

Problems of Cartel Policy¹

By RAYMOND V. McNALLY

WORLD WAR II suspended cartel activities, partly because of the important place that German industry held in most international cartels but chiefly because of governmental pressure for "all-out" production. However, international tensions focus attention on this problem once more, for the question naturally arises as to what the prospects are for resumption of these activities. The purpose of these five books¹ is to acquaint the public with the nature of the cartel problem, to disclose the relationship between these international alliances and domestic monopoly, to impress upon the American people the effect they have on our own economy, and to suggest remedies. All of these authors differ somewhat in their approaches to the problem and in their understanding of it.

That there is need for a clear presentation of the facts is obvious, for when the United States entered the war, the people were so stunned by the revelations concerning the threat to their national security that emotions ran high and reason went out the window. Without any clear idea of what was meant by cartels, the word quickly gained sinister connotations in the mind of the man on the street, for, conditioned as he had been for fifteen years by the irrational vilification of businessmen by politicians, intellectuals and many of the clergy, he applied the term indiscriminately to all private commercial agreements, to mere bigness, and indeed to practically anything he did not like. In such an atmosphere, dispassionate discussion or appraisal of the situation was impossible.

Simply defined, cartels constitute a voluntary, impermanent arrangement among producers engaged usually in the same line of business, designed to limit or eliminate competition among them by regulating production, sharing markets and fixing prices. But not all cartels are necessarily illegal under the antitrust laws of this country, and in England and most other foreign countries, they are not usually regarded as outside

¹ *Cartels: Challenge to a Free World.* By Wendell Berge. Washington, D. C.: Public Affairs Press, 1944, 260 pp., \$3.25. *National Interest and International Cartels.* By Charles R. Whittlesey. New York: The Macmillan Company, 1946, 164 pp., \$2.50. *Cartels in Action.* By George W. Stocking and Myron W. Watkins. New York: The Twentieth Century Fund, 1946, 517 pp., \$4. *Cartels or Competition?* By George W. Stocking and Myron W. Watkins. New York: The Twentieth Century Fund, 1948, 505 pp., \$4. *International Cartels.* By Ervin Hexner. Chapel Hill, N. C.: The University of North Carolina Press, 531 pp., \$6.

the law. In fact, many foreign governments including so-called democracies actually sponsor and direct such activities.

But Mr. Berge, former Assistant Attorney General of the United States, makes a vigorous and uncompromising attack on all cartels. With the zeal of a crusader, he argues that in peace time their high-price restricted-output strategy has impeded the advance of our living standards and general economic well-being; and by wantonly abusing our patent system, these cartels obtained a strangle-hold on a considerable part of our technology, bringing about deliberate deterioration of quality standards and even endangering the health and lives of consumers through adulteration of products.

Further, he insists that large corporations, such as Standard Oil and du Pont, entered into agreements with foreign companies without any regard for the safety of their own country and actually played into the hands of totalitarian nations like Germany. When war came, we discovered serious shortages of vital materials such as aluminum, magnesium and rubber; and the lack of vital drugs endangered our fighting men in fever-stricken areas.

Mr. Berge views the cartelization of industry as a means for exercising political and military control over other nations and asserts that totalitarianism represents simply the ultimate consummation of cartelism. As an example, he refers to Germany's influence in South America as a result of American cartelists agreeing not to compete in that area. Thus the United States lost valuable business and Germany was able to carry on Nazi propaganda and espionage.

The Cartels and Free Competition

WHILE PROF. WHITTLESEY agrees with Mr. Berge that cartels are not desirable, he gives little weight to the argument that they are a political menace, contending that the most fundamental objection to the cartel system is that it is inconsistent with the functioning of the economic system in a free competitive society.

He insists that the wartime shortages were almost entirely the result of expansion in demand due to the extravagant needs of war and not of prior restrictions of supply. Moreover, he claims that the situation was aggravated by the pressure on shipping facilities resulting from wartime conditions and that the list of commodities that were rationed during the war consisted chiefly of items in which cartelization had never been alleged to exist. And apparently it was not necessarily the existence of

cartels that led to Germany's preparations for war, for in view of her national policy, these would have taken place even in the absence of cartels. As for cartel agreements that excluded imports of strategic materials from the American market, he believes that their net effect might have been to strengthen our military preparedness by increasing our self-sufficiency in these materials.

