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CONGLOMERATES: A "NONINDUSTRY"

by

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CONGLOMERATES: A "NONINDUSTRY"

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The large modern corporation typically is not confined to a single industry but embraces many lines of business and its operations extend into the far corners of the earth. We shall call such a firm a conglomerate enterprise.

Such business organizations are not new.[1] Sixty years ago, before they were stopped by the Department of Justice, the major meat packers of the nation were assembling large commercial empires that spanned many industries and many countries.[2] What is new is that, in much of the economy, conglomerate enterprise is no longer the exception, but the rule.

This transformation of the corporation is no less significant than the replacement of many highly fragmented industries by oligopolistic ones by the great merger movement around 1900. Economists responded to the new industrial structure of that era by developing the theory of oligopoly. This theory, which explains market power created by the structure of a particular industry, is not adequate to explain many features of an economy increasingly dominated by conglomerate firms.

The growth of conglomerate enterprise threatens to make obsolete much traditional industrial organization theory that has held favor in the economics professions since the 1930s. Theories of oligopoly, for example, that were framed to explain market conduct and performance in terms of the market structure of an industry, are no longer adequate tools of analysis in an age in which conglomerate firms are enjoying greater and greater dominance. For the power that such firms can bring to bear within a particular industry--and, hence, the influence they can exert over prices, output, new entry, and innovation--depends on their market position not just in that one industry but also in all their many lines of business at home and abroad. When the same huge firms are among the leading producers in separate industries--for example, coal and petroleum--the industry lines themselves may become blurred. This is not to argue that traditional industrial organization theory and research are meaningless, but rather to emphasize a need for including conglomeration as an additional structural variable in explaining behavior in many contemporary industries. This view is shared by Joan Robinson, whose 1933 work, The Economics of Imperfect Competition, is one of the pillars of modern oligopoly theory. In the preface to the 1969 edition of this seminal work, Robinson observes that growing conglomeration had largely made obsolete her theory of imperfect competition: "My old-fashioned comparison between monopoly and competition may still have some application to old-fashioned restrictive rings [cartels] but it cannot comprehend the great octopuses of modern industry."[3]

Because all huge firms are conglomerates to varying degrees, Corwin Edwards coined the term, conglomerate bigness.[4] Because bigness and conglomerates are correlated, increasing centralization of the economy in a relatively few vast corporations is one index of the growing importance of conglomerate bigness in the economy. We, therefore, begin our discussion of conglomerate bigness by examining the growing centralization of the economy, and especially the unique role conglomerate mergers have played in the process in recent years.

I. INDUSTRIAL CENTRALIZATION AND CONGLOMERATE BIGNESS

Although the great merger movement around 1900 centralized control over much of manufacturing, at the time manufacturing represented a relatively small part of the economy. Whereas around 1900 income originating in agriculture almost equalled income originating in manufacturing, today income originating in manufacturing is 10 times greater than that in agriculture.

Moreover, compared with today's industrial elite, the early twentieth-century business monarchs ruled very modest domains. With combined sales of $168 billion in 1980, today's two largest manufacturing corporations have greater sales (even after adjusting for inflation) than did all manufacturing companies combined in 1900.

But the leading corporations have not only grown larger in an absolute sense, but in a relative sense as well. Since the mid-1920s, the leading corporations have expanded substantially their share of the total assets held by corporations engaged primarily in manufacturing. The top corporations' share rose primarily during periods of rapid growth by mergers: first during the frenzied--although relatively brief--movement of 1926-1931, and, again, during the accelerating merger activity since 1950.

The sharpest increase in the postwar years occurred from 1966 to 1968.[5] Indeed, by 1968, the top 100 held a larger share (48 percent) than had been held by the top 200 in 1950, an increase attributable primarily to mergers.[6] Although merger activity ebbed in 1971-1972, thereafter it continued at a heady pace with the result that the top 200 corporations' share of industrial assets has remained at the new merger-achieved highs of the late 1960s.[7]

Some economists seem to infer that there exists no problem of industrial centralization and conglomeration unless the share of assets held by the top 100 or 200 firms does not increase continually. But this misses a crucial point. The most relevant measure of conglomerate bigness is the share held by all very large corporations. One such index is the share held by industrial corporations with assets of $1 billion or more. Whereas in 1929 there were only 3 corporations of this size, by 1980 there were 293. These large corporations' share of manufacturing assets grew from 8 per cent in 1939 to 63 per cent in 1980.[8] Although inflation of asset values explains part of the upward trend,[9] the crucial fact is that, in 1980, so few corporations controlled more than one half of all manufacturing assets.

The trend toward growing centralization and conglomerate bigness is even greater than shown here because corporate decision making is, in many instances, further centralized by numerous corporate joint ventures among the large corporations. For example, leading petroleum companies operate hundreds of joint ventures, both with other large corporations and numerous smaller ones. Such joint ventures involve the partial merging of the parties involved. By forming new communities of interest or by strengthening existing ones, joint ventures create the capacity to reduce both actual and potential competition among their large corporate parents.

The enormous merger movement in manufacturing during the 1960s and 1970s was part of a broader picture of centralization and conglomeration in the American economy. Increasingly, manufacturing corporations acquired many large nonmanufacturing concerns. Firms engaged in retail distribution, insurance, broadcasting, newspapers, and the utilities also were caught up in the movement. Even the holding company returned to prominence as a vehicle by which nonindustrial corporations, especially railroads and banks, extended their control and influence over major industrial activities.[10]

II. MERGERS AND INDUSTRIAL CONGLOMERATION

One of the most important characteristics of recent merger activity is that as it intensified, the share of horizontal and vertical mergers declined sharply, as more and more mergers were of the conglomerate type. Horizontal mergers are those among companies producing identical or very closely interchangeable products--for example, two manufacturers of steel products. Vertical mergers are those between companies in a buyer-seller relationship--for example, a shoe manufacturer and a shoe retailer. Conglomerate mergers are those between companies that are neither direct competitors nor in a buyer-seller relationships with one another. Such mergers may be subdivided into three classes: (1) Geographic market extension mergers, which involve mergers among companies producing identical products but selling in separate geographic (economic) markets--for example, a fluid milk processor in Chicago merging with a fluid milk processor in New York; (2) Product extension mergers, which involve mergers between companies that are functionally related in production and/or distribution but sell products not in direct competition with each other--for example, a fluid milk company merging with an ice cream company; and (3) Pure conglomerate mergers, which involve mergers between companies that fall in none of these categories--for example, a railroad and a tire manufacturer.

In the period 1948-1955, most mergers were horizontal or vertical in nature. As rules of law relative to such mergers became increasingly stringent and as merger activity accelerated, a growing share of mergers were of the conglomerate variety. The result was to enhance further the absolute and relative size of many already large corporations, as well as to create many new ones. Twenty-five large corporations whose growth was accelerated sharply by mergers, primarily conglomerate mergers, are shown on Table 1. This list is restricted to corporations ranking among the 100 largest industrials in 1979. Many of these already were substantial firms in 1960, when 10 ranked among the top 100 industrials and 21 ranked among the top 500. Whereas sales of all corporations engaged primarily in manufacturing grew by 304 per cent from 1960 to 1979, these corporations grew by 1,494 per cent. All but one of these 25 corporations grew by more than 500 per cent and 16 grew by more than 1,000 per cent during the period. All had annual sales of more than $3 billion in 1979, and all but one increased its rank among the top industrial corporations. Three corporations had greater sales than the combined sales of all 25 corporations in 1960.

But these mergers did much more than increase the absolute size of the acquiring corporations. Today, these corporations operate in many geographic and product markets, and most have extensive foreign as well as domestic holdings. In a word, they are huge <u>conglomerate</u> enterprises.

Because the boundaries of such an enterprise extend far beyond particular industries and even nations, its economic significance cannot be comprehended by traditional analyses that focus on individual industries.

TABLE 1

Twenty-five Large Corporations Making Extensive Acquisitions During 1961-1969

CORPORATION	SALES[a] (millions) 1979 ($)	1960 ($)	GROWTH 1960-1979 (PER CENT)	RANK AMONG INDUSTRIALS 1979	1960
ITT	17,197	811	2,020	11	51
Atlantic-Richfield	16,234	561	2,794	12	77
Conoco	12,648	694	1,722	15	64
Tenneco	11,209	535	1,995	18	85
Sun Oil	10,666	750	1,322	20	59
Occidental Oil	9,555	3	--	21	—[b]
Phillips Petroleum	9,503	1,200	692	22	31
United Technologies	9,053	988	816	26	41
LTV	7,997	148	5,303	31	285
Union Oil	7,568	427	1,672	34	107
Beatrice Foods	7,468	443	1,586	35	105
RCA	7,455	1,486	402	36	25
Rockwell Industries	6,466	116	5,474	45	353
Philip Morris	6,144	330	1,762	49	140
Gulf & Western	5,288	24	--	52	—[b]
McDonald-Douglas	5,279	437	1,108	54	110
W.R. Grace	5,267	553	852	55	80
Georgia Pacific	5,207	222	2,245	56	213[c]
Consolidated Foods	4,720	126	3,646	64	—[c]
Greyhound	4,700	287	1,538	65	—
Ralston Purina	4,601	510	802	67	92
TRW	4,560	420	986	68	113
Litton Industries	4,086	188	2,073	81	249
CPC International	3,699	276	1,240	93	171
Textron	3,393	383	786	100	124
Total 25 Corporations	189,963	11,918	1,494%		
All Manufacturing Corps.	$1,741,750	$431,329	304%		

[a]Sales for consolidated subsidiaries.

[b]Not among the 1000 largest industrials in 1960

[c]Not primarily an industrial corporation in 1960

To capture the unique and multifaceted dimensions of corporate conglomeration requires an in-depth examination of individual enterprises. We shall therefore examine in some detail the growth and current scope of International Telephone and Telegraph Corporation (ITT), the most pervasive conglomerate acquirer.

III. ITT: THE ANATOMY OF A CONGLOMERATE

In 1960, International Telephone and Telegraph Corporation embarked on an ambitious diversification-through-merger program to transform itself from what its chairman, Harold S. Geneen, characterized as "primarily a one-product company."[11] Although it had not yet become a household word, ITT already was a substantial enterprise in 1960: It had sales of $811 million and ranked fifty-first among the nation's largest industrials. In the four decades following its founding in 1920, it had become a large international manufacturer of telecommunication equipment and an operator of telephone communication systems.

From 1960 to 1979, its sales grew by 2020 per cent, making it 11th among the nation's industrials. Even this understates ITT's actual size. Its total 1979 consolidated assets of $15 billion did not include the Hartford Fire Insurance Company and other unconsolidated corporations with combined assets exceeding $13 billion; nor did they include the many government-owned facilities that it operated. In 1970, it operated 13 NASA and Department of Defense installations and manufacturing plants with combined assets of $527 million.[12] (Current figures are not available.)

Like many other new conglomerates, ITT is a leading defense-space company. But unlike most others, it also has a vast international organization that, according to an ITT annual report, "operates in more than 80 countries around the globe" extending to seven continents, "making ITT one of the few companies able to claim 'pole to pole' operations."[13]

During 1961-1968, ITT acquired 52 domestic and 55 foreign corporations, with the acquired domestic companies alone holding combined assets of about $1.5 billion. During 1969, alone, ITT's board of directors approved 22 domestic and 11 foreign acquisitions. The three largest--Hartford Fire Insurance Company, Grinnell Corporation, and Canteen Corporation--added more than $2 billion, which brought its acquisitions total for the decade to near $4 billion, far ahead of any other company. Since 1969, it has acquired more than 100 domestic and foreign firms, although in 1971 it signed a consent decree with the Department of Justice that placed partial restraints on its future acquisitions.[14] Significantly, most of ITT's acquired assets came not from small, ailing companies, but from profitable corporations that were already leaders in their field.

Although ITT is primarily a manufacturing corporation, selling to and buying from thousands of other businesses, it also touches directly the lives of millions. As a consumer, you can buy furnishings for your home with personal loans from one of ITT's finance subsidiaries; you can buy radios, phonographs, tape recorders, and TV sets made by ITT in Germany and England; purchase a homesite from ITT-Palm Coast's residential community in Florida; insure your home at ITT-Hartford Fire Insurance; buy your life insurance from one of the ITT's life insurance subsidiaries; invest your savings in ITT-Hamilton Management mutual funds; munch on ITT Continental Hostess bakery products; savor ITT-gwaltney ham and frankfurters; drink ITT soft drinks; stay at hotels or motels owned by ITT-Sheraton; buy books from ITT's Bobbs-Merrill publishing division; attend one of ITT's technical and business schools; or discover whether friends and acquaintences have been selected for inclusion in Marquis Who's Who. Finally, had the ABC-ITT merger, which was abandoned in January 1968 after being blocked by the Justice Department, been consumated, you could have been ITT's guest for an evening of TV viewing.

Moreover, part of each American's tax dollars spent on defense and space programs goes to ITT, which is one of the nation's prime defense contractors. International Telephone and Telegraph maintains Washington's "hot lines" to Moscow, mans the Air Force Distant Early Warning System (DEW) and the giant Ballistic Missile Early Warning System (BMEWS) sites in Greenland and Alaska, and produces navigation equipment for the NAVSTAR satellites.

With it's numerous foreign operations, ITT is an important force in international economic affairs. Since 1960, ITT has acquired many foreign companies and now controls about one third of Europe's telecommunications business.

