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ANTITRUST IN AN OPEN WORLD ECONOMY*

Kenneth W. Dam**

The 1970's were a decade in which received principles of economic policy were shown to be wrong, indeed dangerous for the public interest. Whether the now forming economic policy consensus, with its emphasis on monetary policy and on the supply side, will restore productivity and prosperity in the 1980's remains to be seen. But our old ways of looking at the economy, focusing almost solely on maintenance of effective demand, have surely been relegated to the policy trash heap.

These changes in emphasis from fiscal to monetary policy and from the demand to the supply side are well known. I'd like this morning to call your attention to an equally important change in economic policy thinking that has received much less public attention. From World War II until the early 1970's almost all macroeconomic analysis, particularly in the United States, assumed a closed economy. The United States was the policy unit and the outside world would normally be taken into

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**Kenneth W. Dam is the Provost of the University of Chicago and the Green Professor in its law school. He is the author, with George P. Shultz, of Economic Policy Beyond the Headlines (Norton, 1978). His latest book, The Rules of the Game: Reform and Evolution in the International Monetary System, is now in press. He has written a number of articles on antitrust law and economics.

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account, if at all, only as a complication. If exports exceeded imports, then one might adjust one's estimates to account for what was called "net exports." And in discussions of monetary policy the term "Eurodollars" might occasionally be uttered. But by and large these were matters left to the experts and did not intrude into most policy discussions, whether in government or in the press.

Today it is far more common to think of the United States as an open economy. Any policy measure is now seen to have an immediate impact on money and trade flows, an impact that may either reinforce or, more often, vitiate the original policy move. In part, our shift of focus from a closed to an open economy reflects the far greater trade interpenetration of the advanced countries. More important is probably the financial side, where the elimination of exchange controls on current transactions in Europe and of capital controls on investment transactions both here and in Europe have opened up the major developed economies to a far greater extent than yet fully appreciated. The rapid growth of offshore banking in the 1970's has created a world-wide market in credit to which U.S. domestic regulation is only now belatedly adjusting.

As a result of these changes most economic policy participants now realize that it is no good analyzing monetary and fiscal policy measures in terms of a closed U.S. economy. It is, for example, now more fully appreciated that any additional monetary or fiscal stimulus will have little effect on employment but

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will have an immediate effect on the position of the United States in the world economy. In particular, the immediate effect of attempting through macroeconomic means to stimulate the economy is likely to be an immediate depreciation of the exchange rate. Britain learned this lesson when sterling fell from $2.03 to $1.56 in a period of 8 months in 1976. We learned the same lesson in the early Carter years when the attempts to pump up the U.S. economy led to a decline of the dollar from 2.6 marks to the dollar to under 2 marks in two years. These effects of domestic monetary and fiscal policy are so strong that they swamp attempts to stabilize exchange rates through exchange market intervention. With an open economy perspective we now see the limits of the closed economy assumption that dominated both the Keynesian approach and the narrow monetarism that postulated a one-to-one relationship between Federal reserve actions and domestic economic activity.

Another implication of an open economy perspective is that we now realize that depreciation of the exchange rate is highly inflationary. Continental bankers and finance ministers have probably always believed this, but our fascination with floating rates, which textbooks taught us isolated an economy from the world, obscured this feedback effect on the domestic economy. Pure floating might isolate monetary policy from the outside world, but there is always sufficient exchange market intervention to translate world disturbances to us.

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We certainly learned the lesson. Take the two conscious devaluations of the dollar in the early 1970's. There were few U.S. economists or economic policymakers who believed at the time that they would be an independent engine of inflation. Attention was all too focussed on what those devaluations were supposed to do for our exports. The normal way of thinking was that since imports were only, say, 10 percent of GNP, a 5 percent devaluation could only increase the rate of inflation by 1/2 percent. The poverty of that line of thinking is demonstrated by the explosion of inflation in the 1972-75 period and again in the last few years following the more recent Carter-period depreciation of the dollar.

