firm or firms likewise will increase.”¹⁸ Similar conclusions to the perfect competition model are found within the SCP-Paradigm model, as

16 DOMINICK T. ARMENTANO, *ANTITRUST: THE CASE FOR REPEAL* 13 (Ludwig von Mises Institute 2d ed. 2007).

17 Mark Glick & Eduardo M. Ochoa, *Classical and Neoclassical Elements in Industrial Organization*, 16 *EASTERN ECONOMIC JOURNAL* 197, 201 (1990).

18 Leonard W. Weiss, *Structure-Conduct-Performance Paradigm and Antitrust*, 127 *U. PA. L. REV.* 1104, 1105 (1979).

concentration in the market (monopoly power) leads to inefficient firm conduct and thus market performance. Yet, the SCP paradigm model is built on the same defective reasoning as perfect competition, and largely fails due to the narrow focus on the firm and market structure, similarly neglecting how real, competitive markets operate: “Unfortunately, the structure-conduct-performance paradigm cannot solve the problems industrial organization faces because it still requires implicit notions of the firm and its objectives, of markets, and of competition.”¹⁹ A proper view of competition easily disputes the analytical framework of both the SCP-paradigm and perfect competition, both of which serve as misguided tools in the justification of antitrust.

Rather than striving for an ideal through the abstract model of perfect competition or focusing narrowly on market structure and arbitrarily defined market share through the SCP-paradigm, a comprehensive analysis of antitrust laws must examine the true market competitive process. Austrian economists typically view competition:

Not as a state of affairs, which is called “competitive equilibrium” but as a dynamic process of interacting decisions of market participants in succeeding periods of time. It is a process, because not all decisions of the market participants may have led to the expected results, as the correspondent market participants might have been either too pessimistic or too optimistic. As a result, in the succeeding peri-

19 Glick & Ochoa, *supra* note 17, at 201.

od of time, decisions will be revised. Competition is regarded as inherently rivalrous, because each market participant must not only pay careful heed to the prospective decisions of the actors on the other side of the market, but also to the prospective decisions of actual and potential competitors.²⁰

Competition is a dynamic process in a market as entrepreneurs are constantly attempting to best satisfy consumer desires to reap profits. The real economy does not exist within a static equilibrium state, but rather is a process that takes place in time, through trial and error, where losses are possible, and where firms or businesses can have “monopoly power.” By viewing the market through a lens of a dynamic competitive process which accurately reflects the real world, the necessity for antitrust is dissolved as the free market provides inherent checks and balances against monopoly due to the nature of dynamic competition: “a monopolist can be at any moment outrivaled by another competitor or even by his own consumers through their substitution power.”²¹ For, in real, competitive markets, “Hayek argues ‘the most effective size of the individual firm is as much one of the unknowns to be discovered by

20 Jürgen Wandel, *Competition and Antitrust Policy: An Austrian Economics Perspective*, 30 *PROGRESS IN ECONOMICS RESEARCH* 47, 49-54 (2015).

21 Look no further than Victor Keegan’s (somewhat) famous article from 2007: *Will MySpace Ever Lose its Monopoly?*; Andreas Stamate, *An Economics Interpretation of Neoclassical Monopoly Theory In Light of the Austrian School*, 13 *ANNALES UNIVERSITATIS APULENSIS: SERIES OECONOMICA* 549, 553 (2011).

the market process as the prices, quantities or qualities of goods to be produced and sold.”²²

The narrow focus of analytical tools to judge an equilibrium state through market share or monopoly power simply does not reflect real-world economic phenomena. Neoclassical models have limiting explanatory power and as such, generate potentially dangerous policy conclusions like the necessity of antitrust: “Understanding the limits of the modern neoclassical models is essential to understanding the current debate over the efficacy of antitrust law. If the potential explanatory power of these models is weak, then harnessing them to laws which usurp private property is not only counterproductive, but also exposes government power grabs for what they really are.”²³ “Once one views competition as a dynamic, rivalrous process and acknowledges the importance of entrepreneurship, many of the business activities that the PC/SCP model views suspiciously as monopolistic are interpreted as essential parts of the competitive process. This is not to suggest that monopoly is not a problem, but that its origins are not likely to be the free market.”²⁴

Austrian economists oppose antitrust laws as “[n]ot only are they purposely vague, but they represent a clear government assault upon private property.” (Anderson

22 Wandel, *supra* note 21, at 54.

23 DiLorenzo, *supra* note 14, at 387.

24 *Id.*

2000).²⁵ Neoclassical economists assert antitrust is necessary to correct monopolistic markets, but consequences of antitrust can often be diminished or unnoticed. The state, backed by neoclassical theory, can prosecute firms for engaging in so-called monopolistic practices: in reality, said firm is engaging in practices inherent to a dynamically competitive process. Governments are thus provided justification for breaking apart, harming, or nationalizing any firm deemed to be possessing too much “monopoly power.” This ultimately leads to a decrease in innovation and efficiency, as firms engaging in traditionally competitive behavior could find themselves in an antitrust lawsuit.

