Trade, Antitrust, and Restoring Domestic Competition

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Will more restrictive trade policies harm the U.S. economy by shielding domestic businesses against competition? That's what standard economic theory holds, insisting that pressure from foreign rivals is needed for U.S.-based businesses to continue to innovate, to create the highest quality goods, and to sell them for the lowest possible prices.

Although this theory has often been used as a justification for "free trade," competition within the U.S. market has, for decades, been allowed to wither as a result of corporate concentration and other factors. Indeed, those insisting that increased foreign competition is necessary to keep domestic businesses on their toes are often the same people who claim that domestic monopolies are nothing to worry about. At the same time, foreign competition itself has contributed to greater corporate concentration within the United States, reducing domestic competition.

A more sensible economic strategy, at least in the present situation, would aim in the opposite direction: reducing foreign competition and replacing it with domestic competition. This could be accomplished through more robust trade curbs as well as by reinvigorating long-dormant antitrust policy. A combination of less foreign competition and more domestic competition would create two big, badly needed bonuses: a major boost for lagging

American wages, and healthier, less bubbly U.S. growth, generated more from production and less from consumption.

After all, if the number of domestic employers—which pay relatively high wages—competing for American workers' services were to increase, then U.S. labor would be endowed with greater bargaining power to force businesses to pay even better. Moreover, in a more effectively protected American economy, those same domestic U.S. workers would face much less downward wage pressure from imports supplied by overseas workers, who generally are much lower paid.

In addition, a trade policy that reduced America's enormous deficits would by definition slash U.S. imports by much greater amounts than any reductions in exports resulting from foreign retaliation or from consequently weakened foreign economies. More balanced trade would mean that the nation's prosperity would once again (mainly) reflect its production and income-earning prowess, rather than its ever deeper indebtedness.

Declining Domestic Competition

Since the 1970s, American trade policies supported by presidents and congresses of both parties have exposed the nation's economy to surging levels of foreign competition. When that decade began, imports of goods and services amounted to about 5.2 percent of gross domestic product. By last year, they hit 15.4 percent—despite a dramatic drop in purchases of foreign oil, which are generally unrelated to trade policy decisions. Indeed, import-encouraging trade policies continued long after it became clear that

exports were not nearly keeping pace, even though export expansion was most often the stated goal of liberalizing trade policies.

Yet as foreign competition against domestic businesses and workers kept rising, levels of domestic competition fell dramatically. In the spring of 2016, the Obama White House made waves with a study warning about "three sets of trends that are broadly suggestive of a decline in competition [in the domestic economy]: increasing industry concentration, increasing rents accruing to a few firms, and lower levels of firm entry and labor market mobility." The president's Council of Economic Advisers (CEA) was worried that more and more sectors of the American economy were increasingly dominated by ever fewer, ever larger companies. And the burgeoning power of these giants was enabling them to supercharge their profits, discourage the entry of new rivals, and narrow U.S. workers' range of employment choices.

Some of the evidence marshaled for this proposition—notably, the share of revenues earned by the top few companies in a given industry and their outperformance measured by returns on invested capital—came from sectors of the economy not extensively exposed to international competition, such as health care services, logistics, real estate, and educational services. But the same trend also occurred in sectors that are highly exposed to foreign competition, such as agriculture and its supply industries, information technology, and publicly traded American nonfinancial companies.

Around the time the CEA report was published, a growing body of more detailed scholarly research was arriving at the same conclusions. For

example, one paper written for a 2017 University of Chicago conference on declining competition found that "More than 75 percent of U.S. industries have experienced an increase in concentration levels over the last two decades." In fact, during this period, the average industry's level of concentration nearly doubled.

That same year, a team of noted economists from Harvard and MIT looked at the share of sales generated by the top four businesses in six major American industries—manufacturing, finance, retail trade, wholesale trade, services, and utilities and transportation—and documented "a remarkably consistent upward trend in concentration" between 1982 and 2012.

In manufacturing, which dominates both U.S. export and import flows, consultant Michael Collins reported an "astronomical" rise since the end of World War II in the number of American industries in which the top four companies accounted for at least half of that sector's shipments. Moreover, the most rapid growth in highly concentrated industries has taken place since the early 1980s—when the American economy began opening wide to imports.

The trend toward higher levels of concentration becomes especially apparent upon examining some specific American industries. For example, as late as the 1970s, the U.S. economy had room for four domestic manufacturers of earth-moving equipment. Today, only one—Caterpillar—remains. For a half century starting in the 1930s, seven full-line, U.S.-owned companies competed in the American market for farm machinery and equipment. Today the number is down to three. In 1970, three companies built large-

scale civil aircraft in the United States. Since 1997, Boeing has been the only domestic survivor.

No industry's experience, however, better illustrates the paradox of import-friendly U.S. trade policies and lax antitrust policies than that of the automobile sector. Although by one count fully forty-four American companies were manufacturing passenger cars as late as the 1920s, the industry had become highly concentrated by the eve of the Great Depression, with the "Detroit 3"—Ford, General Motors, and Chrysler—already accounting for some 80 percent of U.S. output.