Some ITT officials have been better known in circles of national and international diplomacy than in business. They have included such notables as former U.N. Secretary-General Trygve Lie, as director of ITT Norway; one-time Belgium Premier Paul-Henri Spaak, as a director of ITT Belgium; two members of the British House of Lords; a member of the French National Assembly; and, at home, John A. McCone, former director of the CIA, and Eugene R. Black, who is widely known in international economic and political circles where he has held such important posts as the special financial advisor to the Secretary-General of the United Nations, and financial advisor to the Sheik of Kuwait, as well as board member of dozens of large corporations. It is not unfair to ask, have such men been on ITT's board because of their business acumen or their power and prestige in domestic and international politics? This raises a corollary question of who is more powerful in international diplomacy, the U.S. State Department or huge international conglomerates like ITT?

Nor is concern with these matters based on mere speculation or conjecture. Recent public exposés document widespread corporate misconduct in foreign affairs. The Senate Foreign Relations Subcommittee on Multinational Corporations documented ITT's efforts to overthrow the Allende government in Chile, including efforts to fund subversion by the CIA.[15] Nor is this intervention in the affairs of other nations unique.[16] In a "sensational Belgium trial," the managing director of ITT-Belgium was found guilty of bribing a high official of the Belgium state telephone service.[17]

IV. CONGLOMERATE MERGERS: MOTIVES

Just what do these developments augur for the future of our economic and political institutions? It is well to begin by appreciating what they do not promise: They do not promise to usher in a new era of productive efficiency or technological advance. Although our knowledge is far from complete, it is clear that recent merger activity was not propelled primarily by the technological imperatives of large scale. Rather most large mergers were motivated by special factors that, while conferring advantage and privilege on the private parties involved, promised no corresponding social benefit. Space permits only a brief review of the evidence.

Perhaps no concept so rapidly captured the imagination of so many as that conglomerate merger managers were able to reap the benefits of synergism--that is, where combining separate substances produces an effect greater than that resulting from the substances used separately. In the popular trade parlance, synergism results in two plus two equaling five.[18] This thesis held that the explanation for the conglomerate merger wave of the 1960s was to be found in the new management techniques of the merger makers. The Jimmy Lings (LTV) and Tex Thortons (Litton Industries) were viewed as a new breed of business manager, omniscient men who could make dynamic firms out of lethargic ones,[19] who could make two blades of grass grow where others struggled to grow one.

For a time there was superficial evidence that the new conglomerates could, indeed, outperform other corporations relying primarily on internal growth. A number showed spectacular increases in their profit performance. This apparent superior profit performance became reflected in seemingly ever-rising stock prices. Few of the new conglomerates were praised more highly than Litton Industries, whose top management team, headed by Tex Thorton, had been schooled in the systems analysis approach so popular at the Pentagon. During 1958-1969, Litton acquired at least 97 relatively small companies in such diverse fields as military and commercial ships, medical X-ray equipment, frozen foods, textbooks, store fixtures and refrigeration equipment, office calculators, typewriters, power transmission equipment, microwave ovens, and education systems.

In what seemed indisputable evidence of synergism, Litton management had a magical record of earnings growth. Earnings per share of common stock doubled from 1960-1962, more than doubled again from 1962-1965, and very nearly doubled from 1965-1967. This profit performance became reflected in the astronomical rise in the value of its common stock, which rose from a low of $6 per share in 1960 to $104-3/4 in early 1968. Then a precipitous decline set in. The first blow to the synergism mystique surrounding Litton came when its profits declined in 1968, the first annual decline in its history. The initial reaction was one of guarded disbelief. As one financial analyst put it, "So hallowed had Litton's name become that, presumably, it was unthinkable among its disciples that the company could ever have anything but one banner year after another ad infinitum."[20] In the face of a generally ebullient stock market Litton's common stock tumbled to a low of $68 in 1968. But the unthinkable happened: 1968 did not prove to be an exception, but the beginning of a long downward slide in Litton's fortunes, as its common stock ultimately fell to a low of $2-1/2 in 1974. In recent years, its fortunes improved, and by the end of 1980 it was selling in the $70s.

Nor was Litton as exception among leading conglomerates. LTV's common stock rose from an average price of $21 in 1960 to $108 in 1968; thereafter it declined steadily, reaching a low of $5.25 in 1978. By the end of 1980, LTV was still selling below $20 per share.

How, then, were some conglomerates able for so long to conceal from stockholders the truth about their corporation's true financial health? The answers lie in some managements' ability to "manage" profit performance by exploiting a host of accounting and tax gimmicks open to firms growing by mergers. The new conglomerate managers did not discover new management techniques, but rather a seemingly endless number of tax, accounting, and financial gimmicks that favored merger over internal growth. Events in the coal industry show how the discovery of a tax gimmick by one firm tiggered other mergers and drastically restructured an industry almost overnight. In 1966, Continental Oil Company acquired Consolidation Coal Company, the country's largest coal producer. According to a Treasury Department report, the merger involved a complicated transaction that permitted Continental to save more than $175 million taxes.[21] Shortly thereafter, Kennecott Copper Company, using the same tax gimmick, acquired Peabody Coal Company, the nation's second-largest coal company. In 1968, the third-largest coal producer was purchased by Occidental Petroleum. Thus, in just 3 years, the three largest coal companies merged into other large corporations, resulting in private gains of hundreds of millions of dollars at the taxpayer's expense.

This is only one of many examples. Consider the effects of the tax loss carry forward provisions of the internal revenue code. After the merger creating the Penn Central railroad, the Penn Central Company (or Corp?) was able to establish a tax loss carry forward of between $500 million and $600 million. The Wall Street Journal reported that "Working under [its] tax shelter... the new company could acquire many profitable ventures and still pay no taxes for 5 or 6 years."[22] Not too surprisingly, Penn Central subsequently became an active acquirer of profitable companies. Its holdings included two big real estate developers, Buckeye Pipeline Company, Southwestern Oil & Gas Company, Royal Petroleum Company, and a large interest in the Madison Square Gardens Corporation. The last acquisition gave Penn Central an interest in New York's professional basketball and hockey teams, the Knickerbockers and the Rangers. Such helter-skelter growth certainly did not contribute to economic efficiency. Indeed, Penn Central's purchases of nontransportation businesses helped exhaust its working capital, which created the liquidity crises that forced the company into bankruptcy proceedings in June 1970. This experience illustrates that the economy would have been better off had Penn Central management devoted more time to running the trains on time than on making mergers that reduced its tax obligations.

Perhaps the most notorious device used by a merger-active company to accelerate its earnings per share of common stock without increasing real earnings is pooling-of-interest accounting. Under pooling-of-interest accounting the book values of merging companies are combined. This permits an acquiring company to list the value of assets at less than their real costs. Abraham J. Briloff demonstrated how Gulf & Western was able to increase greatly its reported earnings following its 1967 acqusition of Paramount Pictures.

> In its 1967 statements, Gulf & Western asserted that its earnings had more than doubled--from $22 million the previous year to $46 million. While this was certainly dramatic, supplemental data furnished by the report were even more euphoric. They revealed that companies acquired during 1967 contributed a whopping $22 million to the conglomerate's 1967 income, although these companies had earned only $2.6 million during 1966.

> Whether this extraordinary increase in earnings was attributable to the special brilliance and genius of Gulf & Western's management depends on how one defines brilliance and ingenuity. The enormous profit inflation was triggered by Gulf & Western's wholesale disposition of television rights to the Paramount Pictures library. Gulf & Western simply disposed of properties which they had acquired in the acquisition of Paramount.
>
> By using the pooling-of-interest method of accounting, the conglomerate was able to pay out over \$184 million for its 1967 acquisitions, while reflecting only a cost of less than \$100 million on its books. It accomplished this by equating the cost of the 1967 acquisitions with the written down (or written off) amounts shown on the books of Paramount and the other acquired companies--that is, \$100 million. The other \$84 million was free to be used to bolster reported earnings and, as asserted above, a good part of it was so used.[23]

The numerous mergers of ITT offered it a seemingly limitless variety of ways of increasing <u>reported</u> earnings per share without any real improvement in operating efficiency. Most important was its exploitation of the opportunities of accounting rules that permit merging companies to pool their interests. As noted above, the accounting procedure permits companies to pay well above the market price of a company and yet show only the book value of the acquired company on their books. A little-publicized Staff Report of the House Antitrust Subcommittee shows how ITT's use of pooling-of-interest accounting permitted ITT to greatly overstate earnings from 1964 to 1968. During that period, it paid \$1,278 million in stock for companies with a net worth of \$534 million. If this excess payment for "goodwill" had been amortized during a 10-year period, ITT's actual reported net income for 1968 would be overstated by 70.4 per cent.[24a] This is only one of several methods used by ITT to increase its profits on common stock. It also increased the company's leverage by increasing the ratio of debt capital and preferred stock to common stock.[24b] After acquisition, it frequently changed the acquired firm's depreciation policy.

Changes in accounting procedures by ITT-Sheraton, Continental Baking, and Rayonier increased ITT's profits by $7.2 million in 1968; this accounting change alone accounted for 11.8 per cent of the increase in ITT's earnings from 1967 to 1968.[24c] None of these changes was reported in the notes to ITT's financial statements in 1968.[24d]

The failure of ITT to disclose the true source of its ever-growing earnings per share came under increasing fire from financial analysts. For example, Mr. David Norr, partner of First Manhattan Company and a member of the Accounting Principles Board, severely criticized ITT's 1970 annual report for not reflecting retroactively the results of the many companies it had acquired. Norr thought this omission was sufficient grounds for the New York Stock Exchange to halt trading in ITT securities.[24e] The exchange did not see fit to discipline one of its leading members.

Other financial analysts have reported their frustrations in seeking to learn the true source of ITT's rising earnings. In an "Alert for Portfolio Managers," investment analysts Scheinman, Hockstin, and Trotta warned, "ITT continues its financial advertising blitz in the financial media with the eye-catching caption, 'Here's the story again--in case you missed it in the press.'"[24f] But after careful study of ITT's financial statements--and with no help from ITT--these analysts found that, in 1968 and 1969, 34 per cent of ITT's increased earnings per share were due to such nonrecurring sources of income as sale of securities and plants.[24g] The report added that it had "good reason to believe that similar or analogous transactions of even greater magnitude took place in 1970."[24h] It concluded that "the key to ITT's 'growth' in 1970 share earnings (ex. Hartford Fire) lies in the undisclosed elements which were responsible for the 1970 increase in deferred taxes--equivalent to 40 cents a share of ITT earnings in 1970."[24i]

Fortune magazine reported that, in 1971, ITT again reaped large capital gains from its Hartford Fire Insurance Company acquisition, and that it was likely to continue to do so for many years to come:

> Last year Hartford netted a total of $105 million. The fact that $36 million of this amount came from capital gains was not recorded. Hartford's unrealized capital gains amounted to about $270 million at the end of last year and, barring a major stock market crash, should for years be available to supplement the steadily growing stream of interest and dividend income that rolls out of the company's portfolio.[24j]

Hartford is a deep well from which ITT apparently can pump increased reported earnings for years to come. Little wonder an ITT executive described it, "a gold mine."[24k]

Banks and investment companies, as in past merger movements, were leading promoters of mergers in the 1960s. One Wall Street investment banker was quoted as follows concerning the shenanigans involved in many merger deals: "I suppose you could call some of it dirty. But it's so much fun. How can anything that much fun be dirty?" However, even some conservative financiers became increasingly concerned lest these questionable tactics ultimately backfire on the business community. Listen to this warning of Paul Costman Cabot, the dean of the Boston financial community, long-time director of J.P. Morgan & Company and one-time treasurer of Harvard University.

> It shocks me that so many investment companies are playing the game too. It works like this: A take-over guy comes to them and says, 'I'm going to take over such-and-such at such a price 50 per cent over the current market price. Why don't you buy 5 per cent of the stock and tender it to me when my offer comes out?' So the take-over guy gets a block of stock in friendly hands and the investment company gets an assured, easy profit. Even if the take-over fails, the raped company marries someone else and the investment company still makes out. This is a game that's going to give the whole investment company business a bad name.[24l]

Cabot observes, "It seems that each generation is cursed with problems all born of greed and a lust for power." After recounting various adverse effects flowing from these developments, Mr. Cabot concludes, "Possibly the most objectionable feature is the concentration of control and power in so few hands."[24m]

These are only among the most obvious gimmicks and motivations that often make mergers a preferred method of growth. Several studies document how various tax and accounting rules and practices encouraged mergers for reasons unrelated to economic efficiency.[24n] A 1969 FTC report concluded, "The balance of evidence so far available lends little support to the view that the current merger movement reflects, in substantial measure, efforts to exploit opportunities to improve efficiency in resource allocation. On the contrary, there are abundant indications that certain institutional arrangements involving tax and accounting methods, aided by speculative developments in the stock market, have played a major role in fueling the current merger movement."[24o]

The accounting and tax gimmickry pursued by some conglomerates ultimately caught up with them, and their stock fell from the dizzy heights of the late 1960s. But it would be a mistake to conclude from this that market forces may ultimately punish some conglomerates (or, more correctly, their stockholders) for their past financial manipulations, thereby somehow dissipating any undesirable effects growing from industrial conglomeration and centralization. Students of industrial history are familiar with many cases where firms with merger-achieved market power performed inefficiently after they became very large; yet they continued to present a serious public policy problem. U.S. Steel is a classic example of this. It was created in 1901 by "a combination of combinations" and on a foundation of watered stock. Shielded from competition by its tremendous market power, U.S. Steel nevertheless was very inefficient and had a lackluster research and development program.[24p] It has presented one of America's most intractable public policy problems for more than half a century. The lesson to be learned from this is that once huge corporations are formed they do wither away.

