

Antitrust, Innovation, Entrepreneurship and Small Business*

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ABSTRACT. The purpose of this article is to discuss a few aspects of antitrust enforcement that are directly related to small businesses. The first point concerns how the antitrust laws work as an economic “charter of freedom” by protecting our economy from the misuse of market power by dominant firms, or from anticompetitive collusion by groups of firms, or from anticompetitive mergers, all of which can blunt the mainspring of our economic success – competitive markets. Second is an expansion on the first theme which focuses on how antitrust enforcement helps preserve two freedoms that I think small businesses care about very much: the freedom to engage in entrepreneurship, and the freedom to innovate. A final discussion involves a few recent cases recently seen at the Antitrust Division that illustrate the many ways in which antitrust enforcement has helped the small business marketplace.

1. Introduction

The U.S. economy is strong. In fact, it’s the strongest in the world. By next month, the current cycle of robust economic growth will be the longest lasting we have ever had. In an unprecedented way, growth has been vigorous, and unemployment low, hovering around 4% for almost two years – while inflation has stayed in-check.

Back in the early 90s, few of us would have predicted that the American economy would turn in this kind of performance. But clearly a number of things mattered, including the decision to balance the budget, and, the decisions we made in our fiscal and monetary policies. To add one

more, this country has a competitive market place. Our economy is more competitive today than it has been in a long time. In fact, today it is the most competitive major economy in the world. As Assistant Attorney General Joel Klein has noted, “Over the past several decades, we have experienced a steadily increasing national commitment to competitive markets and away from a regulatory approach.” In airlines, surface transportation, energy, and telecommunications, our faith in competition has led to more open markets, new competitors and opportunities for entrepreneurship, better and cheaper products, and a better economy within which all businesses, including small businesses, can compete, innovate, and thrive.

2. Competition and anticompetitive behavior

Competition drives our economy. And even countries that used to rely on planned economies and national champions are rushing to competition. Competition clearly is one of the most significant reasons why we are an economic success. That is why the antitrust laws are so important to all of us. If dominant firms are allowed to misuse market power to fence out competition, or if groups of firms are allowed to collude to prevent competition by fixing prices or allocating customers, or if anticompetitive mergers increase prices, reduce output or stifle innovation – our economy will suffer. And because the success of virtually any small business depends greatly on the general condition and health of the economy, unchecked anticompetitive behavior that hurts the economy also hurts small business. Thus, although

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it is important to understand the consumer benefits of antitrust policy, it is also important to know that the central role of antitrust in maintaining a competitive marketplace also benefits small businesses in a direct and very significant way.

Following are a few examples of the ways in which anticompetitive behavior can hurt small businesses. Small businesses are often the first and most directly affected by the harm caused by price-fixers and market allocators. These cartels can, and have, controlled the price, availability and other terms of the essential inputs small businesses need to transact business and make products. In the last year alone, the Division has obtained over \$1.1 billion, yes billion, of court-awarded criminal fines from global criminal cartel price-fixers. Foreign companies paid the vast majority of these fines. These cartels were literally taking money out of the pockets of U.S. businesses and consumers. We currently have over 30 grand juries sitting around the U.S. investigating additional global criminal cartel activity. The misuse of market power by other firms can also affect your business. For example, we recently brought a case against American Airlines for unlawful monopolization and attempted monopolization at its hub in Dallas-Ft-Worth. We allege that American engaged in a number of practices against new low cost entrants serving routes like Dallas to Wichita, aimed at preventing the upstart from eroding American's market power in these routes. Every small business person who travels these routes, of course, is part of this story. In mergers, any merger that leads to an increase in price or a stifling of innovation of your inputs, of course, adversely affects you. In our merger investigations, we usually interview customers to see what the real-world effect of the merger will be in the market, and small businesses are often on the list of customers to whom we talk. Further discussion will involve a few of the merger enforcement actions in telecommunications, banking, advertising and the like in the recent past that benefited small businesses, and will describe a number of actions we've taken to protect competition in e-commerce.