But Mr. Berge argues that the participation of American business concerns in foreign cartels led to military information passing to Germany and obstructed the production of strategic materials in this country. As an illustration, he cites the alliance that Standard Oil made with I. G. Farbenindustrie, the German chemical trust, to meet the threat arising from the new process by which oil could be made from Germany's plentiful coal resources, thereby surrendering its own rights in the chemical field including those in the United States. Thus no one was permitted to manufacture synthetic rubber, which belongs to the chemical field, not even Goodrich and Goodyear, and Standard Oil received little if any information on synthetic rubber from I. G.

On the other hand, Prof. Whittlesey claims that cartels as a device for conveying essential information cut two ways. The rights to the German oil-hydrogenation process which Standard Oil bought from I. G., became the basis of intensive research that led to the discovery of a new method of producing toluol, principal ingredient for TNT, making it possible for this country by 1941 to produce explosives at one-fifth of the cost and on a scale equal to any demand. Spokesmen for cartel interests expressed the opinion that this country was spared years of research and developmental work as a result of the information obtained from the Germans.

Persisting in his effort to view the problem objectively, Prof. Whittlesey writes that because international cartels have been made an instrument of war is not a sound reason for banning them for then, logically, we should also ban airplanes, tanks, submarines and atomic power. In fact, he suggests that the same objection can be made against foreign educational institutions, foreign missionary endeavors, travel abroad and any sort of business activity that crosses frontiers. The important question, he thinks, is whether cartels are essential to the fullest and healthiest development of American economic life.

The proponents of cartels insist that they are, for they regard them as a means of establishing order in an industry, of preventing over-capacity and of conserving capital values. Critics see them as a device to raise

prices and garner huge profits. There is some truth in each of these contentions; but while the desire to increase profits may sometimes give rise to cartels, the risk of losses provides a stronger motivation for attempting to reduce competition. We have only to remember the ill-advised attempt by our own government to cartelize all industry through the NRA to understand this side of the case.

Then also, many businessmen insist that cartels are one of the established institutions of international trade and that Americans must be able to participate in them if this country is to play an active part in the world trade of the future, for otherwise we shall be excluded from foreign markets. They point to the Webb-Pomerene Act as legalizing cartel practices, but Mr. Berge denies this, contending that the Act was designed to help small businessmen to compete with foreign cartels and not to provide a means of joining them.

Prof. Whittlesey ridicules the idea that American business requires cartelization in order to hold its own in markets abroad, pointing out that the history of trade between the two world wars shows that the countries that made free use of cartels were on the whole less successful in export trade than those that did not. This view is supported by Prof. Theodore J. Kreps in his paper, "Experience With Unilateral Action Toward International Cartels" ("A Cartel Policy for the United Nations," 1945), in which he states that not more than a third of world trade is under cartel control and less than 10 per cent is dominated by well-organized foreign businesses supported by the power of their governments.

The Cartels and Economic Dislocation

BUT A STUDY of cartel history leaves one with the impression that it is essentially an instrument used by desperate men to avoid the ravages of competition, which is particularly intensified by the over-expansion created by wars. Yet almost invariably, while cartels seem to remedy a bad situation temporarily, they encourage more production by keeping prices high and attracting new competitors and tend to drive efficient producers out of business and to protect inefficient and high-cost producers.

Stocking and Watkins make this clear in "Cartels in Action," the first volume of a series of three reports issued by the Twentieth Century Fund on the subject of monopolies, as they review the development, describe the methods and analyze the results of international cartels in several important industries: sugar, rubber, nitrogen, iron and steel, aluminum,

magnesium, electric lamps, and chemicals. This book, well documented and replete with tables and charts, and despite the objective and factual style of the authors, reads like a veritable nightmare. In these words, couched in a somewhat nostalgic vein, they express their own viewpoint: "The discrepancy between the truths men live by—in business—and the truths which they profess but do not live by, is one of the most significant, and disturbing, revelations of this survey."

But these writers bring out the fact that governments themselves in some cases took a very active part in cartel arrangements or restriction measures. As in the case of sugar, the pressure exerted on them because of the terrible plight of the growers was too great to resist. Cuba particularly was in a very bad spot because it is practically a one-crop country, and its government could not possibly refrain from interfering. Our own government made matters worse by maintaining a high tariff and imposing quotas on the various sugar-exporting countries, which tended to encourage the high-cost beet sugar producers to continue and even to expand their operations.