None of the preceding is to imply that all, or even most, mergers are promoted to exploit accounting and tax gimmicks or are for purposes of greed or personal aggrandizement. Although a variety of factors may promote mergers, a concensus is emerging among economic researchers as to what such mergers accomplish, or more correctly, what they do not accomplish. In 1970, Dr. Thomas F. Hogarty made a comprehensive review of 50 years of research on the question of whether mergers are more profitable than alternative investments. He concluded: "A host of researchers, working at different points of time and utilizing different analytical techniques and data, have but one major difference: whether mergers have a neutral or negative impact on profitability."[24q]

Recently, Professor Dennis C. Mueller made a similar review of research findings during the 1970s. Perhaps the most important finding of these works is that conglomerate mergers generally do not enhance the profitability or stock values of acquiring firms.[24r] Among the important conclusions flowing from this finding is that management of acquiring firms apparently are pursuing "corporate growth or other objectives not directly related to stockholder welfare and economic efficiency." Dennis Mueller believes this explains "why managers of acquiring firms undertake mergers providing no benefits for their stockholders; why managers of acquisition targets vigorously resist bids which would greatly enrich their stockholders."[24s]

A corollary of this finding is that generally acquired companies are not less efficient than the acquiring companies. This, or course, destroys another often used rationale for justifying all large conglomerate mergers, Professor Henry Manne's theory of "the market for corporate control,"[24t] which asserts conglomerate mergers are not to be condemned but praised. Manne believes they promote economic efficiency as Adam Smith's invisible hand leads efficient corporations to acquire inefficiently managed ones. In this theoretical world the most efficient always win take-over contests. Not only have empirical studies repudiated this theory, simple observation has illustrated its absurdity when applied to large acquired corporations. The truth is that very large corporations are virtually immune from take-over. Consider these facts: During 1971-1978, thousands of corporations were acquired. Of these, none were among the top fifty industrial corporations and only one was among the top 100. Clearly, the largest corporations are largely immune from "the market for corporate control."

In sum, the best research evidence indicates that considerations other than efficiency motivate most conglomerate mergers. But a question still remains: although large conglomerate mergers generally do not promote efficiency, are there any reasons for placing restraints on such mergers?

Research studies suggest at least two kinds of adverse effects of conglomerate mergers. First, some studies conclude that when management becomes preoccupied with growth by mergers, such growth is accomplished at the expense of more socially productive forms of growth, e.g., capital investment in R&D.[24u] Second, conglomerate mergers result in greater overall concentration of economic resources, with a concomitant increase in corporate political power. Dennis C. Mueller observes that whereas in earlier times economists were inclined to dismiss such concerns as unsubstantiated, "...the age of innocence regarding corporate power is now over. Large corporations both have and utilize political power. And it seems reasonable to assume that this power is positively related to company size."[24v] We now turn to the events of the 1970s that were responsible for ending "the age of innocence" regarding the interplay of corporate economic and political power.

V. CONGLOMERATE BIGNESS AND THE POLITICAL PROCESS

We have seen that the recent wave of very large mergers has not been motivated primarily by a quest for economic efficiency. This fact alone would not necessarily cause a serious public policy problem were not our economic system becoming centralized in ways that may transform adversely both our political and economic institutions.

Corwin Edwards in his seminal article on the conglomerate enterprise, spelled out how such firms are able to extend their economic power into political power:

> The political strength of the great concern is an aspect of its ability to spend.... The campaign contributions of large companies and the occasional case of direct or indirect bribery are probably the least significant source of the large company's political power. More important, the large company spends whatever money is needed to argue effectively on behalf of its interest where a particular issue affects it.... The work of many people may be required in assembling facts and preparing persuasive arguments relevant to these decisions.... Large concerns are increasingly skilled in these processes, primarily because they take such work seriously and do it on a large scale.25

Edwards made these observations just before merger activity began accelerating in 1954-1955. Since then mergers have increasingly centralized the economy into a relatively few vast conglomerate enterprises, thereby further transforming our economic-political order. Simply put, this centralization process is destroying our traditional pluralistic political processes, which rest on a diffused, dispersed, heterogeneous pattern of industrial ownership. Justice William O. Douglas articulated well the American tradition toward centralized economic power when he observed, "Power that controls the economy should be in the hands of elected representatives of the people, not in the hands of an industrial oligarchy. Industrial power should be decentralized. It should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men. The fact that they are not vicious men but reasonable and social-minded is irrelevant."[26]

Historians may well record the 1970s as the period when the political power of large corporations was unmasked, making it an issue of great political debate. First came revelations of improper domestic political conduct. International Telephone and Telegraph employed its considerable power in a well-orchestrated drive to receive a favorable antitrust consent decree.[27] The Watergate investigations uncovered numerous illegal political contributions by large corporations. In April 1974, Mr. George M. Steinbrenner, chairman of the board of American Shipbuilding Corporation and owner of the New York Yankees, became the first corporate executive ever indicted on felony charges in connection with illegal corporate political contributions.[28] The numerous disclosures of domestic corporate misconduct in political affairs soon were overshadowed by evidence of massive corporate bribery and political interventions in the affairs of other nations. The ITT efforts to overthrow the Allende government in Chile have been documented by the Senate Foreign Relations Committee.[29]

Over a period of 10 years, Exxon Corp. contributed more than $59 million to various political parties in Italy, alone.[30] Inexplicably, Exxon even contributed $86,000 to the Italian Communist party. It also has admitted making political contributions in Canada and one other country, as well as payments in three unnamed countries to government officials and officials of government-owned companies.

Nor are these isolated cases of corporate bribery and illegal political activities at home and abroad. In 1976 the Securities Exchange Commission (SEC) issued a special report on Questionable and Illegal Corporate Payments and Practices.[31] The SEC's interest in these matters was triggered by the work of the Special Prosecutor appointed to investigate the illegal activities involved in the so-called "Watergate scandals."

Though cautious in drawing conclusions of wrongdoing, the SEC concluded:

> [T]he problem of questionable and illegal corporate payments is, by any measure, serious and sufficiently widespread to be a cause for deep concern. Unfortunately, the Commission is unable to conclude that instances of illegal payments are either isolated or aberrations limited to a few unscrupulous individuals.32

Although expressing concern with the extent of past illegal activities, the SEC report ended on an optimistic note:

> Thus, in the Commission's view, while the problem of questionable or illegal corporate payments is both serious and widespread, it can be controlled and does not represent an inherent defect in our economic system.33

One reason for the Commission's optimism is that many corporations have issued directives ordering the cessation of questionable conduct and have adopted written corporate policies prohibiting similar practices in the future. However, four companies told the SEC that they intend to continue the practice of making questionable payments, particularly in foreign trade.[34]

In 1980, Fortune magazine examined the extent of "crime in the executive suites" of large corporations in a feature article titled, "How Lawless are Big Companies?"[35] In Fortune's words, "A look at the record since 1970 shows that a surprising number of them have been involved in blatant illegalities."[36] The Fortune study was "limited to five crimes about whose impropriety few will argue--bribery (including kickbacks and illegal rebates); criminal fraud; illegal political contributions; tax evasion; and criminal antitrust violations. The latter consist entirely of price fixing...and exclude the vaguer [areas of antitrust]"[37]

The study examined 1,043 major corporations; 117 or 11 per cent of these had committed at least one of the above crimes during 1971-1978. Some corporations were multiple offenders, resulting in a total of 163 crimes. This is a minimum number of actual offenses, since Fortune's list consisted only of instances involving actual conviction on federal criminal charges or resulting in consent decrees during 1971-1978. The list of companies involved reads like a "Who's Who" of large conglomerates: Allied Chemical; American Airlines; Beatrice Foods; Bethlehem Steel; Borden; Du Pont; Firestone; Goodrich; Goodyear; Gulf Oil; ITT; Occidental Petroleum; Penn Central; Phillips Petroleum; R.J. Reynolds; Tenneco; a subsidiary of Time, Inc., publisher of Fortune; TWA; and U.S. Steel.

Fortune opined that "eleven per cent of major American corporations involved in corrupt practices is a pretty startling figure."[38] But the 11 per cent figure understates the relative extent of illegal activity by the largest U.S. corporations. For example, the Fortune list of offenders included 39 per cent of the 100 largest, 30 per cent of the 200 largest and 17 per cent of the 500 largest U.S. industrial corporations of 1979.[39] Additionally, of the remaining 33 violators on the Fortune list, 14 were large nonindustrial corporations (banks, railroads, airlines, and telephone companies) with revenues larger than the 200th largest industrial corporation of 1979. Thus, the great bulk of the corporations cited by Fortune as committing white-collar crimes were very large corporations. (90 per cent had revenues greater than the 500th largest industrial corporation.)

Here are three examples of the crimes reviewed by Fortune.[40]

1. Gulf Oil "used a subsidiary in Nassau to launder funds sent from the U.S. ostensibly to be used to prospect for oil. At least $4.5 million returned to these shores to be distributed as political handouts." Gulf also was cited for bribing an IRS agent and for price fixing.

2. General Tire and Rubber Co. doled out illegal political contributions from at least 1967 through 1973.

3. Bethlehem Steel was fined $325,000 for laundering "hundreds of thousands of dollars" in Europe and returning them to the U.S. for distribution as bribes. Said Fortune, "Such sleazy goings-on by a company as prestigious as Bethlehem indicate that big-business crime hasn't been swept away in a tide of post-Watergate morality."

How to explain the pervasive illegal activity of large corporations? Fortune believes that "Simple economic incentives explain much illegal behavior: corruption seems to pay, at least in the short term."[41] Perhaps the search for enhanced profits is a basic force stimulating such behavior. If so, should it be condoned any more than crimes committed by individuals hoping to improve their economic lots?

The answer seems to be an obvious no to Professor Marshall B. Clinard, the leading expert on the sociology of corporate crime, who concludes:

> Perhaps the strongest argument to be made for criminal sanctions against individual corporate offenders is the effect unequal justice has on the rest of society. When criminal responsibility is negated under the notion that only a 'lack of proper managerial control' is involved and no 'deliberate disregard for human welfare' is evinced, many persons in society conclude that 'the rich get richer, and the poor get poorer' and the law is deliberately ineffective.42

It should be emphasized, however, that many corporations, even very large ones, were not cited for any violations since 1970. This is persuasive evidence that illegal corporate behavior is not endemic to American capitalism. It can be influenced by the codes of conduct set by top management operating within a system of law that prohibits improper conduct. Moreover, the fact that most large corporations succeed without engaging in such conduct demonstrates that corporate success does not require illegal conduct.

The preceding has dealt with evidence of corporate misconduct by the nation's largest corporations. Smaller corporations certainly violate the law as well, though apparently with considerably less frequency. The reason for special concern with corporate crime by the largest corporations is that these enterprises account for the bulk of all business in most industries; therefore, their misconduct has much greater potential impact on the lives of all citizens. These corporations symbolize the American economic system both at home and abroad. Their conduct thus is frequently used to gauge the basic character of our economic and political system. This is why all Americans have a stake in the behavior of the huge corporations that run much of the American economy at home and carry our flag abroad.

VI. CONGOLMERATE MERGERS AND THE COMPETITIVE PROCESS

Economists have identified a variety of ways in which mergers may injure competition. The most obvious injury occurs when merging companies are direct competitors: For example, there was the attempted merger of Bethlehem Steel with Youngstown Steel in 1956. Such horizontal mergers injure competition by eliminating significant direct competitors. After the court decision prohibiting the Bethlehem-Youngstown merger,[43] as well as a number of subsequent Supreme Court decisions, horizontal mergers among large companies declined sharply.

Although during the 1950s many economists would have taken a tolerant attitude toward a horizontal merger of this magnitude,[44] today nearly all applaud the Bethlehem-Youngstown decision, and many embrace the even stricter rules of law spelled out in subsequent cases. Merger-enforcement policy toward horizontal mergers represents a great victory for antitrust policy.[45] Had it been otherwise--had public policy permitted mergers of the Bethlehem-Youngstown variety--concentration levels in many industries would have increased greatly in the postwar years.

Similarly, mergers among companies in buyer-seller relationships also have some readily discernible anticompetitive effects. For example, such vertical mergers may foreclose part of the market to competitors, perhaps triggering a series of defensive mergers by other companies that fear the loss of their markets.[46]

But the economic effects are less self-evident in the case of so-called conglomerate mergers--that is, mergers between companies that are neither horizontally nor vertically related. Since 1960, most larger mergers have been conglomerate in nature. The case study of ITT, the most active acquirer since 1960, illustrates how conglomerates can acquire companies in diverse fields. Some economists reason that competition is not injured so long as the merging companies are not direct competitors. In other words, they reason that there is no link between growing, over-all industrial concentration and conglomeration and the quality of competition in particular markets. As Professor M.A. Adelman is fond of reciting whenever growing conglomeration is discussed, "absolute size is absolutely irrelevant." Indeed, Adelman argues that "a truly conglomerate merger cannot be attacked in order to maintain competition, because it has no effect on any market structure."[47]

This view is based on the overly simplistic assumption that competition is determined solely by the structure of a particular market. As such, it overlooks the fact that the multimarket nature of many large industrial corporations enables them to engage in practices that are peculiarly characteristic of conglomerate firms. As a result, they often enjoy economic power that differs from the traditional concept of market power, that which results from the characteristics of a particular market: the extent of seller concentration, the degree of product differentiation, and the conditions of entry. Traditional market power manifests itself in group behavior that enhances the group's profits for the benefit of its members at the expense of its customers or suppliers.

