“Cleaning up the Wenatchee Oil Business,”

Telecom Mergers, Art Auction Collusion, and the Political Economy of Antitrust

My dad drove an oil truck. He worked for the local Union Oil distributor in Wenatchee, Washington, for 33 years until he retired in the early 1980s. He was pretty far down on the organization chart for Union Oil, but he was in the oil business none-the-less. Once in the middle 1960s, shortly after I got my driver’s license, we had a gasoline price war in Wenatchee. If I was willing to break with family loyalty to Union Oil and buy off-brand, cut-rate gas, I could fill up my ’51 Chevy for under five bucks. I thought this was about as good as it could get. My dad the oil man had a different idea. One time at the dinner table, I remember him saying, “What we need to do is clean up the oil industry, get rid of all the gypo cut-rate guys.” My mom and I usually knew that this was a good time to change the dinner discussion to sports.

My dad had a seller’s view of market structure. Too many sellers made business difficult. Not only were prices lower, but you had little control over price at all. If you could get rid of the cut-rate riff-raff, you and the Texaco man might be able to come to a sensible agreement to stop “hitting each other over the head” on prices. My dad had good company in this view. In 1776 Adam Smith wrote *in The Wealth of Nations*, “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.” (P. 128)

Unless you’re Tony Soprano or Michael Corleone, reducing the number of sellers in the market is not easy to do. For one thing, we have antitrust laws and policy against actions by businesses that will reduce the number of sellers and raise prices. In 2002, both the Federal Communications Commission and the Justice Department ruled against a merger of the nation's two largest satellite-television companies, Echostar Communications Corp. and Hughes Electronics Corp. Regulators at these agencies argued that the merger would raise prices to rural customers who, after the merger, would have one satellite-television alternative instead of two. The companies claimed this wouldn't happen, and that the larger satellite company would have lower costs and provide more competition in urban cable-television markets. Editorial writers for the *Wall Street Journal* said even if prices did rise in rural areas, well, this was just part of living in the country, and fewer larger companies would be more financially stable, enabling them to make the large investment necessary to serve customers better. They attributed the negative merger rulings to zealous regulators protecting their turf. Such is the rich political economy of market structure.

Economists could safely straddle this issue with two prominent theories. First, a movement from competition in the direction of monopoly would likely raise price and reduce the amount of the good or service produced and consumed. With fewer sellers, profits would also be higher. The second theory, however, might side with the *WSJ* and say this might be better for innovation and investment in the long run.

Even if companies don't merge, they can increase profits by jointly restricting output and raising price. We call this type of organization a sellers' cartel. Probably the most famous cartel is the Organization of Petroleum Exporting Countries (OPEC). Over the last thirty years, OPEC has been successful at raising oil prices by using production quotas. The success of OPEC depends to a large extent on the willingness of Saudi

Arabia, by far the largest producer of crude oil, to control its pumping. The successes of OPEC, however, are countered with many examples of the classic failure of sellers' cartels. The desire for greater profit that brings companies (and countries in this case) together is the same force that leads to cheating once production quotas are established. Every seller thinks, "If I sell just a little more at the higher price, my profit will be higher still." They all sell more and price falls. With OPEC, this usually happens a month or so after oil ministers have met somewhere like Vienna to hammer out an agreement. For example, on April 25, 1996 the *Wall Street Journal* ran an article with the headline "OPEC Members Boldly Violate Quotas." Sometimes economic theory predicts pretty well.

Cartels work best when the number of participants is small. Christie's International PLC and Sotheby's Holdings Inc. control over 90% of the art auction market. In 2001, both companies paid to settle a class-action suit alleging they jointly fixed fees to both buyers and sellers of art. Leaders of both companies have either been convicted or are still under trial for conspiracy to violate antitrust laws.

So it appears that Adam Smith was right. Whether in the Wenatchee oil business, the world oil market, the rural market for satellite-television, or the art auction industry, sellers like to reduce the number of rivals and to raise prices if they can. The antitrust laws offer some constraint on this activity. But to an economist, whether a merger or price fixing agreement is bad, and whether we need antitrust laws to prevent these actions, depends to some extent on the particular case, but also on the economic theory we use to evaluate it.

In the short run, actions to limit competition by merger or price fixing will increase price and profit and reduce the amount sold in the marketplace to a level lower than consumers are willing to pay for. Economists would think the latter is bad, and withhold judgement on the price and profit increase. But over the long run higher market power can lead to more innovation and investment. Besides, no business can maintain a barrier to entry forever, regulators are not saints, and cartels with many participants are doomed to failure even without government involvement. The political economy of market structure is a rich subject, indeed.