This modified closed economy perspective, which takes into account imports and exports but neglects feedbacks, overlooks the effect of higher prices for imported goods on domestically produced import substitutes. These substitutes also rise in price due to the reduction of competition from imports. This modified closed economy perspective also overlooks the effect of the depreciation-induced stimulus to exported goods on the domestic markets for those same goods. If we export more because of depreciation of the dollar, then there are fewer goods at home, and the domestic price is bid up. A clear case is grain. If depreciation of the dollar causes more grain to be exported, food prices must rise at home to bid the grain away from foreigners. So depreciation causes higher prices for both imports and import substitutes and for all exportables, whether they are exported or not. Higher

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prices throughout the economy are the result. To be sure, the causation runs both ways, with inflation causing the initial depreciation and with depreciation tending to cause further inflation, unless offsetting domestic policy adjustments are made. Whatever the pure economics of the matter, there is more than a kernel of policy truth to the European view that inflation creates a "vicious circle" in which macroeconomic stimulus leads to inflation, which leads to depreciation of the currency, which leads to even greater inflation.

My purpose here is not to talk about macroeconomic policy. Rather it is to show how transformed economic policy issues become when we postulate an open economy. One economic policy area that is still not often viewed from an open economy perspective is antitrust policy.

In preparing these remarks I wondered whether it was necessary to emphasize before this audience that antitrust policy is a branch of economic policy. Some people invest antitrust with quasi-religious qualities. For some who lean to ideology, antitrust is a way of bashing big business. For others who specialize in interest group politics, antitrust is a way of using enforcement agencies and treble damage actions to protect small companies from the rigors of competition. For still others, and this was a view popular in the Watergate period, antitrust is a branch of the criminal law in which economic policy officials concerned with the impact of antitrust on the efficiency and competitiveness of the U.S. economy

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venture gingerly for fear of being accused of obstruction of justice.

Yet is not antitrust _par excellence_ economic policy? By concerning itself with price-fixing and with monopoly, antitrust policy goes to the heart of the allocation-of-resources problem and hence to productivity and even, though in a minor way, to the inflation problem. Why should those issues be the exclusive province of enforcement officials and, in particular, of lawyers with a prosecution mentality? A view of antitrust as a coordinate branch of economic policy is particularly justified in the formative months of a new Administration that won an election on the promise of a new approach to economic policy.

A great deal of new thinking will be required in the Antitrust Division, and it cannot be limited to that Division or even to the Justice Department if antitrust policy is to make economic sense. Rather than dwell on the organizational aspects of antitrust economic policymaking, I'd like to return to my theme that that thinking should take place within an open rather than a closed economy context. Only in that way can it be brought out of the "dark ages" of the formative decades of the 40's and 50's when the fascination with concentration, barriers to entry, and similar constructs came to dominate the analysis.

How would an open economy perspective change things? Let me take one industry to illustrate. In the automobile

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industry it is taken for granted that the four-firm concentration ratio is upwards of 90 or 95 percent. Four firms, it is said, "dominate" the industry. (I find it hard, I must say, to think of Chrysler as a dominant firm, even a "jointly" dominant firm.) Yet when one looks out the window one sees that one-quarter, perhaps even more, of the new cars on the street are produced by firms outside these four. Nearly all of these additional cars are, of course, imported. The conventional way of expressing this anomaly is seriously misleading. In public policy discussions we tend to talk about the percentage of the market accounted for by imports. Thus, to take a simplified example, if four firms account for 100 percent of domestic production and if imports account for one-quarter of domestic consumption, we tend to say that four firms have 75 percent of the market -- still a rather high figure.

This way of looking at the automobile market is surely wrongheaded. The objective situation is really not that there are four firms and some faceless imports in <u>the market</u>. On the contrary, there are eight or ten important firms in <u>the market</u> and they include such powerful and vital firms as Volkswagen, Toyota, Nissan, Renault, and Peugeot-Citroen. And there are also effective competitors in particular product lines such as Daimler-Benz, Volvo, and Honda. The reason why Chrysler seems so out of place in a list of dominant firms is precisely that it is unable to compete effectively in this world market and in fact has been withdrawing from it, a step

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at a time, by selling off foreign plants. It is now retreating even in the United States much like a formerly dominant military power reduced to a house-by-house defense of its capital city. In a world perspective American Motors too begins to look even less imposing than concentration statistics imply. Whereas in 1959 it was fifth in the world, it had dropped below fifteenth by 1978. Indeed, its recent arrangements with Renault make it look more like a Renault affiliate than a jointly dominant firm.