Although the long-run profit performance of a conglomerate is largely a function of the structure of its various markets, the organizational characteristics of the large conglomerate give it a unique capacity to alter the structures of the markets in which it operates.[48] Hence, the conglomerate may not only possess traditional market power--that is, power vis-a-vis customers or suppliers--but power vis-a-vis actual or potential rivals. The nature and extent of such power depends on the relationship between the conglomerate firm's structure--its relative size, diversification, and profit capabilities in its individual markets--and that of rivals, customers, and suppliers.[49]

Specifically, business conglomeration enlarges two lines of conduct unavailable to single-market firms: the practices of cross subsidization and of reciprocity. It also widens the scope of mutual interdependence among large firms and leads to greater competitive forebearance among them. Conglomeration by merger accelerates the development of conglomerate options and mutual interdependence and allows such conduct characteristics to become significantly more pervasive than they would be if conglomeration could be achieved by internal growth alone.

This is not to imply, of course, that conglomerate power always has anticompetitive consequences. Indeed, there are special market settings in which conglomerate power is used to inject new competition into the market. Specifically, in industries where market concentration is high, new entry difficult, and which already are occuppied by conglomerates, a conglomerate firm may increase competition by entering the industry by internal growth or by acquiring a small firm in such a market and subsequently expanding it.[50]

Cross Subsidization

The first thing to note about large conglomerate corporations is that the great majority operate across many industries and hold prominent positions in the most concentrated manufacturing industries.[51] In addition to being especially prominent occupants of concentrated industries, the largest corporations hold leading positions in many industries.

Because the large conglomerate generally enjoys abnormally high profits in at least some of its markets, it may expand its power by coupling such noncompetitive profits with an ability to "shift marketing emphasis and resources among its various markets."[52] If a conglomerate firm earned a competitive rate of return in each of its product markets, it would have no "excess" profits with which to subsidize particular product lines. But, as we have seen, when a firm operates in many markets, it generally possesses market power in one or more of its important markets and, hence, secures noncompetitive long-run profits. The amount of such profits depends, of course, not only on the degree of market power that the conglomerate firm has in its various markets, but also on its total sales in markets where it has market power.

When a firm enjoys large noncompetitive profits, it possesses the option of engaging in special competitive tactics not open to the firm earning only a competitive return. Conglomeration is an instrument through which these options can be exercised. By operating in many markets, the conglomerate can use excess profits in some markets to subsidize losses in other markets, either by price cuts or by incurring a substantial increase in costs--for example, abnormally large advertising outlays. If the subsidized markets are small when compared to the overall operations of the firm, subsidization may have very little impact on overall profitability. When a firm undertakes this policy after a rational investment decision, it expects to enhance its long-run profits by virtue of the effects of subsidization on the structure of the subsidized markets and the firm's relative position in these markets.

Not only may such practices have a direct impact on industrial concentration, but one conglomerate merger may beget others, as nonconglomerate firms within an industry respond defensively to the entrance by a conglomerate with the capacity to employ cross-subsidization tactics. The reaction of an official of the Sunshine Biscuit Company, itself a sizable firm (sales of $201 million), to a proposed merger between its leading competitor, National Biscuit Company (NBC), and Coca Cola, illustrates that even substantial enterprises may respond defensively to mergers that promise to increase the market power of their rivals. One of Sunshine's directors stated:

> While there has been a tendency toward lack of interest in proposals of consolidation in the past, the recent reports of NBC and Coca Cola, although now called off, would in my opinion justify our careful consideration of this offer [from American Tobacco]....
> It seems definitely certain that if our competitor with an already larger advertising fund than ours should join with someone with similar advantages--that we could be snowed under in this field, much to the detriment of our future sales and profits.[53]

This illustrates the essentially contagious nature of conglomerate mergers, as less powerful firms feel obliged to merge with others lest they "be snowed under" by the superior power of their conglomerate rivals. Corwin Edwards summarizes aptly the advantages conferred by this dimension of conglomerate power:

> It can absorb losses that would consume the entire capital of a smaller rival.... Moment by moment the big company can outbid, outspend, or outlose the small one; and from a series of such momentary advantages it derives an advantage in attaining its large aggregate results.[54]

Many case studies have demonstrated how large corporations have used their conglomerate-derived power to engage in cross-subsidization.[55] Here we review briefly recent events in the beer industry, where a conglomerate merger appears to have played an important role in increasing concentration.[56]

There was a persistent decline in the number of brewers following World War II, from 404 companies in 1947 to about 75 in 1970, reflecting in part economies of large-scale production and advertising. By 1970, the share of U.S. beer production held by the top four firms was 44 per cent. But while the number of local and regional brewers dropped sharply between 1947 and 1970, the total sales of all regional brewers remained about the same, which meant the surviving regionals were increasing their market share. Thus, in the late 1960s and early 1970s it appeared that the imperatives of large scale would result in an industry ultimately consisting of perhaps 5 to 10 national brewers, a fairly large number of effectively competitive regionals that would expand gradually toward national status, and a fringe of small local and regional brewers.

Economists researching the beer industry in the 1960s and early 1970s were optimistic about the future of competition in the industry. Professors Ira and Ann Horwitz concluded:

> It appears unlikely that concentration in the brewery industry, at least with regard to the leading five firms, will increase to any great extent in the near future, though we might anticipate that concentration for the leading 25 firms, say, will enjoy appreciable gains.57

Similarly, Professor Kenneth Elzinga concluded in 1973:

> Unlike Shakespeare's empty tigers and roaring seas, giantism in brewing is not inexorable. Nor is there an inevitable antitrust conflict between the goals of efficiency in resource utilization and widespread consumer choice among competing firms. There is no evidence [that] there are significant multiplant economies of scale. Consequently, given the size and estimated expansion of the national beer market, and allowing even a generous estimate of the minimum optimum size plant, the industry could support at least 30 efficient and independent firms.58

Seldom have the predictions of prominent economists been proven wrong so quickly. The reasons for their errors are to be found in events not impacting the industry when they were examining it.

In 1973, a critical change occurred in the evolving structure of the industry. In that year, the sales growth of the national brewers began to accelerate at the expense of locals and regionals.

Most important, by 1980 Anheuser-Busch and Philip Morris-Miller had a combined share of 50 per cent, which was greater than the share held by the top four brewers in 1970. Only two other regional or national brewers increased their shares during the period, and one of these, Heileman, accomplished its increase largely through acquiring other regionals. A mere 12 brewers made 98 per cent of all U.S. beer sales in 1980.

These dramatic events naturally raise the question, what happened that brought about a much more concentrated industry structure than the experts had predicted just a few years ago. The poor showing of even the other national and large regionals brewers, which had been prospering until 1973, suggests that more than economies of scale were involved. The answer seems to be found in Philip Morris' acquisition in 1969-1970 of the Miller Brewing Company for $229 million.

Prior to its acquisition, Miller was one of four national brewers. Although it made only 4.5 per cent of total beer sales in 1969, its share of "premium beer"--the rapid growth segment of the industry--was about 16 per cent. Miller was a financially successful company, whose operating income during 1967-1969 about equalled that of the three other national brewers. But by comparison to its acquirer, Philip Morris, Inc., Miller was a financial midget. Philip Morris is a huge, powerful multinational conglomerate firm.

The Philip Morris-Miller (PM-Miller) merger created a potential for anticompetitive effects because of the disparity in its size and market power and that of other companies in the beer industry. Its 1979 net profits of $508 million were as great as the combined net profits of all other brewers. The huge and profitable PM-Miller towers over all other firms in the beer industry, with the exception of Anheuser-Busch.

The significance of this dominance is magnified because of the specialized characteristic of other brewers.

Twenty years ago Dr. John M. Blair emphasized the crucial importance of distinguishing among the types of market structures in which conglomerate mergers occur. When a large conglomerate firm enters by merger an industry composed of other equally powerful conglomerates, it is not possible to predict whether the conglomerate's entry will promote or retard comptition. If it engages in cross-subsidization, its rivals will be able to match dollar-for-dollar its competitive strategies. The outcome of such a merger, therefore, is indeterminate because it merely increases the number of conglomerates in a market already dominated by conglomerates.

But the outcome is different when a powerful conglomerate enters an industry composed of "single-line" firms. As Blair put it, "The danger to competition posed by cross-subsidization, whether actual or anticipated, is at a maximum in unconcentrated industries populated largely by single-line firms," though "cross-subsidization may appear as a danger to single-line producers in oligopolistic as well as unconcentrated industries...." The key here is that, "What had been a 'symmetrical' oligopoly, with each of the oligopolists having about the same position, might be transformed into an 'asymmetrical' oligopoly, with the new entrant assuming a position of dominance and leadership."[59]

When a conglomerate acquires a small factor in a market, it has a strong incentive to engage in cross-subsidization to expand its position. But as its market share grows, the industry leaders are unlikely to stand idly by foresaking without a battle their positions to the conglomerate intruder. Although all of the largest single-line firms would not succeed in maintaining their market positions, in the escalating price and nonprice rivalry triggered by the entering conglomerate's strategies, the leaders would fare better than the small firms caught in the resulting struggle for survival. In ensuing rivalry the conglomerate that argued it was merely engaging in "hard competition" was like the elephant that said, "every man for himself," as he danced among the chickens.

This is the structural setting in which the PM-Miller merger occurred. Philip Morris' multiproduct and multinational operations in highly concentrated industries gave it the capacity to engage in sustained cross-subsidization. This capacity coupled with the functional relatedness of Philip Morris and Miller provides a powerful vehicle for industrial restructuring. Finally, the specialized nature of firms in the beer industry provides an industrial setting for the successful application of cross-subsidization by a powerful, functionally related conglomerate firm. Thus, on its entry in 1970 it appeared that Philip Morris possessed the potential for restructuring the beer industry.

Commencing in 1971-1972, Philip Morris initiated a policy that translated potential power into actual power, as it began subsidizing the expansion of Miller with the aim of becoming number one in the beer industry. In 1976, Miller President John A. Murphy said:

> Although we can be proud [upon becoming number four], we are not content. We did not come into the beer business to become number four. We have one simple objective--to be number one. That's what we're after, and that's what we'll do...[60]

To accomplish this end Philip Morris initiated an aggressively orchestrated strategy of demand creation and capacity expansion that prompted one financial analyst to characterize PM-Miller as the "juggernaut" of the beer industry.[61]

In 1972, P M Miller acquired the Meister Brau and Lite brands of Meister Brau, Inc., of Chicago, one of the top three brands in the Chicago area. Commencing in 1973, PM-Miller began accelerating advertising outlays for the Meister Brau "Lite" brand. Measured media advertising expenditures for this brand accelerated from $525,000 in 1973 to $27.7 million in 1979. Business Week characterized "Lite's heavy advertising program as a classic example of a company identifying a market segment and then blitzing its way into it, discouraging competition from others."[62]

The Lite success story represents the ultimate achievement of advertising-created product differentiation, being able to sell a lower cost product at a higher price: "Despite the fact that the product is cheaper to produce, due to lower raw material usage and lower physical capacity requirements, Miller priced the beer above 'premium' levels in most markets...Miller correctly perceived that the consumer would be unaware of manufacturing costs and would pay a premium price for perceived quality or benefit."[63]

Having succeeded with its Lite Brand, PM-Miller raised its advertising of its "domestic import," Lowenbrau, to $17 million in 1979, up 10-fold over 1976. One measure of the enormity of the expenditures for Lowenbrau is that neither Pabst or any leading regional brewer spent this much on advertising in 1979, although all sold substantially more beer then the Lowenbrau brand.

In sum, Philip Morris-Miller has pursued a policy of brand creation commencing in 1971. The accelerating cost of this program is suggested by its increasing measured media advertising. Whereas in 1970 it spent $9.4 million, this increased to $75.0 million in 1979, an increase of 700 percent. This was well above the increase of other major brewers.

Paralleling its enormous outlays for brand creation, Philip Morris poured enormous amounts into expanding its existing plant facilities and building new ones. Immediately after acquiring 100 percent of Miller's stock in 1970, Philip Morris initiated an unprecedented plant expansion program. It expanded its brewing capacity from about 5 million barrels in 1972 to 37 million in 1979. Over the 6-year period, 1972-1979, Philip Morris' cumulative capital investment in Miller grew from about $228 million to over $1 billion. In December 1979 Philip Morris announced plans to build a new $412 million, 10 million barrel brewery at Trenton, Ohio; this plant, alone, will have greater capacity than all but five other existing brewers.

Other brewers have been forced to emulate the advertising and merchandising strategies that Philip Morris imported from the cigarette industry. Anheuser-Busch and Miller are battling over the creation of new lucrative market segments. Even Coors, long credited with being able to grow successfully with very little advertising, increased its expenditures 12-fold between 1975 and 1979, from $1.1 million to $15 million.

This is the environment in which other brewers are now struggling for survival. As PM-Miller and Anheuser-Busch further segment the market with new brands supported by enormous advertising outlays, competing brewers will be crowded out of the market unless they can strengthen their brands and increase their offerings. Regional brewers have been especially disadvantaged in the new environment because of its heavy emphasis on television advertising, where regional brewers were unable to obtain equal access to the television media.[64]

Miller's record expansion after 1970 was made possible by Philip Morris' ability and willingness to engage in deep and sustained subsidization of Miller's operations. Financial analysts and industry experts agree unanimously that Philip Morris has engaged in considerable subsidization in expanding Miller. Philip Morris' conglomerate character enables it to pursue a strategy of subsidizing its expansion until such time as it achieves sufficient market power to recoup its losses. Emanual Goldman, a senior financial analyst with Sanford C. Bernstein & Co., contrasted PM-Miller and other brewers as follows: "Miller does not have to make any return on its invested capital near term. The thing that all the other brewers have in common is that they have to make a decent return on investment; for now that is not the case with Miller."[65]

The extent and significance of PM-Miller's cross-subsidization can best be appreciated if Miller is viewed as an autonomous profit center. This lays bare the financial prerequisites of Miller's expansion in the face of deep and sustained losses. According to my estimates, Philip Morris' Miller division incurred losses every year during 1971-1975, totalling $120 million. In 1976 and 1977 it earned very modest profits.[66] Since then its profits have risen. At its current rate of improvement in operating income, Philip Morris will have recouped its accumulated losses and earn an average return on its investment sometime in the mid 1980s. Thus, after over a decade of subsidized expansion, causing massive structural reorganization, Philip Morris will have converted Miller into a profitable operation, having increased its position from eighth place in a relatively unconcentrated industry to second place in a highly concentrated one.