R. Preston McAfee and Nicholas Vakkur highlight the failures of antitrust from the perspective of private lawsuits in their work *The Strategic Abuse of The Antitrust Laws*. McAfee and Vakkur recognize several in which private competitors can abuse antitrust laws to reduce competition and force other firms to either pay hefty fines and remuneration or engage in lengthy and costly legal battles. Inefficient companies now have an opportunity to acquire wealth through antitrust lawsuits (or slow competitors down), instead of allowing competition (through best satisfying consumers) to select winners on the market. As such, McAfee and Vakkur conclude that “As with many laws, there are serious unintended consequences of these

25 Anderson L. William, *Economics and Antitrust*, MISES INSTITUTE (May 11, 2000, 12:00 AM), <https://mises.org/library/economists-and-antitrust> [<https://perma.cc/88PR-WJNN>].

laws. There are several uses of the antitrust laws that have nothing to do with promoting competition, and at least two uses whose purpose is reducing competition.”²⁶ Antitrust thus pursues goals of consumer welfare, but ironically supports inefficient firms.²⁷ When markets do not align with neoclassical perception, antitrust laws cause far greater harm than protection for consumers as competitors can utilize antitrust as a weapon against other competitors, or to break up efficient and welfare-enhancing industries. In Microsoft’s famous case in the 1990s, Netscape alleged that Microsoft’s bundling of its Internet Explorer browser with the Windows operating system along with exclusive contracts were anticompetitive practices that would grant Microsoft a monopoly in the browser sphere (conveniently ignoring Netscape’s overwhelming market share just years earlier). In *U.S. v Microsoft*, Microsoft ultimately lost and was forced to pay millions in fines and alter its business practices. Unintended consequences of antitrust predictably went unnoticed:

Consumers are the focus of this case. Are they harmed or benefited by what Microsoft did? I think the evidence is overwhelming that the browser competition between Microsoft’s Internet Explorer and Netscape Navigator has led to an incredible

26 Randolph P. McAfee & Nicholas Vakkur, *The Strategic Abuse of the Antitrust Laws*, 1 JOURNAL OF STRATEGIC MANAGEMENT EDUCATION 15 (2004).

27 Robert H. Bork, *The Goals of Antitrust Policy*, 57 THE AMERICAN ECONOMIC REVIEW 242 (1967).

expansion of what we now call the “Net.” We now sit in awe of the massive shift of resources in capital markets and the rush of consumers to embrace powerful new e-commerce technology. However, that shift did not create these benefits by half measures of regulated competition. This tremendous outburst of browserware was a robust, violent process of creative destruction.²⁸

Netscape, an inefficient firm, was able to use antitrust as a weapon that consumed time, money, and innovation. Microsoft’s true crime was evidently being too efficient at providing consumers with a product they desired: “Rather than possessing a competitive advantage over Netscape in bidding for the Internet access provider accounts, Microsoft succeeded merely because it offered them, and therefore their subscribers, a better deal.”²⁹ Antitrust is not a win for consumers, but rather a weapon for firms to diminish competition. Rivals can effectively engage in antitrust warfare by alleging monopolistic practices and thus entering a lengthy and costly legal battle. Firms that are stuck in antitrust suits must now devote time and resources away from innovation and towards legal fees. Therefore, even a

28 Thomas Hazlett et al., *Legal and Economic Aspects of the Microsoft Case: Antitrust and the Information Age: Prominent Scholars Explore the Issues*, 35 *BUSINESS ECONOMICS* 45, 47 (2000).

29 Benjamin Klein, *The Microsoft Case: What Can a Dominant Firm Do to Defend Its Market Position?*, 15 *JOURNAL OF ECONOMIC PERSPECTIVES* 45, 55 (2001).

win in court still costs significant damages in reputation, time, and money.

