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THE PLACE OF ECONOMICS IN THE COURSE ON TRADE REGULATION*

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It takes temerity, perhaps I should say brashness, to speak to this group upon my assigned subject. I am not a member of the bar and have never either studied or taught law. What I know about the law is only what I have absorbed by a kind of intellectual osmosis during eleven years as a government economist working with lawyers on problems which were both economic and legal. My attention has been focused, not upon the use of economic materials in the law school, but upon the use of legal materials in the economics department. My ideas about the teaching of law are inferences from my own problems in teaching economics courses which have to do with the antitrust policy and the public control of business. As a naive approach to your field, what I have to say may include some suggestive novelties; but if the voice of authority rings out in any part of it, that tone will misrepresent the tentative and humble spirit in which this advice is offered.

Although I have been asked to talk about the course in trade regulation, I shall confine my remarks to one part of such a course. I understand that the subjects included in this type of course differ considerably in different law schools. Those which appear in the casebooks with which I am most familiar do not seem to me to have sufficient coherence to be treated as a single unit from an economist's point of view. One part of the casebook has to do with the enforcement of the antitrust laws and with related issues arising in restraint-of-trade cases under the common law. Another part has to do with such matters as infringement of trade-marks, appropriation of trade secrets, and the copying of styles and designs; another with misrepresentative advertising, misbranding, and adulteration. These different fields of study have to do with separate objectives of public policy and different types of legislative devices.

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They raise widely different economic issues. Broadly speaking, the antitrust laws attempt to enable each trader to protect himself in the market by preserving a variety of enterprises and policies on the other side of the market, so that he can transfer his custom readily from one to another. Closely related to this central objective are the purposes of laws such as that against price discrimination, which seek to control the policies of single enterprises to the extent necessary to prevent these enterprises from destroying competition among those with whom they deal. There is a sharp contrast, however, between this body of law and the laws designed to prevent single enterprises from deceiving or otherwise injuring the unwary buyer or from inflicting injury upon competitors by types of action contrary to good public morals. The antitrust laws attempt to preserve competition, and rely upon competitive forces to bring about satisfactory results. The laws against misrepresentation and competitive torts seek to determine affirmatively the plane of business conduct. The policy underlying the first group of laws is competition; that underlying the second group is public regulation.

I shall discuss today only the bearing of economic materials upon the antitrust part of the trade regulation course. I shall assume that the economic materials, like the legal materials, have the purpose of making good lawyers—persons who are competent in their jobs and who contribute to the effectiveness of the law as an instrument of social order. Whatever the virtues of economics as a cultural subject or as an aid to the citizen, my concern with it here is as a part of professional training.

It should be platitudinous to say that for economics to contribute to the professional training of a lawyer it should be relevant to the intellectual problems he will face and should supply information and ideas which can help solve these problems. Nevertheless, some of the experiments with economics in the law schools recognize this platitude very imperfectly. It does little or no good to interrupt a study of legal cases in order to present a guest economist who will analyze, from a strictly economic point of view, the nature of monopoly or of price discrimination. A self-contained little course in economics may use some of the same words which appear in the law course, but they mean different things, the relationship of which is not brought out, and the student is to be pardoned if he decides that economics is an academic irrelevancy. Similarly, it does little good, and may do positive harm, to instill a systematic, fully developed, neo-classical economic theory. I am one of those who question the usefulness of such heroic theoretical structures even for economists; but be that as it may, lawyers do not need extraneous subject matter to train them in rigorous logic, and they may be diverted, by the data-ignoring pattern of such theory, from that effort

to establish a congruity between theory and recalcitrant fact which is the great merit of the case method of study.

What economic materials are useful? The question may be better answered if we see clearly why a lawyer needs economic materials at all. If the law is viewed as a body of established principles distilled from past decisions and applicable without change to future cases, is it not sufficient for the lawyer to learn and apply this body of principles? Will not the nice precision of his legal reasoning be blurred by the introduction of concepts extraneous to the legal pattern?

The answer appears to me to be that a legal issue does not arise solely as an exercise in legal logic. Indeed, no social institution draws its intellectual content entirely from the law, and none can be safely regarded as a mere intellectual pattern apart from the forces and purposes which work through that pattern. An antitrust case, for example, is likely to proceed on at least four levels simultaneously, whether or not the persons involved in it are aware of all four.

First, there is the level of legal tradition, consisting of established points of law and established methods of formulating legal issues. On this level the principle of stare decisis governs so far as it can be applied.