This illustrates how an autonomous firm would have been forced to perform in the capital market to accomplish a similar result.

Most important, it shows that during 1971-1976 Miller would have sustained losses of $120 million at the same time it was borrowing $480 million for capital expansion. It would have been forced to borrow an addtional $394 million during 1976-1977, years in which it just barely covered its existing debt burden.[67]

It is extremely unlikely that an autonomous firm of Miller's size and earnings record could have borrowed such huge funds at any rate of interest much less at the modest rate it paid as part of Philip Morris. Thus the advantage Miller enjoyed from Philip Morris' ability to cross-subsidize is only partially measured by the deep losses absorbed by Philip Morris during 1971-1976. Miller drew upon the great financial strength flowing from Philip Morris' profitable conglomerate operations to enter the debt capital market to subsidize Miller's unprecedented expansion.

Anheuser-Busch has been fighting back the PM-Miller tide. Recently, its chairman and president, August A. Busch III, announced his company's goal is to increase its share to 40 percent by the late 1980s.[68] With PM Miller still pursuing its goal to become number one, the future of most other brewers looks bleak in the decade ahead. The chief exceptions are local brewers that survived the 1970's. These brewers employ a "home town" advantage that reduces their costs and enhances their consumer acceptance without massive advertising.

Thus, the PM-Miller conglomerate merger triggered an inexorable trend toward shared monopoly in which price competition is replaced by promotional competition and higher prices; an environment in which survival and success often depend on market power, not efficiency.

The case study evidence of the impact of conglomerate power on market concentration is reinforced by recent statistical analyses in banking and food retailing. In both industries, conglomerate acquisitions by large corporations tend to increase concentration in the acquired firm's market.[69]

Reciprocal Selling

We turn now to another competitive strategy open to conglomerate firms, reciprocal selling. Simply defined, this practice involves taking your business to those who bring their business to you. It becomes important as a potentially harmful competitive strategy under two conditions: (1) when the market structure creates special incentives in the promotion of a firm's sales; and (2) when the product and organizational characteristics of a business will create extensive opportunities for engaging in the practice. In short, both the incentive and the opportunity are prerequisites to its successful use.[70]

A firm has an incentive to engage in reciprocity when doing so promises to increase its profits. In purely competitive markets there would be no incentive. In the absence of product differentiation, price alone would govern sales and purchases. But, in markets of relatively few firms, sellers recognize their interdependence. Each, knowing that it may influence the price level by its decisions, avoids price competition. Firms in these markets, therefore, have an incentive to engage in various nonprice strategies to promote sales--for example, advertising, innovations promotion, and tying arrangements. Reciprocal selling is another such nonprice strategy.

In markets where firms sell a specialized product to firms similarly organized, there generally are few opportunities to practice reciprocity. It arises only when each firm produces something required in the operations of the other. An enterprise must purchase goods or services from companies that are also potential customers for its products to make possible the arrangement, "You buy from me and I'll buy from you."

The volume of sales that may be influenced by reciprocal trading depends on the number, volume, and type of products bought and sold. A single-line producer will have relatively few opportunities, whereas a firm that buys and sells a large variety and volume of products has the best opportunity to engage in reciprocal dealing. It is in the large conglomerate enterprise that reciprocal dealing develops into a major strategy for expanding sales.

Some economists have dismissed reciprocity as a significant anti-competitive problem by resorting to a simple theoretical model. This dismissal is most categorical among economists of the Chicago School, who reason (1) that in perfectly competitive markets reciprocity can have no adverse effects, (2) that firms with monopsony power can exploit their power without resorting to reciprocity, and (3) that reciprocity is prompted primarily by a desire to increase efficiency by eliminating selling costs. After dismissing reciprocity on these theoretical grounds, members of the Chicago School usually close their argument on the subject by echoing Professor George Stigler's observation that, in any event, "reciprocity is probably much more talked about than practiced and is important chiefly where prices are fixed by the state or a cartel."[71]

This problem is too complex to dispose of with such simple logic. Analysis of reciprocity must begin with the recognition that most contemporary markets, although falling short of monopoly, are sufficiently concentrated so that price competition already is somewhat muted. As noted here, in such markets, oligopolists have an incentive to resort to a variety of nonprice strategies to promote sales. Reciprocity is such a strategy. But, unlike most others, the capacity to practice it depends on the overall size and conglomeration of the firm, not its position in an individual market.

In the real world, reciprocity is found in the broad spectrum of markets falling between the polar extremes of perfect competition and monopoly. Stigler et al. fail to explain adequately the competitive process in such markets and, therefore, minimize the potential market power that reciprocity may confer on its users. They find some "frictions" in imperfectly competitive markets, but conclude that, "A plausible explanation for reciprocity under effectively competitive conditions is the desire to minimize costs of searching and selling."[72] Thus, they believe it is "plausible" that most reciprocity is merely a means of cutting the costs of locating and persuading customers, something to be applauded, not condemned. The only exceptions they find to reciprocity motivated by the quest to minimize selling cost are in markets in which firms have monopoly power or in markets subject to regulation. But here, again, they see reciprocity mainly as having a beneficial influence, either by reducing producers' surplus to the monopsonistic buyer or by enabling the market to approach a more optimal allocation of resources in regulated markets.

This analysis is wrong because of the unrealistic assumptions concerning the structural environment in which reciprocity is practiced. It greatly underrates the capacity and propensity of large conglomerate firms to practice reciprocity. These authors apparently have not looked at, or have ignored, the considerable evidence showing that in imperfectly competitive industrial markets--covering a wide range of competitive structures--reciprocity is a pervasive, and often decisive, factor in determining the allocation of sales.[73] It can restructure markets by increasing concentration and by raising entry barriers to new competitors, and it can make prices more rigid.

Significantly, the firm engaging in reciprocity to expand its market share need not have a monopoly or monopsony in the conventional sense. Indeed, it may have relatively modest market shares as a buyer, certainly falling far short of monopsonistic dominance. The classical Waugh Equipment case, frequently cited by the Chicago School, illustrates this point.[74] Waugh was the first reciprocity case brought by the antitrust authorities.[75] Briefly, the facts are these. In 1924, three officials of Armour & Company became affiliated with the Waugh Equipment Company. Because one of these was an Armour vice president in charge of traffic, he was in a position to work out reciprocity arrangements with the railroads by promising to route Armour business on railroads that agreed to buy draft gears from Waugh. As a result, Waugh increased its share of the draft gear market from about 1.5 per cent in 1924 to nearly 50 per cent by early 1930. During the period, Waugh sold to nearly every railroad in the country.[76]

Importantly, Armour did not have monopsony power in the traditional sense--that is, a dominant share of the market. It did not hold a commanding position as a purchaser of freight cars; it accounted for less than 2 per cent of all railroad freight shipments in 1929. Armour derived its bargaining advantage because, through Waugh Equipment Company, it was the only meat packer tied in with a draft gear supplier to railroads. This enabled it to exchange favors with the railroads.

Nor is it correct to infer that none of this would have happened had railroad rates not been regulated. For had the railroads simply behaved like other oligopolists, each still would have had an incentive to gain or retain business by nonprice competition--in this case reciprocity--thereby not disturbing the price structure, and the ultimate result would have been the same. Moreover, the effects of the practice are no less objectionable merely because a regulated industry is involved. For had Armour-Waugh achieved monopoly power in draft gears, or perhaps shared such power with another firm or two, the railroads almost certainly would have ended up paying higher prices for draft gears.

Nor is it an answer to say that competition was not injured because the draft gear industry was quite oligopolistic prior to these developments. For whereas before the injection of reciprocity into the picture the draft gear industry was quite easy to enter, thereafter, new entrants faced much more formidable entry barriers because they would have to be conglomerates capable of practicing reciprocity to compete on an equal footing with Armour-Waugh.

It is a mistake to assume reciprocity can only foreclose entry by very small firms. As documented by the FTC Merger Report, entry into an industry by even a billion-dollar corporation can be prevented by reciprocity-created entry barriers when the market has become tied up by larger rivals. For example, in the 1960s, the Cities Service Corporation found its entry into the rubber-oil market blocked because the major tire companies had developed extensive reciprocity arrangements with other large petroleum companies.[77]

Nor is there legitimate basis in fact for the argument expressed by Stigler that reciprocity generally "restores flexibility of prices" in oligopolistic markets.[78] This is patent nonsense. Logic and industrial experience argue that the reverse is more likely to be the case. When firms become associated as reciprocity partners, "outsiders" soon learn that it is futile to compete for such accounts, for doing so promises to "spoil" the open portion of the market (that not covered by reciprocity agreements) while failing to dislodge business from reciprocity partners, who, at most, simply renegotiate transaction prices. Indeed, once reciprocity becomes pervasive in an industry, reciprocity partners tend to minimize price as a factor in their transactions.

This is not idle speculation. The available evidence demonstrates that reciprocity creates tight trading bonds among practitioners. And while reciprocity partners often claim that they only deal with one another on an "all-or-other-things-being-equal" basis (and, indeed, this is often the case), reciprocity partners often so completely short-circuit the market that they do not adequately test it to discover their lowest price alternatives. In fact, it is not uncommon to pay prices above the going market price, although not for the reasons Stigler assumes--namely, to grant secret price concessions to customers; rather, they do so in order not to rock the boat in an otherwise stable market. This is illustrated by an Atlantic-Richfield Trade Relations Manual, outlining buyers' procedures for selecting vendors. It directed buyers to place business with bidders offering the lowest cost, "unless other factors, including trade relations, make it advisable to pay a higher price."[79] This is not an isolated incident. Not only do firms frequently pay higher prices to their reciprocity partners, they, at times, even accept lower-quality products in their drive to maintain an equitable balance of payments.[80] Such facts cannot be reconciled with the Chicago School's predictions that, in oligopolistic markets, reciprocity (1) is practiced mainly as a device to discover new customers, (2) erodes price rigidity, and (3) generally improves the allocation of resources.[81]

The manner in which conglomerate mergers enhance the reciprocity opportunities of already huge corporations was documented in the case of several of ITT's major acquisitions. For example, when ITT was considering its acquisition of Avis, Inc., the second-largest car rental company, the ITT board was informed by its staff of the reciprocity opportunities created by the merger: "As one of the largest purchasers and renters of automobiles from two of the major manufacturers, the Avis relationship can possibly develop additional markets for our manufacturing operations that would otherwise not be available to us, especially for our components business."[82] In 1967, ITT-Avis purchases from Chrysler totaled $28 million and from General Motors $23 million.[83] It is hardly surprising, therefore, that ITT anticipated that Avis' purchasing power might "develop additional markets [with GM and Chrysler] that would not otherwise be available to us...."[84] A merger of ITT and Avis promised not only to increase ITT's sales but Avis' as well. Robert Townsend, Avis president at the time it was acquired by ITT, immediately recognized the great reciprocity potential inherent in a merger with ITT. Even before the merger was consummated, Townsend asked ITT to use its business with ITT suppliers to increase Avis' business.[85]

The record in the ITT-Grinnell case shows many instances of reciprocal dealing by ITT. For example, ITT-Sheraton purchased Philco-Ford TV sets in return for Ford's use of Sheraton hotel rooms and services.[86] ITT-Lamp Division explored ways of increasing its sales potential by virtue of ITT-Continental Baking Company's purchases of equipment.[87] The record further demonstrated that Grinnell Corporation already practiced reciprocity prior to its merger with ITT and that the merger greatly increased its potential use of the practice.[88] The record of the ITT-Canteen case documented how ITT promoted reciprocity with banks. The Justice Department discovered more than 30 identical letters written to banks stating, in part, "It is a pleasure being a customer of your bank and perhaps a member of our corporate family can likewise do business with you."[89] In this case, ITT was using reciprocity to sell insurance to banks. Similarly, although the government never completed its discovery efforts in the ITT-Hartford Fire Insurance case--the case was settled before the final trial--substantial evidence of actual reciprocity and reciprocity opportunities was developed in the preliminary injunction proceedings.[90]

Chairman Harold Geneen testified in the ITT-Hartford preliminary injunction that ITT had a long, well-established antireciprocity policy. Yet the record in the ITT-Grinnell case demonstrates that Geneen himself had engaged in reciprocity arrangements.[91] In view of the evidence, it is obvious that Chairman Geneen's strict antireciprocity policy was honored in the breach. Indeed, Geneen admitted that the only ITT personnel ever reprimanded for violating this policy were those whose reciprocity activities were uncovered in the antitrust suits.[92]

As the House antitrust staff study of ITT concluded:

> A major consideration in ITT's merger program was the acquisition of companies that would reinforce marketing efforts of other ITT subsidiaries. This cross-fertilization of total system effort was expected to confer desirable heft in particular markets and to increase the competitive strength of the individual subsidiaries in their business activities with outsiders.[93]

Although the ITT case ultimately was settled by a controversial consent decree,[94] Richard McLaren, head of the Antitrust Division, maintained even after he had settled the cases that the challenged acquisitions involved "systematic reciprocity and the power to develop further reciprocity arrangements through interrelationships of the different companies.... I think a strong economic case can be made against those mergers."[95]

A recent decision of the Federal Communications Commission (June 1980), provides a flagrent illustration of reciprocal trading by a huge conglomerate--General Tire and Rubber Company. General Tire has made numerous acquisions, and by 1980 had sales of $2.2 billion. Not only is General one of the worlds largest tire makers, but its operations include, among others, plastics and chemicals, electronics, construction, ordinance, commercial aviation (Frontier Airlines), athletic products, soft drink bottling (Pepsi Cola), and radio and television broadcasting (RKO-General). RKO operates 13 radio and television stations, mostly in large cities. General Tire's large size and conglomerate operations enable it to develop pervasive reciprocal trading arrangements. The FCC found that General Tire carried on "an intensive trade relations program" whereby "companies were induced to advertise on RKO stations as a condition of doing business with the General Tire family."[96] The FCC concluded that "the purpose and effect of this scheme was, in part, to obtain advertising customers for RKO stations, not on the basis of those stations' advertising rates and demographics, but, instead, on the basis of the General Tire conglomerate's large scale buying power.[97] Because of this and other misconduct,[98] the FCC concluded that RKO General was not qualified to serve as the licensee of television stations in Boston, New York and Los Angeles.