The restriction of competition in foodstuffs and raw materials has been due less to international agreements than unilateral national policies involving protection and subsidization of local producers. However, some people favor government action rather than private agreements despite the fact that it increases economic nationalism and makes for much more restriction and much less flexibility.

Yet it would be naive to expect that men will soon learn that neither cartels nor government controls can possibly correct basic maladjustments. History is all against such hopes, for it seems that the dynamic forces of life are constantly driving men from one phase to another—from monopoly to freedom and back again.

This is excellently illustrated in Stocking's and Watkin's second volume, "Cartels or Competition?" Cartel practices are as old as business, but the cartel *movement* is young, as it is the product of a mature, not an infant, industrial society. "It represents a rejection by businessmen and statesmen, after more than a century of almost reverent acceptance, of Adam Smith's obvious and simple system of natural liberty."

By the beginning of the twentieth century economists and humanitarians were questioning the assumptions on which the logic of competition rested. The competitive ideal assumes a market of many sellers and many buyers, but modern technology was demanding larger and larger production units requiring vast amounts of capital. This fact,

coupled with the mysteries of physics and chemistry which were becoming more and more essential for productive efficiency, shut off business opportunities from the uneducated man of small means.

Mass production with its requirements of large quantities of fixed capital brought increasing overhead or fixed expenses in relation to variable expenses with the result that rapid adjustments, when necessary, were difficult to make without sacrificing capital values. Out of these evolving conditions trusts were born, and as businessmen began to rely more and more on collective action, these soon became international in scope.

Competition or Cartelization

IN THE LIGHT of these historical facts it seems absurd to denounce private cartel practices as essentially wicked or as un-American. The question is whether competition or cartelization promotes the general welfare; but if we refrain from *a priori* conclusions, no definite answer on an empirical basis is available.

Dr. Hexner insists that generalizations have little value unless they are based on scientific investigation of both cartellized and non-cartellized markets and the behavior patterns of consumers and businessmen. In "International Cartels," which is heavily documented, he discusses the over-simplification and confusion resulting from the lack of case material and offers descriptions of more than a hundred international combinations together with appendices containing the complete texts of many important cartel documents. Other writers would do well to emulate his objectivity and realism.

It does not follow, he points out, that competition, increased volume and low prices inevitably exist in the absence of restrictive agreements, nor that cartels always result in contraction. Frequently the anticipation of profits and "stable" markets attract large investments leading to improved production techniques and greater output. Thus it is a fallacy to assume that a combination must operate against the consumer, for it is questionable whether the consumer, in some cases, would receive the benefits that flow from large-scale, long-term investment were it not for the existence of some degree of private monopoly.

However, Dr. Hexner is not unalterably opposed to competition since he seems to regard the frailty of private marketing control schemes as a virtue compared to the hardships and rigidities of government controls. But the fact that underground competition and the constant jockeying for the dominant position within many cartels force the members to

expand goods and services whether they like it or not is ignored by cartel critics. Thus they demand legislation to *force* businessmen to compete, for their attitude is based on two strange propositions: 1. Free enterprise does not embrace the freedom to *refrain* from competition. 2. Businessmen have no moral right to conserve capital values; only consumers and labor have rights.

The problem is further confused by the lip-service Americans pay to the ideal of free enterprise in the face of their predilection for all kinds of trade restraints. In fact, there is nothing more fantastic than the spectacle of the government piously exhorting other nations to establish free international trade while at the same time maintaining tariffs, immigration laws, farm parities, fair trade practice laws, and laws for the protection of labor unions.

Perhaps the issue is not competition vs. monopoly after all but rather private planning vs. government planning, for the pathological fear of private monopoly leads to acceptance of the myth that government monopoly is always in the public interest. But the psychological implications are sensed by Dr. Hexner, for if man is not actually shown up here as a sham, at least his muddled state is clearly revealed for all to see. In fact, compared to man as he really is, Adam Smith's "economic man" is too simple and artificial a creature to command belief.