Second, there is the level of evidentiary fact. In it arise many technical questions as to truth and as to relationship between facts which cannot be determined on the basis of legal principles alone. These questions may require use of materials from almost any field of human knowledge. In an antitrust case they are almost certain to call for the use of economic concepts. Without mastery of these concepts, the facts may be misrepresented or their relevance may be overlooked.

Third, there is the level of business strategy. A lawsuit is an incident in the effort of one or more participants to accomplish particular purposes. From the point of view of the parties, legal tradition is something to be manipulated. The particular lawsuit may be only one instrument out of many pointing toward the same end. Often the strategy of a case can be understood only if the objectives of the parties are known, and in the light of these objectives cases and legal maneuvers apparently unrelated may be intimately connected as a part of a common pattern, even though their legal issues and their facts, narrowly conceived, are entirely separate.

Fourth, there is the level of public policy. The antitrust laws express a social purpose and an idea of appropriate social means. In proceedings instituted by the Government, the persons whose interest is supposedly served by the policy are not likely to be parties to the case, and conduct which may be condemned or required by the court is likely to be

appropriate to the social purpose only because of an economic environment much of which is not directly in evidence before the court. Thus both the objectives and the means of the law are derived from economic and political ideas as much as, or perhaps more than, from legal ones. They can be fully understood only through these ideas. Furthermore, as in all criminal legislation, an important aspect of the public policy is to influence conduct by making certain types of behavior hazardous, and for this reason the chief significance of many antitrust cases lies in their probable effect upon the action of persons who are not before the court. Legal tradition has little to say about the use of judicial process to create effects outside the courtroom.

The three levels other than that of legal tradition which appear in an antitrust case cannot safely be ignored in the training of a good lawyer. For lack of knowledge of economics, accounting, and statistics, lawyers frequently fail to squeeze the juice out of the facts in their cases. For example, in the *Maple Flooring* case,[1] the Government argued that since practices similar to those of the maple flooring industry had already been condemned by the courts, the activities of the maple flooring association must be unlawful. The defendants offered elaborate evidence, statistical and otherwise, which supported the point that, whatever effect these practices might have elsewhere, they were not restrictive in the maple flooring industry. Specifically, it was argued that the prices of maple flooring had not risen because of the practices in question but had moved up and down with the prices of other types of lumber; and in support of this argument charts based upon price statistics were offered in evidence. The charts showed that before the questioned practices were initiated maple flooring prices were following other lumber prices upward, whereas thereafter maple flooring prices led other lumber prices in a further rise. The Government failed to bring out this point either in cross-examination or in rebuttal, but instead offered an expert witness who testified that nothing much can be proved by statistics.

More significant still, lawyers may miss opportunities to modify and develop the legal tradition itself. According to my lay understanding, the best legal theories now emphasize the point that successive problems are so stubbornly individual in their facts as to make the application of established legal principles a matter of invoking loose and often conflicting analogies. According to this view, legal principle is stretched each time it is re-applied. How can one determine how far to stretch it and in what direction? This crucial question cannot be answered from the legal tradition itself. It must find its answer in the peculiarities

[1] Maple Flooring Mfrs' Ass'n v. United States, 268 U.S. 563, 45 Sup.Ct. 578, 69 L.Ed. 1093 (1925).

of the facts, the purposes of the parties, and the public purposes which constitute the policy of the law. In so far as economic analysis casts light upon these matters, it provides guidance as to the trend and variation of the legal tradition itself.

Thus far I have said that economic insights are needed to make more effective lawyers. In a deeper sense, they are needed to make a more useful structure of law. Improvement of the strategic and tactical skill of those who practice before the courts is in one sense largely a waste of time. Like the improvement of munitions, its effects tend to cancel out. Heavier guns and heavier defensive armor appear on both sides of the conflict, and only the difference in the increase of strength makes for victory. In another sense, however, this type of improvement in the skill of lawyers may be a clear social gain. The infirmity of the law, which lawyers have done more than anyone else to criticize, is its tendency to become an intricate conceptual game, played for its own sake without regard to the consequences of the play. To insist that the economic significance of the facts be brought out is to insist that evidence be adequate and not deceptive. To insist that the strategy of the parties be understood is to insist that the issues be realistically interpreted. To insist that the policy of the law be illuminated by economic and political analysis is to insist that the law's meaning is to be found in the forces that made it and the purposes which governed its making rather than in mere legal semantics. Grounded in economic analysis, the judicial process can provide socially acceptable solutions to real controversies, whereas otherwise it is in danger of providing merely verbal solutions for illusory controversies.