In addition to the domestic effects of an antitrust policy, are the international effects. According to SBA statistics, small businesses represent over 96% of all individual U.S. exporters of goods and services, and account for over 29%

of the value of all U.S. exports. This is significant, and says a lot about small business' role in a global digital economy. And, the competitive nature of the U.S. economy helps U.S. businesses abroad. As Michael Porter, an economist at the Harvard Business School, has pointed out in his book *The Competitive Advantage of Nations*, "active domestic rivalry is strongly associated with international success" – whereas reliance on huge and non-competitive "national champions" rarely results in international competitive advantage. Porter's point is a simple one: firms that face competitive markets at home are lean and mean competitors on the international stage. Accordingly, by Porter's lights, "a strong antitrust policy . . . is essential to the role of upgrading any economy."

There is another very important way in which U.S. antitrust enforcement helps U.S. businesses succeed internationally. In the last decade, as the benefits of competitive markets have been seen throughout the world, the Antitrust Division has undertaken a significant competition policy and enforcement role. We have engaged with existing antitrust authorities in bilateral discussions and agreements, and helped developing countries create antitrust laws and enforcement structures so they can transition to a competitive, market-based economy. In 1997, the Attorney General and Assistant Attorney General Joel Klein appointed a blue ribbon Advisory Committee to study the issues of transnational mergers, global cartel enforcement and the intersection of trade and competition policy. After extensive public hearings, they are preparing a report, which should be delivered in the not too distant future. This past November, I had the honor of serving as a member of the U.S. delegation to the WTO in Seattle, where a number of competition issues were part of the discussion. Obviously, antitrust and competition are being seen as global issues. In any case, it is clear that as markets in the rest of the world get more competitive and open, U.S. businesses will benefit from the ability to compete in those markets. And American business, at the cutting edge of innovation in the digital economy, will lead the way in setting the physical and knowledge infrastructure of the new economy in developing countries.

3. Entrepreneurship and innovation

Antitrust laws protect two freedoms important to small businesses: the freedom to engage in entrepreneurship and the freedom to innovate. First, entrepreneurship – and for this a bit of history will help.

Small businesses were an important constituency that helped to pass the Sherman Act in 1890. Then, small businesses were concerned that the railroads, which at the time enjoyed regional monopolies, were charging non-competitive and discriminatory shipping rates, and discriminating against certain customers for their own advantage. In addition, small businesses were concerned about the tactics of the Standard Oil company, and other trusts, that controlled, among others, the fuel oil, sugar, tobacco, cotton seed oil, and whiskey markets. The trusts employed predatory tactics against small businesses and drove out entrepreneurs with coercive threats of “sell or be ruined.”

Even before that, Adam Smith recognized the need to have laws to ensure competitive markets. And, given that history, it is plain to see why the Sherman Act, and the subsequent Clayton Act, were vital to the protection of entrepreneurs in the 20th century. And, as is clearly seen today, they will be even more vital in the 21st century. Perhaps more than any other society on earth, the United States is dependent on the willingness of its people to take risks in pursuit of success. We practice an intensely entrepreneurial flavor of capitalism. And, we think of entrepreneurship not just as vital to our economic success, but also to our social fabric, and our sense of who we are. That is, entrepreneurship creates certain values that we like – and that we believe are tied-in to the success of our country. Values like opportunity. There are reasons aside from the desire to create wealth that cause us to want to sustain entrepreneurship: responsibility for ourselves and to others, succeeding or failing on our own merits, and enjoying the fruits of our hard work. But people won't be willing to spend money, sweat, time and tears on their own venture if the market is rigged against them. People are willing to take risks, but not foolish risks.

The antitrust laws help to sustain this entrepreneurial spirit by ensuring that markets are open, and that new entrants can compete, and, if they

build a better mouse trap – have the chance to succeed. The importance of this role can't be overstated: in keeping markets contestable, the antitrust laws enrich our social fabric, and country, as well as our economy.