The costs of an antitrust case are also inherently difficult to measure. The legal costs of the firms to engage in battle, opportunity cost of being in court, the cost of enforcement from the U.S. government, the cost of harming efficient firms, and the cost of potential future firms who fail to innovate for fear of antitrust lawsuits all contribute to implicit and explicit costs of antitrust. Jonathan Baker, former Director of the Bureau of Economics at the Federal Trade Commission believes that the benefits to consumer welfare is far greater than the cost of antitrust enforcement: “Overall, the benefits of antitrust enforcement to consumers and social welfare—particularly in deterring the harms from anticompetitive conduct across the economy—seem likely to be far larger than what the government spends on antitrust enforcement and firms spend directly or indirectly on antitrust compliance” (Baker 2003).³⁰ Baker, however, along with conventional neoclassical economists, completely neglects hidden costs beyond simply pure monetary expenditure and the potential deterrent for anticompetitive conduct: “other costs of this model go unacknowledged . . . There is no better example to illustrate this claim than the billions of dollars that have been wasted both prosecuting and defending against antitrust lawsuits, and the vast harm supposedly antimonopolistic laws have done to the struc-

30 Baker, *supra* note 3.

ture of the economy.”³¹

Lastly, while neoclassical literature recognizes that government regulation can be a source of monopoly power, the doctrine fails to fully articulate that monopoly is more accurately defined as a grant of privilege by the state.³² In fact, “the monopoly granted by the State is not as harmless as the private one, which can develop on a free market.”³³ The state can guarantee a persistent monopoly, enforceable by law, that cannot be found on the free market. The state can either provide direct benefits in the form of subsidies and bailouts, or more subtle, indirect benefits through regulation. Binding regulation reduces consumer welfare by imposing costs that benefit larger, incumbent firms. Larger firms can more easily absorb the costs of regulation, driving smaller firms out of the market, shielding larger firms from competition. In essence, state privilege (regardless of intention) grants either monopolies or quasi-monopolies. A grant of special privilege by the state imposes the exact high barriers to entry that neoclassicals warn of, yet supposedly the solution to monopolistic markets is more government intervention. Monopoly cannot originate due to dynamic competition on the unhampered market; rather, it is the direct privilege by a state that confers monopoly benefits. Economist Thomas DiLorenzo puts the final nail in the coffin for neoclassical monopoly theory as he humorously

31 Barnett II, *supra* note 15, at 59.

32 ROTHBARD, *supra* note 12, at 113.

33 Stamate, *supra* note 22, at 553.

explains the absurdity of neoclassical theorists in failing to recognize the true cause of monopoly:

It is socially wasteful for an economist to spend his career seeking to uncover the extent to which price diverges from marginal cost at a point in time or spinning endless oligopoly tales. Cloistered in his windowless office, he ignores the fact that he is paying a monopolistic price for his cable TV, is forced to cater only to the US Postal Service's monopoly in first-class mail, he must send his children to a monopolistic public school system, have his garbage collected by a government monopoly, pay gas, electric and water bills to other government-sponsored monopolies, pay supracompetitive prices for the services of taxi drivers, physicians, attorneys, hairdressers, undertakers and myriad other service providers because of supply-reducing occupational licensing laws, he is victimized by misguided anti-trust regulation which encourages inefficient businesses to sue their more efficient rivals for cutting their prices or expanding their product lines, and he pays higher food prices caused by acreage allotments and other forms of farm protectionism.³⁴

Overall, neoclassical doctrine utilizes abstract models to provide an ideal state by which real-world markets are compared to. This faulty foundation leads to the conclusion that so-called monopoly power grants firms the right to charge above their marginal costs, at a point deviating from the perfectly competitive price. Any deviation from

34 DiLorenzo, *supra* note 14, at 387-388.

the perfectly competitive price results in a loss in consumer welfare and is inefficient for society; thus, antitrust must be necessary to correct these market imbalances. This model, however, suffers terribly from the fact that the neoclassical model does not represent an accurate assessment of the economy or markets. On the contrary, a dynamic view of competition is congruent with the real economy and eliminates the necessity for antitrust by explaining that the practices considered anticompetitive or monopolistic by neoclassicals, are in fact part of the normal competitive process. Antitrust enforcement is perceived as beneficial in protecting consumers, yet consumers are largely harmed due to the exorbitant costs associated with it which ultimately reduce competition, reduce innovation, and benefit inefficient firms. Additionally, while neoclassical literature recognizes that government intervention can serve as a barrier to entry, there is widespread failure among the neoclassical school of thought to fully recognize the extent to which the state harms competition. Rather than focusing on the illusory distinction between perfectly competitive and monopoly price, neoclassical economists' effort would be better spent recognizing the state's role in monopoly through grants of privilege or antitrust itself.