If the statement of the problem which I have just offered is acceptable, it suggests an answer to the question, What kind of economic materials are appropriate to legal study in the antitrust field? The materials needed are those which explain the economic considerations and the economic analysis underlying the antitrust policy. They are those which describe the purposes and analyze the strategies of the enterprises and groups involved in antitrust cases. They are those which describe and analyze the business practices most commonly encountered in antitrust proceedings and which interpret the types of evidence which can be found about such practices. What is wanted, in other words, is not a body of systematic economic analysis relatively remote from legal materials, but rather a selection of the economic concepts and techniques of analysis which are most immediately appropriate to the legal problem. Such subject matter should be introduced as a part of a fuller study of particular cases or particular statutes and should be used directly to

raise new issues and suggest new lines of attack upon the legal problems involved.

The significance of this suggestion will appear more fully in the answer to the question how the economic materials ought to be used.

As I see it, there are three appropriate types of use of economic materials, corresponding roughly to the three non-legal levels already discussed.

Perhaps the simplest of these is analysis of the objectives and business strategies of the persons involved in an antitrust proceeding. The most significant source of information for this kind of work is usually evidence assembled for the proceeding itself and evidence available from cases and public investigations involving the same parties. In particular instances, such factual materials from the cases may be supplemented by monographs and books about the companies or the industries in question.

An illustration may indicate the light which this kind of analysis can throw upon a particular law or a particular case. One of the great economic controversies of our time is that between independent food distributors and the great corporate food chains. The chain stores have grown rapidly in number of outlets and in absolute and relative volume of business. Many independent distributors have been eliminated and others believe that they are threatened with elimination. Manufacturing groups in the food industry have often resented the buying power of the great chains because of the pressure which it puts upon their own prices and operating margins.

For nearly a generation the groups opposed to chain stores, which are numerous and therefore politically influential, have attempted to hamstring the corporate chains by legislation. Their first maneuver was the enactment of state tax laws under which distributors were to pay taxes at rates graduated according to the number of their distributive outlets. At first these rates were determined by the number of outlets within the state. Later the device of basing the rate upon the number of outlets owned everywhere was invented and successfully defended in the courts. This made it possible to establish high tax rates for the great corporate food chains without seriously affecting lesser chains of various types which operate on a smaller scale but may have a high concentration in a single state. When the corporate chains found their tax bills thus increased, they sought political power adequate to block such legislation. They tried to win the support of consumer groups by emphasizing their lower price policies, and in certain cases created false-front consumer organizations to propagandize against chain-store taxes. More significant, they made an alliance with certain farm organizations, by

which they agreed to cooperate with these bodies in moving farm surpluses at satisfactory prices in return for political support on the tax issue. Farmers being also numerous, chain-store taxes ceased to be a threat.

Thereupon, the anti-chain forces proposed a new device, amendment of the laws against price discrimination. Their bill, as originally drafted, would have outlawed basic pricing practices of the corporate chains, but it was so sweeping that it would have caused great difficulties for many other enterprises. The modified bill which was enacted by the Congress still contained provisions which affected the corporate chains. The buyer as well as the seller was made liable for unlawful discriminations, injurious discriminations not justified by cost were prohibited, allowances not granted on proportionally equal terms were forbidden, and brokerage allowances by sellers to buyers were outlawed. Though these legal provisions required alteration of many chain-store practices, they did not cripple the chains. Chain stores abandoned brokerage allowances in favor of simple price reductions. They obtained from the seller affidavits that these reductions were justified by his costs, and they obtained their advertising allowances upon types of service which others could not render, where the issue of proportionality was therefore difficult to raise. Since the legal status of some of the substituted practices has not yet been finally determined, the law's impact upon the power of the great chain organizations is not yet fully clear; but it is obviously not decisive for the survival of chain organizations.

The anti-chain-store forces next turned to the states in an attempt to control the selling policies of the corporate chains instead of their buying policies. The device was the unfair practice act, which establishes minimum prices based upon purchase cost plus a markup to cover the cost of doing business. These laws were disappointing to their sponsors, for the legislatures were unwilling to set the minima high enough to assure the independent distributors a profit, and with the minima set lower the effect was merely to induce the corporate chain which had made deep price cuts upon a few items to make instead shallower cuts upon more items. Furthermore, being able to buy at the point of origin while the independents had to buy from local wholesalers, the corporate chain was able, whenever it chose, to establish a low retail price in which the minimum markup stood in lieu of both transportation and handling costs, whereas the independent, whose transportation cost was included in his purchase price, had to compute his minimum markup from a higher base. Thus the initiative in price cutting was legally transferred to the corporate chains.