Continued conglomerate expansion--both by merger and internal growth--promises to increase reciprocity opportunities, threatening thereby to result in closed-circuit markets from which medium and small businesses are excluded. Thus, oligopoly in individual markets would be magnified in circular integration, by which purchases of the leading firms would be tied to sales, foreclosing the opportunities of firms without substantial reciprocity opportunities to gain access to the inner circle of firms. As stated in Fortune:

> trade relations between the giant conglomerates tend to close a business circle. Left out are the firms with narrow product lines; as patterns of trade and trading partners emerge between particular groups of companies, entry by newcomers becomes more difficult.99

Indeed, Fortune concludes that "the United States economy might end up completely dominated by conglomerates happily trading with each other in a new kind of cartel system."[100]

VII. CONGLOMERATE INTERDEPENDENCE AND COMPETITIVE FORBEARANCE

We have seen how the current merger movement is contributing to the creation of a dual economy in which a few hundred enormous corporations are expanding their control over the bulk of industrial activity and the literally thousands of smaller businesses share the remainder. We also have seen how conglomerate mergers propelling this centralization have greatly increased the reciprocity opportunities of large corporations as they expand their product lines, thereby increasing the potential buyer-seller linkages with other corporations.

But growing reciprocity opportunities are only the most obvious manifestation of the changed competitive environment flowing from growing conglomeration. Reciprocity is but a symptom of the larger problem of conglomerate interdependence and competitive forbearance that is the inevitable concomitant of an economy in which most commerce is controlled by a relatively few huge corporations.

It is now well recognized in economic theory and industrial experience that, in a market of few sellers, firms tend to behave interdependently. That is, each seller takes into account the direct and indirect consequences of its price, output, and other market decisions. This is called oligopolistic interdependence.

The theory of oligopoly explains the behavior of firms operating in a single market where their discretion in pricing is constrained by certain structural characteristics of the market. Those especially relevant are market concentration, product differentiation, and barriers facing would-be entrants.

The competitive conduct characteristics of particular markets may be influenced not only by these three traditional structural characteristics, but also by the conglomerate character of some of the firms operating in the market. We have just seen that a conglomerate enterprise possesses a unique capacity to practice reciprocal selling. In addition, however, the multimarket characteristics of firms may result in what we will call <u>conglomerate mutual interdependence and competitive forbearance</u>[101] among actual and potential competitors--an interfirm relationship that differs from <u>oligopolistic interdependence</u> as traditionally viewed.

Conglomerate interdependence and forbearance can arise because (1) the same or related decision makers have simultaneous access to both firms or (2) the firms share contact points in input output markets that create a mutual awareness of common interests. Interlocking directorates, intercorporate stockholdings, and joint ventures represent the first set of factors facilitating coordinated relationships among firms. A <u>firm's</u> structure--that is, its size and conglomerateness--constitutes the second set of factors creating a commonness of interest. These determine the number and nature of the contact points that the firms will share. By increasing both size and diversification, the conglomerate merger increases the number of contacts shared with competitors, suppliers, and customers, thereby increasing the mutual awareness of common interests among firms. Simply put, growing conglomeration and over-all industrial concentration greatly broaden and extend traditional "communities of interests" among key industrial decision makers.

The continuing merger movement of the 1960s and 1970s has greatly increased the "contact points" among large corporaions and, therefore, the likelihood that conglomerates will exercise forbearance in their competitive confrontations.[102]

Perhaps the simplest form of conglomerate interdependence involves price decisions. Firms meeting as competitors in many markets are likely to regard each other with greater deference than if their decisions were constrained solely by structural conditions in particular markets.

But conglomerate interdependence may take more subtle forms, as conglomerates accommodate and harmonize their behavior. Although generally ignored or overlooked by economists, antitrust proceedings provide rich evidence of such behavior going back more than half a century. This evidence demonstrates the inherent logic of conglomerate power: to possess it inevitably invites its use.

For example, after Du Pont became a large diversified corporation in the early 1920s, it developed a community of interest with other leading national and international corporations. The evidence demonstrates that when these corporations met as actual or potential competitors, they often exercised mutual forbearance. As early as 1923, a Du Pont vice president explained his company's policy toward Imperial Chemical Industries of Great Britain (ICI), the world's second-largest chemical firm, which it met in many international markets:

> It is not good business sense to attempt an expansion in certain directions if such an act is bound to result as a boomerang of retaliation. It has been the Du Pont Company's policy to follow such lines of common sense procedure....103

Du Pont's philosophy of self-restraint in dealing with ICI was summed up succinctly as follows:

> This was done on the broad theory that cooperation is wiser than antagonism and that in the matter of detail the chances in the long run were that the boot was just as likely to be on one leg as on the other.[104]

Irenee du Pont pointed out, in 1927, that it was his company's policy to encourage the establishment of an esprit de corps among the country's "great corporations." As he put it, the Du Pont company felt "that the great corporations of the country, especially those that are leaders in business ethics and in service to the economic structure, should stand together without fear of veiled threats from companies which are more predatory."[105]

Standing together may prove to be a euphemism for avoiding actual or potential competition with one another. For example, Union Carbide and Carbon, in 1931, purchased rights to a process for manufacturing a transparent wrapping material it thought might be competitive with Du Pont's cellophane. Lammot du Pont reported that in a conversation on this topic with Union Carbide officials:

> They assured me repeatedly they did not wish to rush into anything; most of all a competitive situation with Du Pont. Their whole tone was most agreeable.... In the course of the conversations, various efforts at cooperation between Carbide and Du Pont were referred to and in every case assurances of their desire to work together.[106]

There also is evidence that, in recent times, Du Pont has continued the "common sense procedures" it discovered earlier in its history as a conglomerate enterprise.[107]

A well-documented example of conglomerate confrontation and swift accommodation involved a large conglomerate food manufacturer and food retailer, Consolidated Foods Corporation, and a large multi-market food retailer, National Tea Corporation.[108] As a manufacturer of many food products as well as a food retailer, Consolidated met National on two fronts, as a supplier and a competitor in food retailing. In early 1965, Consolidated attempted to expand its supermarket sales in Chicago by initiating an aggressive "miracle prices" campaign, claiming "price levels slashed on over 5000 items." Because National had annual supermarket sales of around $250 million in Chicago, its profit margins were threatened by Consolidated's move. National responded quickly by having its president warn that the next day there would be fewer Consolidated lines on National shelves. Consolidated got the word. It not only stopped its price campaign immediately, but it further accommodated National by selling its Chicago stores.

The lesson to be learned from this confrontation is clear. Conglomerate interdependence and forbearance eliminated Consolidated as an aggressive rival in food retailing. Because Consolidated was a food manufacturer as well as a food retailer, the competitive strategies it followed in one market boomeranged by inviting retaliation in another. Had National not been one of its customers, Consolidated could have behaved independently of National in expanding food retailing operations in Chicago and consumers would have benefited from its aggressive price campaign.

Conglomerate interdependence and forbearance is especially distructive of compeition when it involves giant corporations that have the greatest potential of entering one another's markets. Such behavior allegedly occured between AT&T, the world's largest private corporation, and IBM, another of the world's largest and most powerful corporations. Documents in a private antitrust suit between Litton Industries, Inc. and AT&T revealed the following course of conduct.[109]

In 1969 IBM began studying the introduction of its telephone switching equipment system, called Carnation, in the United States. Selling Carnation in the United States would have put IBM in direct competition with AT&T, a substantial buyer of IBM products. The prospect for successful entry by IBM was promising, since AT&T's PBX facilities were becoming outmoded. Despite predictions that Carnation could ultimately prove to be an extremely successful venture, IBM decided in 1973 not to enter the American market. Carnation was subsequently introduced successfully on a large scale in Europe. For example, today IBM does about 50 per cent of the PBX business in Great Britian. This raises the obvious questions, why did IBM forsake its planned entry into the large American PBX market?

Litton asserts that documents demonstrate IBM did not challenge AT&T for fear it would look elsewhere in meeting its large computer demands. The documents indicate, among other things, that after IBM announced in 1973 its decision to not enter the U.S. market, AT&T contracted to purchase $353 million in computers from IBM, although AT&T allegedly received a bid of $194 million for similar equipment from Digital Equipment Corporation. Thus not only did IBM forbear in competing with AT&T, but AT&T's response helped preserve IBM's dominant position in the computer industry. Litton alleges, "The evidence clearly shows that IBM's decision not to enter the PBX market and AT&T's decision to purchase computers from IBM were interdependent."

All the facts in this matter are not yet in. But the available evidence led a Federal judge who admitted the documents into the record in the Litton-AT&T case over IBM and AT&T's objections, to observe there is "substantial suspicion that pressure was applied by AT&T to IBM."

The "interdependent" behavior of these two industrial giants apparently is of long standing. The two firms have been substantial suppliers of one another for years. Their ties also have involved patent agreements that permitted each to use the others patents so long as AT&T did not use IBM patents in data processing and IBM did not use AT&T patents in communications.

This example illustrates how linkages or contact points between huge corporations create an environment destructive of competition between them. Such shared contact points leads to the consideration, proposal, and possible realization of acts of conglomerate interdependence and forbearance that can affect market shares, entry, and pricing practices. Reciprocal buying is symptomatic, a manifestation of the more general problem of conglomerate interdependence and forbearance. Conglomerate interdependence and forbearance may well represent the most serious threat to competition resulting from the growing merger-achieved centralization of economic resources among a relatively few conglomerates that meet as actual or potential competitors or customers in many markets. Its ultimate result is a closed economic system in which price and other business decisions by vast conglomerates become largely immune from the disciplining influence of the market. Such a system smacks of the Zaibatsu system in Japan, in which a handful of huge financial-industrial conglomerates working in concert with the state exercise great control over many key economic and political decisions. Although such a system may be preferred by the Japanese, it clearly runs counter to the basic assumptions of a free competitive enterprise system relying on the market to discipline the use of private economic power.

Conglomeration by merger accelerates the development of such a system, and, when it involves large firms, widens the market power differential between the largest firms and other firms in the economy.

There, thus, exists a causal relationship between the growing merger-achieved centralization of control over American industry and the competitive structure and behavior found in particular markets occupied by giant conglomerate enterprises. It is extremely difficult to quantify how growing aggregate concentration and conglomeration changes the structure and behavior of particular markets. However, the available case studies of cross subsidization, reciprocity, and conglomerate interdependence provide important evidence of the effects. This case study evidence is reenforced by several statistical analyses: One study found a significant positive relationship between the share of an industry held by the nation's 200 largest industrial corporations and increases in concentration within the industry. This finding supports the hypothesis that the more extensive the presence of very large corporations in an industry, the greater is the likelihood that market concentration will rise.[110] Another statistical analysis found that conglomerate interdependence among banks that meet in different markets reduces competitive rivalry in banking.[111]

These findings have rich implications for public policy toward conglomerate mergers. It may provide an important bridge between the concern with overall centralization of economic power expressed by the Congress in enacting the Celler-Kefauver Act, and the language of the act that focuses on competition in specific markets. We turn now to the questions of whether existing legislation and its enforcement are adequate to cope with the problems created by the increasing conglomeration of American industry.

VIII. PUBLIC POLICY

Public policy must begin with the premise that large conglomerate enterprises will not wither away. Even very ineffecient large corporations do not disappear from the economic landscape. Because of anticipated catastrophic consequences to stockholders, employees, and entire communities, when a large corporation's survival in threatened, either the government bails it out--for example, Lockheed Aricraft and Chrysler--or permits it to merge with another large coporation, even a direct competitor--for example, the merger of McDonnell Co. and Douglas Aircraft.[112]

Strengthening the Merger Law

More vigorous antitrust enforcement, alone, will not deal effectively with conglomerate mergers and problems resulting from existing levels of conglomeration. New legislation is required to overcome these problems.

Following the traditional case-by-case antitrust approach, it could take a decade or more to explore the outer boundaries of the existing law. Indeed, since the ITT case was settled in 1971, few big conglomerate cases have been brought. Moreover, during the 1970s the Supreme Court has become increasingly tolerant of mergers, leading one student of the Court to charge that the "Burger majority harbors an anti-antitrust bias."[113] The standards established by "the new antitrust majority," as Justice White has labeled it,[114] have made it virtually impossible for the government to challenge successfully conglomerate mergers. Since 1973 the Justice Department has lost nine consecutive conglomerate merger cases and the Federal Trade Commission and private parties have lost 11 cases.[115]

Quite clearly, existing law as interpreted by the Burger Court is not capable of preventing undesirable conglomerate mergers. A more direct approach is called for: legislation that applies special legal standards to very large mergers. This legislation would recognize explicitly that such mergers pose serious economic and political dangers that transcend the economist's narrow preoccupation with a merger's competitive impact on an isolated market.