Problems of Policy

WHAT THEN is to be our cartel policy? Stocking and Watkins believe there is no simple solution for the problem. They have little hope that, in a world devastated by war, freedom of production and trade can be fully established, due to the reluctance of nations to give up the controls and regulations that they regard as essential for survival. Furthermore, while they deplore the growth of monopoly, these writers have little faith in competitive market forces to do the proper job in the case of certain raw materials except over a long period and at very great human and social cost.

To avoid that cost and to reduce the risks of unstable production and trade, they think that intergovernmental commodity agreements with suitable safeguards are justified (despite past experience), but they do not favor unilateral or bilateral agreements. At the same time, they are opposed to the United States assuming a weak attitude toward cartels generally and believe that because of its magnificent industrial set-up, it should and can make an effort to preserve as much freedom of op-

portunity as possible. Specific proposals for attaining this the authors are deferring to their next report. However, in a general way, they recommend repeal of the Webb Act and replacing it with new legislation permitting the formation of export associations and subjecting them to clearer and stricter rules; also the reforming of the antitrust and patent laws.

Prof. Whittlesey agrees that we should work for economic freedom but, nevertheless, favors some degree of latitude on the part of our administrative authorities to permit cartel practices "when they can be shown to be clearly in the national interest." Also he recommends a re-examination of the Webb-Pomerene Act, modification of existing patent provisions, and continuance of antitrust enforcement plus, unfortunately, an expansion of bureaucracy in the form of new agencies to handle cartel problems.

Mr. Berge is much more uncompromising and asserts that the most effective weapon for combating monopolies and cartels is vigorous enforcement of the antitrust laws, although the record shows that enforcement of the Sherman Act since it was placed on the statute books in 1890 has utterly failed to achieve the desired results. The Department of Justice has lost most of its suits, and it is significant that most companies prefer to sign consent decrees rather than spend the time and money to defend themselves, but these decrees involve the acceptance by the government of the companies' assertions of innocence.

In fact, natural laws have been more effective in curbing unnecessary combinations, for most trusts have been unsuccessful. Moreover, it is well known that small business has been fighting a losing battle against economic forces during the last eighteen years, the very period in which antitrust suits increased by about 3,000 per cent. And, besides, Mr. Berge must know that attempts at enforcement inevitably interfere with production, for it was for this very reason that in March, 1942, President Roosevelt ordered these suits to be postponed until after the war. Nevertheless, we can expect that trust busting will continue indefinitely, for the Sherman Act is sacred in this country, and prohibitive measures are generally regarded as the only way to correct economic maladjustments. But any fool can prohibit something if he has the power to do so. If competitive conditions do not seem to exist, what could be easier than to hamper the functioning of large corporations?

In view of his profound understanding of a complex subject, it is not surprising, on the other hand, to find Dr. Hexner taking a more or less

neutral position. However, the human mind seldom knows its own limitations, for despite his insistence that considerably more research is necessary to arrive at definite conclusions and to formulate policies, he ventures to offer twenty suggestions centered chiefly in the idea of supervision of cartels by an international convention of governments. At the same time, he warns the reader that even his own generalizations are suspect if unsupported by adequate information.

New York

Land Monopoly in Argentina

WHEREVER THE SCHOLAR who has a special interest in land economics seems to turn, he finds the perennial land question in one form or another. Dr. Carl C. Taylor, the distinguished rural sociologist, was in Argentina from March, 1942, to April, 1943, on a research assignment for the United States Department of State. He traveled 20,00 miles within the country, interviewed more than 120 families and gathered data on population and rural life. One product of this opportunity is his book, "Rural Life in Argentina," published last year by the Louisiana State University Press.

The book contains a wealth of information on the life of the rural family in Argentina and there is much interesting information on land tenure in the country, as in Dr. Taylor's classic text on rural sociology. N. Y. Whetten of the University of Connecticut summarizes this aspect of the book in *Rural Sociology* (Sept. 1948) as follows:

"There is probably no other society wherein the inhabitants prize ownership of farm land more than in Argentina, yet 44 per cent of the farmers are tenants and there is a semi-monopoly of the land in large holdings. Most of the tenants are hired men trying to ascend to ownership, not dispossessed owners" (p. 331).

Whetten declares that one of the book's important results should be to stimulate Argentines to make rural life studies of their own country. The fact is, of course, that fundamental studies of the agrarian land problem in Argentina have been made by such men as Prof. C. Villalobos Dominguez. Taylor's work may stimulate them to undertake more rounded studies.

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