Disappointed in this legislation, the Ohio food distributors sought to adapt laws which were being used by distributors in the drug industry, under which chain distributors could be required to observe the terms of a resale price contract made between producers and one or more independent distributors. However, resale price control proved ineffective for groceries because manufacturers were unwilling to peg their resale prices unless their competitors had done so first and because no system of resale price control could prevent the corporate chain from pushing its private brands at any prices it might choose. Indeed, relatively high and fixed resale prices upon manufacturers' brands provided a wonderful opportunity for expansion of the private-brand business.

Immediately before the war the independent distributors launched their next legislative program: an effort to enact state laws which would prevent a manufacturer from controlling more than two distributive outlets. This legislation was intended to strike at the private-brand business of the corporate chains.

In the strategy of this fight, tax laws, price discrimination laws, laws against sale below cost, resale price maintenance laws, and laws against vertical integration all appear as joint or alternative weapons by the same persons against the same persons. The continuity of pattern in the antagonism between the independent distributors and the corporate chains is as striking and as reliable in its way as the continuity of legal doctrines; but the cases and statutes which fall together under this type of analysis would never be studied together on the basis of legal analysis alone. An awareness of the strategic pattern is an aid to an understanding of many peculiarities in the laws themselves.

The second use for economic materials is to clarify the economic concepts involved in the facts of a marketing relationship which raises an antitrust problem. To handle a complex antitrust issue, a lawyer should know something of the economic significance of price stability, uniform price change, spreads between prices and costs, and the like. Unfortunately, he will get less help in this regard than he should be able to get, for thus far many economic theorists have regarded such market data as beneath their notice; many professors of marketing have not felt it necessary to subject the facts to economic analysis; and many lawyers have handled such matters only on the legal plane. Nevertheless, some efforts are being made to analyze price policies, cost-price relationships, price movements for specific commodities, distributive relationships, and similar relevant materials. These efforts are highly suggestive in providing evidence and aiding the analysis of evidence. The inception of one antitrust case in the building materials field, for example, was an examination of statistics which showed that the price of the material

rose counter-cyclically in the face of a decline in the volume of its production. This paradoxical behavior seemed to call for explanation. A fine illustration of the evidentiary use of economic analysis is to be found in the recent tobacco case,[2] which was built on the basis of the work of economists who analyzed price spreads for grades of tobacco, demonstrated that preclusive buying had been used to drive up the prices of grades used by independent manufacturers, and brought out the economic significance of various other market practices.

Of at least equal importance, however, is another type of clarification of concepts—that which has to do with the theory upon which prosecution is brought or defense is offered. The possibilities appear most clearly in the monopoly cases. Decisions by the courts in these cases are confusing. There appears to be frequent vacillation between the idea that monopoly consists in occupancy of a large part of the total market and the idea that mere size is no offense but monopoly consists in behaving like a monopolist. There is also considerable uncertainty as to what the courts will recognize as monopolistic behavior. Coercive acts are easy to identify and are usually accepted as relevant. But monopolistic exploitation of the consumer is less readily identified and accepted. Underlying these ambiguities of the law is a failure of the Government to develop and apply an appropriate economic theory. The simple textbook descriptions of monopoly offer little guidance as to how one is to identify significant degrees of monopoly power and how one is to distinguish in the actual market between a competitive price and a monopoly price. The hints which are available in the theory have not been tested and elaborated into a code of practice.

Moreover, the traditional legal concept of monopoly may be inadequate to circumscribe the problems of economic power with which the antitrust agencies are now attempting to cope. The power of a large enterprise consists not merely in its control of a particular market or a particular commodity but also in sheer financial strength based upon its aggregate assets and in ability to maneuver based upon structural characteristics such as diversification of products and vertical integration. The duPont Company probably has as much power in selling a product of which it makes forty per cent of the total supply as in selling one of which it makes seventy-five per cent. In attacking such problems, the antitrust agencies and the courts are broadening the legal meaning of the term monopoly. A clear economic analysis of the nature of power and its abuse might promote clarity in the pleadings, or, failing that, at

[2] American Tobacco Co. v. United States, 328 U.S. 781, 66 Sup.Ct. 1125, 90 L.Ed. 1575 (1946).

least a clearer understanding of the types of legal fiction which are being created.