In 1979, Senator Kennedy introduced a conglomerate merger bill, S.600, aimed at mergers among large corporations and acquisitions of firms holding large market shares. Specifically, it would have prohibited mergers among companies where each had sales of $350 million or more, or where a company with sales of $350 million acquired a company with a market share of 20 per cent or more in any significant market. The bill provided that a merging company could provide the following affirmative defenses: (1) the merger "will have the preponderant effect of substantially enhancing competition; (2) the merger will result in substantial efficiencies;" and (3) within one year before the merger the parties shall have divested one or more viable business with revenues at least equal to revenues of the smaller merger partner. (The above affirmative defenses would not apply where each of the merging companies had revenues exceeding $1 billion.)

In introducing the bill, Senator Kennedy expressed his concern with the ability of existing law to deal with conglomerate mergers, which in his view are antithetical to our system on political, social, and economic grounds.[116]

Such strict restraints on large conglomerate mergers would both prevent much merger-induced conglomeration and contribute to the erosion of existing market concentration. By preventing large corporations from entering new industries by acquiring large corporations, such firms would be encouraged to enter other industries by building new capacity or by acquiring small concerns. Then, instead of merely substituting themselves for an already large competitor in an industry, it would increase the number of significant competitors, thereby eroding the market position of entrenched firms.[117]

Legislation Requiring Restructuring Concentrated Industries

Vigorous enforcement of existing and new-merger legislation may effectively prevent further conglomerate centralization, but it will do little to erode existing centralization. History suggests that widespread and expeditious divestiture in an industry requires direct legislation. Perhaps the most familiar such legislation was the Public Utilities Holding Company Act of 1935, which specified massive divestiture. However, there are other instructive examples. The direct legislative approach also has been taken to divest conglomerate-like centralizations of power. The Banking Act of 1933, which divorced investment banking from commercial banking, restructured numerous large and medium-sized banks. The result was the spin-off of such large investment bankers as First Boston Corporation and Morgan Stanley & Company. Many of today's leading regional brokerage firms also had their genesis in the massive divestiture required by the 1933 act. As a result, our banking structure is much less centralized than it would be otherwise. Similarly, the McKellar-Black Air Mail Act of 1934 forced General Motors to relinquish its interests in various air carriers and airline manufacturers. These various acts accomplished more industrial decentralization than the total achieved under the Sherman Act since its enactment in 1890.

These experiences teach that the direct legislative route would be far preferable to antitrust action in divesting existing conglomerations of power in areas that the Congress views as being particularly troublesome. A likely target is the energy industry, where vast multinational petroleum corporations have come to control large shares of alternative energy sources, especially crude oil and natural gas, coal, uranium, oil shale, and tar sands.[118] It would consume all the resources of the antitrust agencies for decades to achieve an even modest degree of deconglomeration in these areas. The Congress could spell out guidelines that would restructure the energy industry in a relatively few years. Although the legislative approach probably should be used sparingly, there doubtless are other areas in which legislative action would be infinitely more effective and less time-consuming than conventional antitrust enforcement. Unless the legislative approach is used, the antitrust agencies will remain hopelessly mired down in a few big cases and have no real impact on existing levels of industrial conglomeration.

Proposals to deconcentrate some industries are not merely the creation of academic economists. Some persons intimately involved in business affairs also are outspoken advocates of such policies. For example, Arthur Burck, who spent most of his business career in promoting mergers and acquisitions, argues forcefully that deconcentration is essential to the restoration of economic efficiency and progress in industries now shielded from the gales of competition. He acknowledges that his current views may seem heritical, coming as they do from someone who has contributed to the present state of affairs: "If there is irony that one who has spent most of his lifetime in merging activities now promises de-merging as the salvation of the free enterprise system, so be it."[119]

Eliminating Corporate Secrecy Via Federal Chartering

Even at best, the preceding measures will not bring about sufficient industrial restructuring to insure that conglomerate power will be disciplined by the market place. Because of the enormous economic and political power of modern conglomerate corporations, explicit recognition should be made that they are not purely <u>private</u> institutions. There is a need for an explicit public policy declaration that the large conglomerate corporation's business is very much the <u>public's</u> business. Simply put, the huge conglomerate enterprises that control most industrial resources are quasi-public institutions that have been granted the privilege--although not the explicit responsibility--of running the American economy. Former ITT chairman, Harold Geneen, acknowledged this when he said, "Increasingly, the larger corporations have become the primary custodians of making our entire system work."[120] This quite naturally raises questions of legitimacy, of whether these powerful corporations are running the economy in the public interest.

Justice William O. Douglas identified the problem more than three decades ago when he observed: "Enterprises...which command tremendous resources...tip the scales on the side of prosperity or on the side of depression, depending on the decisions of the men at the top. This is tremendous power, tremendous responsibility. Such men become virtual governments in the power at their disposal. In fact, if not in law, they become affected with a public interest."[121]

An appropriate first step in recognizing that the large corporation is not a purely private enterprise is to require that all very large corporations receive a corporate charter from the Federal government rather than from individual states.[122] In the nearly 100 years since New Jersey amended its constitution, in 1875, to liberalize greatly the incorporation process, state chartering statutes have become increasingly framed to suit the interests of corporate enterprises. The whole thrust of this development has been to confer on the corporation the rights and privileges of private citizens. Yet, during that period, as more and more of the economy became the domain of enormous corporate enterprises, they increasingly have taken on the characteristics of public enterprises as they influence directly and indirectly the livelihood of all Americans.

A Federal chartering statute would spell out a set of corporate responsibilities as well as rights. A major purpose of such a charter should be to remove the veil of secrecy covering much corporate decision-making vital to the public interest. It need be restricted to only the very largest corporations, perhaps those controlling assets of $250 million or more. (The 470 industrial corporations of this size controlled about 75 per cent of all manufacturing assets in 1979.)

This, in skeletal form, is a program for providing greater public disclosure of corporate affairs. It clearly is not an attack on our market economy but an effort to perfect it. Although Federal chartering is not a panacea, it is a first step in recognizing the large modern corporation for what it is--an essentially public institution.

Nor is this proposal a substitute for a vigorous program to make competition more effective wherever possible or for the other reforms mentioned here. On the contrary, it complements efforts to improve competition by opening new opportunities for the operation of "natural" market forces. However, even though the program recognizes that competition is not dead as an important disciplining influence in most American industries, it also recognizes that giant conglomerate corporations enjoy great discretion in making numerous decisions that affect our social, cultural, political, and economic welfare. More complete disclosure by large corporations, therefore, serves the dual objective of aiding natural market forces and of providing the broader benefits to society that flow from more complete information of corporate affairs. The elimination of unnecessary corporate secrecy is based on what Justice Louis Brandeis emphasized as "the essential difference between corporations and natural persons."

The author holds no illusions that any of the above proposals will be adopted in the near future. Proposals to restrain conglomerate mergers have received little support in recent years. Nor are they likely in the near term. President Ronald Reagan is on record as opposing such restraints as "arbitrary, unnecessary, and economically unsound"[123] and the new chairman of the Senate Committee on the Judiciary has eliminated that Committee's Subcommittee on Antitrust and Monopoly, which has been the leading Congressional body concerned with conglomerate mergers. It appears that in 1981 there were fewer proponents of vigorous antitrust policy in high places than in any time since World War II.

But those concerned with shaping public policy alternatives that would improve our economic system must not be swayed by the popular moods of the times. To do so would silence all voices of reform.

FOOTNOTES

[1]Even the economic power of the old Stand Oil Trust, which economists often cite as an early example of horizontal power, might better be explained in the context of conglomerate power. See S. Loescher, "A Sherman Act Precedent for the Application of Antitrust Legislation to Conglomerate Mergers, Standard Oil, 1911," in J.W. Markham and G.F. Papanek (ed.), Industrial Organization & Economic Development, (New York: Houghton Mifflin, 1970, pp. 154-215).

[2]See the report to President Wilson by the newly created Federal Trade Commission, FTC, Report on the Meat-packing Industry (Washington, D.C.: U.S. Government Printing Office, June 24, 1919).

[3]J. Robinson, The Economics of Imperfect Competition, second edition (London: The Macmillan Press, Ltd., 1969), p. IX.

[4]Corwin Edwards, "Conglomerate Bigness as a Source of Power," in Business Concentration Price Policy (Princeton, N.J.: Princeton University Press, Conference of National Bureau of Economic Research, 1955), pp. 346-347.

[5]FTC, Staff Report, Economic Report on Corporate Mergers (Washington, D.C.: U.S. Government Printing Office, 1969), p. 173. Hereafter referred to as FTC, Merger Report.

[6]The top 200 corporations share of total industrial assets is even larger than the preceding estimates suggest because many corporations hold large investment interests in other domestic and foreign corporations. Were these unconsolidated assets included in the calculations, the top 200 corporations may hold as much as two thirds of all assets of United States corporations engaged primarily in manufacturing. See U.S. Congress, Senate, Subcommittee on Antitrust and Monopoly, Committee on the Judiciary, Economic Concentration, Hearings, 91st Cong., 1st sess., pt. 8, 1969, p. 4550. (Testimony of Willard F. Mueller.)

[7]W. F. Mueller, The Celler-Kefauver Act; The First 27 Years, A study prepared for the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary, House of Representatives (Washington, D.C.: U.S. Government Printing Office, 1978), pp. 76, 81.

[8]1929 estimates based on Norman Collins and Lee Preston, "The Size Structure of the Largest Industrial Firms, 1909-1958," American Economic Review, 51:1005-1011 (Dec. 1961); 1980 estimates from FTC, Quarterly Financial Report for Manufacturing Corporations, Third Quarter (Washington, D.C.: U.S. Government Printing Office, 1980), p. 17.

[9]After adjusting for changes in the price level for 1929-1979, 36 corporations would have had assets exceeding $1 billion in 1929 and would have controlled 18 per cent of industrial assets.

[10] FTC, Merger Report, op. cit., pp. 65-67.

[11] ITT, Annual Report, 1967, p. 3.

[12] Prepared testimony of W.F. Mueller, in United States vs. ITT and Grinnell Corporation, Civil no. 13319, Appendix 5.

[13] ITT, Annual Report, 1979, p. 14..

[14] W.F. Mueller, "The ITT Settlement: A Deal with Justice?" Industrial Organization Review, 1:80(1973).

[15] U.S. Congress, Senate, Committee on Foreign Relations, Subcommittee on Multinational Corporations, International Telephone and Telegraph Company and Chile, 1970-1971, Report, 93d Cong., 1st sess., June 21, 1973, pp. 4-6.

[16] See Morton Mintz and Jerry Cohen, America, Inc. (New York: The Dial, 1971), pp. 330-337, who document ITT's political power in Great Britain, Canada, Denmark, Iceland, and the United States.

[17] New York Times, July 27, 1975, Sec. 3, p. 1.

[18] See "Wall Street: The Lure of 2 + 2 = 5," Newsweek, May 8, 1967, p. 82. This theme echoed the contemporary explanations given for the great merger wave peaking in 1929, when journalists also "discovered" that merger makers of that day were making "business history by adding two and two to make five." Business Week, Nov. 27, 1929, p. 27.

[19] Among the proponents of this belief are W. Fred Weston, "The Nature and Significance of Conglomerate Firms," St. Johns Law Review, Spring 1970, pp. 66-80; and Neil H. Jacoby, "The Conglomerate Corporation," The Center Magazine, July 1969, p. 41.

[20] Financial World, 129:12(Feb. 14, 1968).

[21] U.S. Treasury Department, Tax Reform Studies and Proposals, Joint Publication of the House Committee on Ways and Means and the Senate Committee on Finance (Washington, D.C.: U.S. Government Printing Office, Feb. 5, 1969), pt. 2, pp. 268-269.

[22] Wall Street Journal, Apr. 17, 1968, p. 25.

[23] Abraham J. Briloff, "Financial Motives for Conglomerate Growth," St. John's Law Review, Spring 1970, p. 877.

[24a] U.S. Congress, House, Antitrust Subcommittee of the Committee on the Judiciary, Investigation of Conglomerate Mergers, Staff Report, 92d Cong., 1st sess., June 1, 1971, p. 414.

[24b] Ibid., p. 140.

[24c] Ibid., p. 139.

[24d] Ibid.

[24e] "Accountant Urges Better Reporting Practices," New York Times, July 24, 1971.

[24f] Scheinman, Hochstin, and Trotta, "Alert for Portfolio Managers," Supplement P, July 1971, p. 1.

[24g] Ibid., p. 1.

[24h] Ibid., p. 3.

[24i] Ibid.

[24j] Fortune, op. cit., p. 216.

[24k] Ibid., p. 212.

[24l] Prepared statement of P.C. Cabot before the U.S. Congress, House, Committee on Ways and Means, Hearings on Tax Reform, 91st Cong., 1st sess., Mar. 12, 1969.

[24m]*Ibid.*

[24n]FTC, Staff Report, *op. cit.*, pp. 69-160; Briloff, *op. cit.*, pp. 872-879; Henry B. Reiling, "EPS Growth from Financial Packaging: an Accounting Incentive in Acquisitions," *St. Johns Law Review*, Spring 1970, pp. 880-894; and Roger Sherman, "How Tax Policy Induces Conglomerate Mergers," *National Tax Journal*, Dec. 1972, pp. 521-529.

[24o]FTC, *Merger Report*, *op. cit.*, p. 159; cf. Samuel R. Reid, *Mergers and the Economy* (New York: McGraw-Hill, 1968).