The market in automobiles has clearly become the world. In that market GM had only 28 percent in 1978 and probably less today. Ford had only 19 percent. Volkswagen and Daimler-Benz together had 12 percent. Toyota and Nissan together had another 10 percent, and probably even more today. Renault and Peugeot-Citroen together had still another 10 percent.* Although GM and Ford are large, they hardly dominate the real market, as opposed to the antitrust construct of a market. Using number of cars and trucks produced, rather than volume of sales, to eliminate exchange rate factors, J. Fred Weston calculated that the top four in the world automobile market have only 50 percent of the world market.**

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*Percentages are overestimated for all companies because they take account, due to data limitations, of the sales of only the fifteen principal manufacturers. Source: General Motors study based on The Fortune Directory of the 500 Largest Industrial COrporations and The Fortune Directory of the 500 Largest Industrial Corporations Outside the U.S., Fortune, 1960 and 1979.

** Taken from an unpublished paper by J. Fred Weston, Domestic Competition and International Markets (Jan. 15, 1981).

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An open economy approach reflects economic reality in many ways. Any attempt to increase U.S. prices above those of imports leads to a great increase of imports and even fewer exports. Moreover, the strong companies act in both manufacturing and sales as if the market were worldwide. The well-advertised push of General Motors for a "world car," with component manufacture and assembly strategically sited to reach all consuming centers, is simply the manufacturing and marketing reflection of the economics of the matter.

When one looks at other major industries, world concentration ratios are even lower. Weston's calculations for steel, for example, show a four-firm concentration ratio of 14 percent.

The dissolution of the U.S. domestic market into a larger world market is proceeding apace not merely in consumer goods, such as cameras and electronic products, where it has long since been accomplished fact, but also in basic industries, such as automobiles and steel.

What is happening in this larger world market? What is happening is, unfortunately, that the position of U.S. firms is slipping badly.* In chemicals, for example, DuPont has dropped from first in 1959 to fourth in 1979, with Union Carbide falling from second to seventh. In 1959 the United States accounted for seven of the top ten firms, in 1979 for only three.

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*The following review is taken from New Research Findings, The Relative Sizes of U.S. and Foreign-Based Multinational Corporations, in Mergers and Economic Concentration, Hearings before the Senate Antitrust Subcommittee on S.600, Part 1, pp. 725-733 (1979) updated using data from annual Fortune surveys.

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In electronics and appliances, six of the top eight firms in 1959 were American. In 1979 only three were still in that group.

In industrial and agricultural machinery, Caterpillar slipped from first to second and Deere from fourth to sixth. Allis-Chalmers, fifth in 1959, had disappeared from the top ten.

In metal manufacturing, U.S. Steel fell from first to second and Bethlehem Steel from second to fifth. In 1959 the United States accounted for nine of the ten top companies, in 1979 for only two.

In pharmaceuticals American Home Products slipped from third to fifth, Johnson & Johnson stayed in fourth place and Pfizer dropped from fifth to ninth. In 1959 seven of the ten top companies were American, in 1979 only five.

Many reasons can be advanced for the slippage of U.S. firms in world markets. Surely the general productivity problem is one, but exactly what the components of the productivity decline in the United States may be is not an easy question on which to obtain informed agreement. So too the inexorable workings of the principle of comparative advantage play a role. The United States now has a comparative advantage in agriculture, services, and, though the advantage is slipping, in specialized manufactures such

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as wide-bodied aircraft and computers. The iron law of comparative advantage dictates that we must have a comparative disadvantage in something, and that something appears to be increasingly the so-called "basic" industries. To be sure, some of the slippage in the reported sales statistics simply reflects exchange rate changes rather than unit output changes, yet one can also ask whether the decline of U.S. industry did not in fact lead to the decline of the dollar.

The point here is not simply that U.S. antitrust policy does not recognize the new environment in which U.S. companies must operate. The point is also that antitrust policy as it has been administered has placed large impediments in the necessary adjustment of the U.S. economy to the new international conditions. Today many antitrust rules make it difficult for U.S. companies to rearrange their affairs in a way that reduces costs and increases productivity in order to permit them to compete both here and abroad on equal terms with their foreign competitors.