The Detroit 3's dominance, and especially GM's position, strengthened further following World War II. And just as mainstream economic theory predicts, the industry became fat, lazy, and addicted to juicing sales through gimmicks like planned obsolescence and tailfins rather than by offering ever better products. Not surprisingly (at least not in retrospect), by the 1970s, the import invasion was in full swing. The Detroit automakers' pleas for protection weren't answered until their market-share losses alarmed even the free-trading Reagan administration, which led to the imposition of "voluntary" import quotas on German and Japanese producers.

These trade barriers, in part, temporarily stemmed the tide, but an arguably more effective recipe for strengthened domestic auto industry competitiveness was actually proposed much earlier in Washington, though ultimately rejected: a forced breakup of GM. An investigation into GM's anticompetitive practices was launched by the Eisenhower Justice Department in 1956 and completed ten years later. But the company's massive size, signs of an economic slowdown, and the beginning of Vietnam

War–related divisions and civil rights tensions persuaded President Johnson to avoid such a potentially disruptive step. The result, according to legal scholars Harry First and Peter Carstensen, was the loss of a momentous opportunity. Writing in 2009, soon after the Bush and Obama administrations decided to bail out and take over the then-floundering company (along with Chrysler), they argued:

> The failure to pursue antitrust action against GM at a time when it could have spun off healthy assets, not failing ones, is a cautionary tale for antitrust enforcers. Had GM been reorganized when it was still a powerful and efficient competitor, the result might have been a stronger, larger, and more domestic automobile industry, where firms would have been under continuing competitive pressure to reduce prices and to innovate, whether by producing smaller cars, more efficient cars, or safer cars.

Foreign Competition's Role in Encouraging Corporate Concentration

Why was concentration in American business allowed to increase—and competition allowed to decrease—so dramatically during the last several decades? One important reason: starting in the 1970s, a growing scholarly and political consensus concluded that long-standing antitrust policies had become outmoded and heavy-handed. With Ronald Reagan's election as president in 1980, control of competition policy passed to free market enthusiasts convinced both that the private sector could adequately police the most harmful business collusion, and that the cause of antitrust generally mattered less than promoting economic efficiency.

Even after Reagan, free market fundamentalism remained a strong influence limiting antitrust enforcement. Moreover, inherently sluggish legal mechanisms involving piecemeal approaches proved no match for concentration impulses supercharged by broader economic policy decisions (ranging from favorable tax treatment for financing acquisitions via debt issuance to slashing the overall cost of capital with super-easy monetary policies).

Ironically, rising foreign competition itself has been used as a rationale for permitting more corporate bigness: without eased antitrust enforcement, the argument went, U.S.-based businesses could never reach the scale needed to compete effectively against mammoth Asian and European rivals.

Financial industry consolidation is one leading example of this phenomenon. Starting in the late 1980s, American banks and lawmakers began claiming that Depression-era and other long-standing curbs on their size and operations were crippling their domestic and international competitiveness. In particular, prohibitions on interstate banking constrained their geographic reach, and the mandated separation of commercial and investment banking denied them vital economies of scale. Yet they faced Asian and European rivals that labored under no such restrictions.

As finance writer Edward Harrison reminds us, by the 1990s, these regulatory discrepancies appeared to threaten the U.S. financial sector's very independence:

> By the 1990s, the now internationalised European universal banks were on the prowl in America. . . . We saw Credit Suisse acquire First Boston, SBC acquire Dillon Read, and Deutsche Bank acquire Bankers Trust. [W]e were seeing international universal bank behemoths that had huge balance sheets and huge investment banking and trading operations in America. The American companies felt at a disadvantage because of Glass-Steagall [the law preventing commercial and investment banking by the same company]. And, in truth, they were.

The end result: the repeal, in 1994, of interstate banking restrictions and, in 1999, of the Glass-Steagall ban on financial conglomerates.

Concerns about antitrust laws undermining U.S. manufacturing's competitiveness date to at least the Carter administration, and peaked in the late 1980s as fears spread about the American economy's inability to keep pace with foreign—especially Japanese and European—rivals. Indeed, in 1988, no fewer than two Reagan administration cabinet secretaries wrote *Wall Street Journal* articles contending that outmoded regulations were preventing U.S. businesses from cooperating on research and development and production in order to meet challenges from foreign systems where such joint ventures allegedly were encouraged.

In response, according to *Congressional Quarterly*, "More than half a dozen bills [were] introduced to offer a degree of protection from antitrust laws for joint ventures in U.S. manufacturing." By the end of the decade, this activity produced federal approval for industry consortia to speed up technological progress in electronic packaging, software development, parallel computer architecture, and semiconductor manufacturing.

Corporate Concentration, Wage Stagnation, and Business Dynamism

Nowadays, calls for more robust antitrust enforcement have made a comeback, focused mainly on issues surrounding the behavior of technology behemoths, including privacy intrusions, voter manipulation, and censorship practices.