Much the same can be said of antitrust's role in preserving the freedom to innovate. It is well known that many important technological breakthroughs have been made by small businesses. Historically, small businesses gave us: the self-winding watch, the oxygen process in steel making, and the stainless steel razor blade. Today, small businesses are in the forefront in developing new advances in telecommunications – for example, the next generation of lasers, routers and optical switches that will allow fibre optic networks to move ever-increasing amounts of data at the speed of light. Small companies are also important players in biotechnology; for example, small biotech firms are heavily involved in the search for an AIDS vaccine. Small businesses also reinvent older technologies. For example, small business is now in the lead in developing the fuel cells that may one day replace the internal combustion engine in cars.

Innovation, like entrepreneurship, is risky. It costs money. It takes time. It often fails. Therefore, common sense tells us that there will be a lot less of it if markets are not open to competition from businesses that have a better idea. Just think for a moment of the world of telephony before and then after the breakup of AT&T. Think of the enormous acceleration in the rate of innovation – fibre optics, wave division technology, compression technology, the common use of the Internet, and now broadband Internet access – all spurred by the introduction of competition into this critical area of the economy. Here's just one example: when MaBell was the only buyer of telephone equipment, an innovative small supplier of equipment faced a difficult environment. Improvements in equipment technology, under the old MaBell system, appeared at a pace dictated by AT&T, not by the needs of businesses or residential customers. And because MaBell had its own manufacturing subsidiary, it had the ability to impede other manufacturers. But when competition was introduced, in long distance and by the separation of long distance and local services, the best technology was given a chance to succeed. Of

course, the breakup of AT&T has helped small businesses and consumers directly by bringing down the price of long distance calls. According to the FCC, long distance prices (international and domestic), as approximated by average revenue per minute, have fallen by more than 50 percent since 1980. And along with the drop in prices, usage has increased – FCC data indicates that long distance traffic has increased by almost 400% percent since 1984.

4. Antitrust violation and regulation

Another relevant point related to how antitrust enforcement helps small businesses is that antitrust laws are market-based. They are not regulatory. Application of the antitrust laws up-front staves off regulation. The antitrust laws reflect a decision that market forces should guide the private sector provision of goods and services, and that government should, for the most part, be a spectator rather than a participant in the marketplace. But antitrust enforcement is critical. Because small businesses are often the source of both technological and managerial ideas that provide them with significant competitive advantages, small businesses can thrive in open markets, which is what antitrust laws protect. And because antitrust enforcement preserves competitive markets, it reduces the urge for government to regulate, which urge arises most often when markets are not competitive.

Following are some recent specific merger, non-merger and criminal actions that directly benefit small businesses,¹ the first of which involves the banking industry. In the last three years, the Division has reviewed a number of bank mergers, which threatened to harm small businesses by reducing competition in the provision of small business loans, and other specialized banking services. In 1998 and 1999 alone, the Division required divestitures to satisfy competitive concerns in at least nine separate mergers involving large regional banks covering most areas of the country. In all, these actions required the merging parties to divest over \$20 billion in assets, as well as sell over 450 branch offices.

The Division has also been working to ensure that markets for wireless telephone service remain competitive. On December 6, 1999, we reached a

consent decree with Bell Atlantic, Vodafone AirTouch and GTE that allowed Bell Atlantic to create a national wireless phone network, provided the companies agreed to divest wireless assets in 96 markets in 15 states, including major metropolitan markets like San Francisco, Phoenix, Seattle and Cincinnati. Wireless telephones are, of course, a useful small business tool.

The Division has also been active in ensuring that radio and billboard advertising – two methods of reaching customers on which many small businesses depend – stay competitive. In 1998 and 1999 alone the Division intervened in at least six proposed mergers in the radio industry, and required the divestiture of more than 36 radio stations in order to preserve competition. The Division's action preserved the choices, and advertising rates, available to advertisers, often small businesses, in those cities.