[24p]George W. Stocking, *Basing Point Pricing and Regional Development* (Chapel Hill, N.C.: University of North Carolina Press, 1954), p. 140; Edwin Mansfield, "Size of Firm, Market Structure, and Innovation," *Journal of Political Economy*, 71:556-576 (Dec. 1963); Walter Adams and Joel Dirlam, "Big Steel, Invention and Innovation," *Quarterly Journal of Economics*, 80:169(May 1966).

[24q]T.F. Hogarty, "Profits from Mergers: The Evidence of 50 Years," *St. Johns Law Review*, special edition, 44, Spring 1970, p. 389.

[24r]D.C. Mueller, "The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence," *Journal of Banking and Finance*, 1:339(1977), p. 339.

[24s]*Ibid.*

[24t]H. Manne, "Mergers and the Market for Corporate Control," *Journal of Political Economy*, 73:110-120(1965).

[24u]S.R. Reid, *Mergers, Managers and the Economy* (New York: McGraw-Hill, 1968). W. Sichel, "Conglomerateness: Size and Monopoly Control," *St. John's Law Review*, special edition, 44:354-377 (1970).

[24v]D.C. Mueller, *op. cit.*, p. 342.

[25]Edwards, *op. cit.*

[26] United States v. Columbia Steel Company et al., 334 U.S. 495(1948).

[27] Mueller, "The ITT Settlement: A Deal with Justice?" op. cit., pp. 67-86.

[28] "Before and After the Felony," New York Times, Sept. 7, 1975, sect. 3, p. 1. Steinbrenner and the corporation subsequently pleaded guilty to reduced charges and were fined $15,000 and $20,000, respectively.

[29] The International Telephone and Telegraph Company and Chile, 1970-1971, op cit., passim.

[30] "Exxon Concedes That Donations in Italy Were for Promoting 'Business Objectives,'" Wall Street Journal, July 17, 1975, p. 2. "Exxon Says Donations in Italy Exceed $46 Milion; Communists Got $86,000," Wall Street Journal, July 14, 1975, p. 10. "Exxon Discloses More Foreign Payments in Filing, Says SEC May Demand Details," Wall Street Journal, Sept. 26, 1975, p. 6.

[31] SEC, Questionable and Illegal Corporate Payments and Practices (Washington: Government Printing Office, 1976).

[32] Ibid., p. 54.

[33] Ibid., p. 56.

[34] Ibid., pp. 46-47.

[35] "How Lawless are Big Companies?" Fortune, December 15, 1980, p. 57.

[36] Ibid.

[37] Ibid.

[38] Ibid.

[39] Ibid., pp. 58-61.

[40] Ibid., pp. 57-58.

[41] Ibid., p. 62.

[42] M.B. Clinard and P.C. Yeager, Corporate Crime (New York: Macmillan, 1980), p. 298.

[43] United States v. Bethlehem Steel Corporation, 168 F. Supp. 576 (1958).

[44] Several prominent economists testified in behalf of Bethlehem, arguing that the merger would actually enhance competition because Bethlehem would not otherwise enter the Midwest market, a prediction subsequently proved false.

[45] U.S. Congress, House, Antitrust Subcommittee, The Celler-Kefauver Act: The First 27 Years, 95th Cong., 2nd sess., Staff Report, 1978. Since 1950, the antitrust agencies have challenged more than 1400 mergers, practically all of which involved horizontal and vertical mergers.

[46] See Willard F. Mueller, "Public Policy Toward Vertical Mergers," J. Fred Weston and Sam Peltzman, Eds., Public Policy Towards Mergers (Goodyear Publishing Co.: Pacific Palisades, Calif., 1969), pp. 150-166.

[47] M. A. Adelman, "The Antimerger Act, 1950-1960, "American Economic Review, 51:243 (May 1961).

[48] FTC, Merger Report, op. cit., pp. 225-230. The following discussion of the sources of conglomerate power draws heavily from the FTC report, which was prepared under the author's directions. I wish particularly to acknowledge Professor Robert E. Smith, now of the University of Oregon, for helping to develop the ideas presented in this section.

[49] Bradburd recently demonstrated theoretically that a conglomerate firm may have market power even though it does not possess market power in any of its markets. R. M. Bradburd, "Conglomerate Power Without Market Power," American Economic Review, 70:483-487 (June 1980).

[50] Howard H. Hines, "Effectiveness of 'Entry' by Already Established Firms," Quarterly Journal of Economics, 71:132-150(Feb. 1957).

[51] FTC, Merger Report, op. cit., pp. 214-215.

[52] John Narver, Conglomerate Mergers and Market Competition (Berkeley: University of California Press, 1967), p. 105. See Chap. 4 in Narver for a discussion of other sources of economic power possessed by a conglomerate enterprise.

[53] FTC, Merger Report, op. cit., pp. 6-124. (Italics supplied.)

[54]Edwards, _op. cit._, pp. 334-335.

[55]FTC, _Merger Report_, op. cit., pp. 406-457; John Blair, _Economic Concentration_ (New York: Harcourt, 1972), pp. 43, 51, 363-367, and 594.

[56]The following discussion of the beer industry is based largely on W.F. Mueller, testimony before the Subcommittee on Antitrust and Monopoly, Committee on the Judiciary, U.S. Senate, the 95th Congress, 2d sess., May 12, 1978, pp. 78-124. Hereafter cited as Mueller testimony (1978).

[57]I. Horowitz and A.R. Horowitz, "Firms in a Declining Market: The Brewing Case," _Journal of Industrial Economics_, March 1965, p. 152.

[58]K.G. Elzinga, "The Restructuring of the U.S. Brewing Industry," _Industrial Organization Review_, 1:114(1973).

[59]J. Blair, "The Conglomerate Merger in Economics and Law," _Georgetown Law Journal_, Summer 1958, p. 693.

[60]_Miller Times_, Vol. 2, issue 2, April-June, 1976.

[61]Emanuel Goldman, partner at Sanford C. Berstein & Co., "Beverage Industry: A Round Table Discussion," _The Wall Street Transcript_, New York, May 24, 1976, p. 106.

[62]_Business Week_, October 13, 1975, p. 117.

[63]J.M. Weingarten and Y.P. Hentic, Research Department, Investment Recommendation, Anheuser-Busch, Inc., Wertheim & Co., December 30, 1975, p. 15.

[64]See W.F. Mueller, submission to the Department of Justice, January 15, 1979, "Competitive Significance for the Beer Industry of the Exclusive Advertising Rights Granted National Brewers in Major Network Sports Events," (available on request from the author).

[65]Mueller testimony (1978), _op. cit._, p. 100.

[66]_Ibid._, pp. 100-102.

[67]_Ibid._, p. 102.

[68]"Anheuser-Busch Outlook Rosy," _St. Louis Post Dispatch_, November 18, 1980, p. 3.

[69]R.W. Cotterill & W.F. Mueller, "The Impact of Firm Conglomeration on Market Structure: Evidence for the U.S. Food Retailing Industry," The Antitrust Bulletin, 25:557(1980). S. Rhoades, "The Impact of Foothold Acuistions on Bank Market Structure," The Antitrust Bulletin, 22:119-129 (1977).

[70]For further elaboration of the conditions necessary to practice reciprocity, see George W. Stocking and Willard F. Mueller, "Business Reciprocity and the Size of Firms," Journal of Business of the University of Chicago (Apr. 1957), and FTC, Merger Report, op. cit., pp. 323-332.

[71]See George Stigler, "Reciprocity," and Roland Coase, "The Conglomerate Merger," working papers for the Nixon Task Force on Productivity and Competition, Feb. 18, 1969. These arguments are also made by James M. Ferguson, "Tying Arrangements and Reciprocity: An Economic Analysis," Law and Contemporary Problems, Summer 1965, 30:552-580.

[72]J.H. Lorie and P. Halpern, "Conglomerates: The Rhetoric and Evidence," Journal of Law and Economics, 13:149-166(Apr. 1970).

[73]For an extensive discussion of the scope and practice of reciprocity see FTC, Merger Report, op. cit., pp. 332-397.

[74]See Ferguson, op. cit. and Lorie and Halpern, op. cit.

[75]Waugh Equipment Company, 15 FTC 232 (1931).

[76]FTC, Merger Report, op. cit., pp. 338-340.

[77]Ibid., pp. 383-384.

[78]Stigler, op. cit., p. 3.

[79]FTC, Merger Report, op. cit., p. 387.

[80]Ibid., pp. 392-393.

[81]See footnote 71.

[82]U.S. Congress, House, Antitrust Subcommittee, House Committee on the Judiciary. Investigation of Conglomerate Corporations: Hearing on, 91st Cong., 1st sess., pt. 3, 1969, p. 371.

[83]Ibid., p. 601.

[84] Ibid.

[85] United States v. International Telephone & Telegraph Corporation, Civil Action No. 13319, PX 125 and PX 126. Hereafter cited as ITT-Grinnell case.

[86] Ibid., PX 136-137, Tr. 1877-1879.

[87] Ibid., PX 180.

[88] Ibid., Government's "Proposed Findings and Conclusions of Law" cites many examples, pp. 53-59.

[89] U.S. Congress, Senate, Committee on the Judiciary, Hearings on the Nomination of Richard G. Kleindienst, 92d Cong., 2d sess., Mar. and Apr. 1972, p. 1252. (Hereafter cited as Kleindienst Hearings.)

[90] See "Memorandum in Support of Government's Motion for Preliminary Injunctions," United States v. International Telephone & Telegraph Corporation and the Hartford Fire Insurance Company, undated.

[91] ITT-Grinnell case, op. cit., PX 123-126.

[92] Ibid., Tr. 1651-1655; Geneen deposition, p. 48.

[93] U.S. Congress, House, Antitrust Subcommittee of the Committee on the Judiciary, Investigation of Conglomerate Mergers, 91st Cong., 1st sess., June 1, 1971, p. 125.

[94] Mueller, "The ITT Settlement," op. cit.

[95] Kleindienst Hearings, op. cit., pp. 121-122.

[96] Federal Communications Commission, In Re Applications of RKO General, Inc., Memorandum and Opinion, released November 26, 1980. p. 2. For a discussion of General Tire's use of reciprocity in dealing with large petroleum companies see, FTC, Economic Report on Corporate Mergers, op. cit., pp. 383-384.

[97] Ibid.

[98] In addition to its reciprocal trading, the FCC found that General had engaged in "a pattern of misconduct, including improper domestic political contributions, schemes which defranded its affiliates, improper foreign payments and improper secret accounts designed to avoid foreign tax and currency exchange laws." Ibid, p. 3.

[99]*Fortune*, 71:194 (June 1965).

[100]*Ibid*.

[101]Edwards first identified this problem in *op. cit.*, pp. 346ff.

[102]FTC, *Merger Report*, op. cit., pp. 198-224.

[103]Cited in Willard F. Mueller, *Du Pont: A Case Study of Firm Growth* (Ph.D. diss., Vanderbilt University, 1955), p. 393.

[104]*Ibid*.

[105]*Ibid*.

[106]*Ibid*., p. 202.

[107]FTC, *Merger Report*, op. cit., pp. 463-467.

[108]*Ibid*., pp. 468-470.

[109]The following discussion is based on Merrill Brown, "Backstage with Big Business," *Washington Post*, February 1, 1981, pp. F1 and F4, and "Litton Evidence Alleging AT&T coerced IBM will be Permitted at Antitrust Trial," *Wall Street Journal*, February 9, 1981, p. 5.

[110]FTC, *Merger Report*, op. cit., pp. 230-234. For an analysis of this study see Leonard Weiss, "Quantitative Studies of Industrial Organization," in M.D. Intriligator, ed., *Frontiers of Quantitative Economics* (Amsterdam: North-Holland, 1971), pp. 378-379.

[111]An unpublished study by A.A. Heggestad and S.A. Rhodes finds that conglomerate interdependence reduces competitive rivalry in banking: "Multi-market Interdependence and Local Market Competition" (Aug. 1976).

[112]When Douglas Aircraft encountered serious financial difficulties, the Antitrust Division approved its acquisition, in 1967, by one of its leading competitors, McDonnell Company.

[113]H.R. Lurie, "Mergers Under the Burger Court: An Anti-Antitrust Bias and Its Implications," *Villanova Law Review*, Vol. 23, January 1978, p. 214.

[114]*Marine Bancorporation*, 418 U.S. at 644. Justices Brenner and Marshall concurred in Justice White's dissent.

[115]"Justice Department Won't Appeal Loss on Merger Theory," Wall Street Journal, December 3, 1980, p. 12.

[116]E. Kennedy, comments on S.600. Congressional Record-Senate, March 8, 1979, pp. S.2417-2419.

[117]William G. Shepherd, "Leading-firm Conglomerate Mergers," Antitrust Bulletin, Winter 1968, pp. 1361-1382.

[118]Willard F. Mueller and Roy A. Prewitt, "Structure of the Petroleum Industry and Its Relation to Oil Shale and Other Energy Sources," in FTC, Economic Papers, 1966-1969 (Washington, D.C.: Government Printing Office, 1970), pp. 184-200.

[119]Arthur Burck, "Why Auto Companies are Too Big," Business Week, November 17, 1980, p. 19.

[120]Quoted in Anthony Sampson, The Sovereign State of ITT (New York: Stein & Day, 1973), p. 125.

[121]William O. Douglas, Democracy and Finance (New Haven, Conn.: Yale University Press, 1940), p. 15.

[122]For a more detailed discussion of this writer's views on Federal chartering see W.F. Mueller, "Corporate Disclosure: The Public's Right to Know," in A. Rappaport and L. Revsine, eds., Corporate Financial Reporting (Evanston, Ill.: Northwestern University Press, 1972), pp. 67-94.

[123]"Government May Abandon Fight to Stem Conglomerate Takeovers," Wall Street Journal, November 23, 1980, p. 23.