For example, consider the recent Sherman Act proceeding against the Great Atlantic and Pacific Tea Company.[3] Viewed as an old-fashioned monopoly case, this prosecution has puzzled many economists and lawyers. The company had a percentage of the food supply which was smaller than that frequently regarded as consistent with competition in other cases. It had followed a low-price policy upon most of its sales at retail. The appearance of a chain store in a retail neighborhood was ordinarily regarded as a sign of intensified competition there. True, the evidence in the case indicated regional price discrimination, localized monopoly power in particular cities, and instances in which a policy of high or collusive prices was being followed. Proceedings appropriate solely to this type of evidence, however, would have been much smaller in scale than the attack which was launched by the Government. The puzzling features of the case disappear if it is regarded as an attempt to cope with a type of economic power which is derived from bigness and from multiplicity of market interests rather than from domination of a particular market and a particular product. At the retail end, A & P could afford to cut prices without limit in any locality because of the breadth of its market coverage. It could and, according to the evidence, did engage in tactics of differential price reduction in localities and even in regions. As a vertically integrated concern it was able to make so much in its manufacturing and wholesaling business that, according to the accounting evidence submitted by the Government, it could and did operate its entire retailing business substantially at cost. It thereby provided a threat to the independent retailer against which he was powerless. Its progressive enlargement of its food volume was attributable to devices which could be used without visible limit except that imposed by a handful of other large food chains capable of applying the same devices. Because of vertical integration, A & P was able to play the independent grocery manufacturers against its private brand business and thereby either obtain discriminatory concessions from the manufacturers or throw its major merchandising effort behind its private brands. As both buyer and wholesaler of fruits and vegetables, it could work a discriminatory price squeeze upon its independent customers and could obtain discriminatory concessions from its sources of supply. The power which produced such results is traceable partly to vertical integration, partly to horizontal diversification, and partly to great aggregate size.

[3] United States v. Great Atlantic & Pacific Tea Co., 67 F.Supp. 626 (E.D.Ill.1946).

Economic analyses of concepts of monopoly and of economic power generally are relevant to clarification of these issues. Unfortunately, very little such work has been done. For the most part, it will be necessary for the law schools, alone or in collaboration with the colleges, to foster appropriate types of analysis.

The third use of economic materials is in analyzing the significance of the policy of the law and the bearing upon it of particular business practices and particular industrial arrangements. A theory of what is supposed to be accomplished by competition is necessary to an understanding of the policy of the antitrust laws. Unfortunately, while there is a great literature describing so-called pure or perfect competition and a rapidly growing literature describing a highly abstracted form of so-called monopolistic competition, there is not much economic writing which seeks to describe the kinds of competition which actually prevail in competitive markets or the kinds which it is reasonable to expect can be maintained by government action. Such literature as can be found is highly relevant. Equally relevant is an effort to relate the theory of particular lawsuits and the probable effect of particular decrees to this desired competitive pattern.

In the case of the A & P Tea Company already referred to, for example, I have suggested that the case broadens the meaning of monopoly under the Sherman Act. Is this enlargement appropriate to the policy of the law? In so far as the purpose of the law appears to be to provide consumers with cheap merchandise by encouraging the development of price-lowering forces among sellers, there appears to be an inconsistency, and this point has been stressed both by commentators and by the defendant. In so far as the purpose of the law is to prevent the exercise of types of economic power through which success can be attained regardless of efficiency, less powerful enterprises can be destroyed however efficient they may be, and concentration may grow without visible limit, the case appears to be an attack upon forces and techniques which have been too long neglected. The case illustrates the point that these two interpretations of the law, which often run parallel, may cut across one another. It highlights the need for explicit and hard-headed economic and legal analysis as to the relative weight which should be given to these two aspects of public policy in devising the civil decree which would be a logical sequel if the conviction in the lower court should be finally sustained.

In summary, I have suggested that economic analysis may lead to a more discerning treatment of evidence, a better understanding of the business maneuvers which underlie legal controversies, more appropriate concepts of monopoly power, and a better understanding of the policy

of the law. The most appropriate materials for such analysis are the facts and relationships of the cases themselves, together with whatever studies may be available about the enterprises and practices involved in the cases. Broader studies of the nature of competition and of business policies are also appropriate; but they need to be based upon data, to produce conclusions which can be identified when they present themselves in the data, and to discuss issues and alternatives of current public policy. Since little work of this description has been done by economists, it will be necessary for law schools to stimulate it to meet their needs.