The Division's recent efforts in the billboard advertising industry are also noteworthy. In 1998 and 1999, the Division intervened in three billboard company mergers that we believed created a threat to competition, and required the divestiture of outdoor advertising properties in more than three dozen cities and counties around the U.S. These actions will help small businesses by maintaining competitive markets for this type of advertising, which is an important small businesses advertising avenue.

The Division has also protected competition in the market for employee health insurance. The Division recently required divestitures in the merger between Aetna and Prudential Health Care's HMOs where we believed that their dominance would enable them to raise prices above competitive levels. Health care costs are, of course, a significant expenditure for many small businesses, and the Division's action in the Aetna/Prudential merger will help preserve choice and constrain price.

A high priority of the Antitrust Division continues to be the investigation and prosecution of cartel-type activities, such as horizontal price fixing, market allocations and group boycotts. Such collusive activity artificially raises prices and suppresses or excludes competition. Small businesses are frequently purchasers, and, thus, are often the victims of such practices.

Late last year two high-ranking Swiss execu-

tives from F. Hoffmann-La Roche agreed to plead guilty and serve time in a U.S. prison for their participation in an international conspiracy to fix the price of vitamins. Two of the conspiring companies in this matter, Swiss firm F. Hoffmann-La Roche and German firm BASF AG, were fined \$500 million and \$225 million, respectively. The \$500 million fine is the largest criminal fine in the history of the Department of Justice, under any law, not just the antitrust laws. Thereafter, three Japanese pharmaceutical companies also agreed to plead guilty in this matter and pay fines totaling \$137 million. In all, the Division recovered more than \$850 million in fines relating to this conspiracy.

Finally, over the years, the Division has prosecuted a large number of bid-rigging conspiracies, many of which hurt consumers, small businesses, and the public fisc. In the most recent of these matters, just over a month ago the Division charged an Illinois construction company and its former CEO with conspiring to rig bids and allocate contracts for the sale of materials and supplies used in the construction of cable-stayed bridges in the U.S. This case illustrates how widespread the harm stemming from antitrust violations can be. Most often, bridges are built and paid for by government agencies. So stamping-out this conspiracy helped save money for all taxpayers, including small businesses.

5. E-commerce

Finally, a look at the role of antitrust in the new world of e-commerce is in order. Clearly, the growth of e-commerce is opening up countless opportunities for small business, especially because the Internet can, in many instances, help small businesses compete with larger players. This may be particularly true in the business-to-business segment of the market, where business buyers and sellers are reaching-out across the net to create new relationships. Already the Division has been active in ensuring that these new markets remain open and competitive. In July 1998, in the MCI/WorldCom merger, the Division required MCI to divest its "Internet backbone" business to address Division concerns that the merger would

have an anticompetitive effect on the all-important backbone. In a 1998 FCC wireless license auction case, the Division prosecuted several firms for anticompetitive signaling during an electronic auction for wireless licenses that took place over the Internet. Also in 1998, the Division sued the Visa and MasterCard networks for limiting competition in credit cards, a behavior that stifled competition and innovation in products like smart cards and secured transactions over the Internet. And finally, in the Citibank/Transactive merger challenge, the Division sued to stop a merger of the two main competitors in the provision of government benefits delivered by electronic benefits transfer. The same principles apply in e-commerce as in other applications of the antitrust laws, and as the market develops, we will continue our job of keeping the marketplace competitive.

6. Conclusions

In closing, competitive markets have been central to the strength of our economy. People are now recognizing that competition policy stands with fiscal and monetary policy as the necessary underpinnings of our economic success. The truth of this has become even clearer in the post cold-war era as countries that relied on planned economies now rush to embrace competition. A competitive economy and the ability to compete are conditions in which small businesses thrive – innovating, spurring entrepreneurship and living the American dream. We understand the importance of competition.

Notes

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¹ This list is truncated as there have been many such actions in just the last few years. Therefore, please refer to the following website for further examples: www.usdoj.gov/atr.

Reference

Porter, Michael, *The Competitive Advantage of Nations*, New York: The Free Press.

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