What might the new administration do to help place antitrust policy in an open world economy context? Many useful changes might be made, even without legislation. For starters, the Antitrust Division might throw out the Merger Guidelines and start afresh with a merger law enforcement policy that recognized the U.S. place in an open world economy. Joel Davidow, speaking for the Antitrust Division, has argued that world market shares should be ignored if there is an anticompetitive

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effect in "any section of the country."* That may still be standard judicial doctrine.** But it is head-in-the-sand economic policy for the 1980's. Surely the "any section of the country" language in Section 7 does not require enforcement officials to ignore the actual competitive situation in an industry.*** When a market extends from where China ends to where Russia begins -- in short, a world market in which products and resources flow freely -- it makes little sense to limit the inquiry to a 3000 mile sector between the Pacific and Atlantic oceans simply because the writ of enforcement officials is geographically defined. In such a larger perspective the relevant market shares are world market shares. Though one could still debate whether General Motors could acquire say Chrysler in view of their world market shares, the solution should not have to depend upon the interpretation of the failing company defense.]

The main effects on merger policy of a world market perspective would not lie, however, in horizontal mergers but rather in the vertical and conglomerate area. I doubt that the prohibitions against vertical mergers can be defended on economic grounds at all. But even if they can be, it surely makes no sense to judge whether unintegrated U.S. firms may merge vertically to gain the efficiency advantages of integration and thereby to compete more effectively with

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*Joel Davidow, "Antitrust, International Policy, and Merger Control," remarks before the Federal Bar Association Conference on Antitrust and International Mergers and Acquisitions (Aug. 28, 1980).

**But see United States v. General Dynamics Corp., 415 U.S. 486 (1974).

***Ibid.

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foreign firms primarily on the basis, as the Guidelines call for, of their shares in the U.S. market. If we take such a short-sighted approach, the alternative is likely to be either a resort to protectionism to shore up the less-competitive domestic firms or a fall in their market share to the point where they end up being acquired by more powerful foreign competitors.

The economic case against conglomerate mergers makes even less sense (I would say nonsense) where U.S. firms compete against foreign competitors who are subsidized by their governments. In industry after industry, in country after country, there is no need for the competitors of U.S. firms to diversify or to merge to acquire a stable source of capital because those competitors are owned by their governments and thus have a direct claim on the public treasury.* We ought to see conglomerate mergers not merely as a lesser evil but as an important means of competition against state-owned and state-subsidized companies.

Many other useful changes in antitrust policy could be made but most of them would require legislation. Just as vertical mergers are pro-competitive in an open world economy context, so too an open economy perspective casts even graver doubt on many of the vertical rules than the new antitrust

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*See Kenneth D. Walters and R. Joseph Monsen, State-owned Business Abroad: New Competitive Threat, 57 Harvard Business Review 160 (March-April 1979).

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learning reflected in the Sylvania case would suggest.*
Various long-term contractual arrangements should be seen as desirable, not merely saved from the per se rule by legal radiations from Sylvania. So long as private treble-damage actions can be brought, U.S. industry is unlikely to undertake the optimum degree of contractual vertical integration. To be less than optimally vertically integrated is to be more vulnerable in contexts where foreign companies are not subject to similar inhibitions. Thus, an open economic perspective suggests that either substantive law should be clarified by legislation or the treble damage remedy should be seriously restricted.

Other kinds of antitrust legislative initiatives become possibilities once one adopts an open economy perspective. For example, a host of proposals have been made to exempt U.S. firms from the antitrust laws when they engage in exporting and in foreign joint ventures. Some of these proposals make sense, but I believe that they should be approached with caution. We certainly need not encourage U.S. firms to engage in price-fixing in foreign markets in order to make them more competitive. Horizontal price-fixing rarely improves efficiency. On the contrary, we ought to encourage U.S. firms to restructure themselves, particularly in their vertical arrangements, in order to make themselves more efficient world market competitors.

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*Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

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Such an approach would be leading from strength. And it would have the priorities right. Though we all have an interest in promoting U.S. exports and foreign investment, we have an even greater interest, particularly as consumers, in promoting the efficiency of the U.S. economy.

Antitrust policy has an important role in this respect, if only to avoid getting in the way of the natural competitive responses of U.S. firms to increased foreign competition in our own front yard. Reform of antitrust policy may be less important than such other vital policy measures as the elimination of tax disincentives and the conquering of the cancer of inflation. But a division of labor is necessary in policy matters too. Those of us most concerned with antitrust policy cannot continue on in our old comfortable, closed-economy modes of thought.

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