But the same research that spotlighted worrisome growth in business concentration throughout the economy has pointed to other noteworthy economic tolls as well. The Obama administration report which found that competition in many industries had fallen by troubling extents specifically warned that the results could eventually undermine the benefits of freewheeling markets long identified by economists: "lower prices and better products for consumers, greater opportunities for workers, and a level playing field for entrepreneurs and small businesses that seek to enter new markets or expand their share."

Academic research has identified especially significant effects on wages flowing from more concentrated, less competitively structured industries—which makes perfect sense according to the laws of supply and demand. A study released this February by the National Bureau of Economic Research looked at eight thousand American labor markets and reported not only that the average region is "highly concentrated," but that a tripling of the degree of market concentration is statistically linked with a 17 percent decline in wages. In other words, the fewer companies that were competing for workers, the less power these workers had to goad those companies into a bidding war for their services.

Similarly, according to a 2016 paper from the University of Chicago, if competition in the United States returned to its 1984 level, wages would be 24 percent higher. And a January 2018 Northwestern University study examining the period from 1977 to 2009 found a near-lockstep—but inverse—relationship in the United States between the degree of employer concentration in a labor market and its wage levels. That is, the higher the former, the lower the latter. And, over time, the wage-weakening effects of declining job opportunities for workers became stronger.

Oddly, the latest evidence is decidedly mixed for the best-known prediction about the dangers of monopoly and declining competition in general—that businesses enjoying unusually strong market positions will use this power to supercharge consumer prices. For example, in 2016, a Federal Reserve study of 187,000 manufacturing plants found that mergers and acquisitions in the sector have "significantly" increased "markups on average, but have no statistically significant average effect on productivity." Yet the following year, Georgetown University economist Sharat Ganapati came to precisely the opposite conclusions.

Much less ambiguous have been the results of research measuring increasing business concentration's effects on one of American capitalism's greatest strengths: its dynamism. Here, the main indicator is the so-called birth-death rate, which measures the extent to which new businesses are being formed and old ones are exiting the stage. Consistent with Joseph Schumpeter's venerable notion of creative destruction, most economists agree that the higher this so-called churn rate, the more innovative and productive the economy tends to be. As summarized by the 2016 Obama White House report, however, considerable academic research has detected

an overall downward trend in business churn since the 1970s, with the decline almost entirely driven by the drop in new business formation. Moreover, although waning business dynamism had been largely restricted during the 1980s and 1990s to a handful of sectors (notably retail), one major 2017 study discovered that, since the 2000s, it has spread throughout the entire economy.

Encouraging Domestic Industry and Competition

Breaking up these monopolies and oligopolies while pursuing trade policies that privileged U.S. industry and production would create more wage-boosting domestic competition for U.S. workers. But could purely domestic competition keep product costs in check, and maintain quality and innovation? Reasons for optimism abound.

The high degree of economic concentration characterizing the American economy by definition shows that it is capable of generating much more competitive pressure than at present, and all the more so since the gap between U.S. GDP and that of the world's next biggest economies is so great. For example, the United States is 62 percent larger than the world's second-biggest economy, China. It is more than three and a half times bigger than Japan and nearly five and a half times bigger than Germany. And although South Korea is a major exporter to the United States, its economy is only one-thirteenth as big.

As a result of its relative size, even if every unit of economic activity outside the United States places an identical amount of new competitive pressure on the American economy (an assumption that's never been tested, but one

that's logically consistent with Washington's long-time determination to maximize foreign competition), then it's easy to see how significantly enhancing levels of domestic competition can satisfactorily substitute for much current foreign competition—and ensure that the benefits stay at home rather than leak overseas.

Domestic competition's potential to replace foreign competition looks even more compelling upon realizing that the United States already holds global leads in many crucial measures of competitiveness, like productivity levels and innovation measures. Therefore, it's likely that foreign competition's effectiveness versus domestic competition has been considerably overstated.

On the other hand, it's true that several major foreign economies produce goods and services that equal or outshine their American counterparts—for example, Japan and Germany in automobiles; Japan, South Korea, and Taiwan in certain kinds of semiconductors; Japan and the Netherlands in semiconductor manufacturing equipment; Germany in specialized industrial machinery; China, Sweden, and Finland in state-of-the-art (5G) telecommunications hardware; and virtually all of these countries in machine tools.

Where America does lag in higher-value sectors, however, it's best advised not to content itself with importing—which increases the odds that it will remain behind. Far better would be to use its vast market power to require foreign companies to manufacture these goods in the United States and share with or transfer outright their best technology to American partners. Countries much smaller and weaker than the United States, as well as giants like China and India, routinely use such practices to enhance their

technological prowess; America can surely be at least as successful. Indeed, during the 1980s, the Reagan administration used tariffs to press foreign firms to improve America's steelmaking capabilities in just this way. At the same time, continually strengthening U.S. manufacturing competitiveness also requires more effective incentives for domestic private sector research and development, along with stepped up federal support for innovation.

And what of those many areas where imports now hold sizable shares of the U.S. market despite lacking notable competitive edges? Domestically produced counterparts should steadily become available thanks to a combination of stronger antitrust policies reducing barriers to entering these industries; the ready access to investment capital that should be enabled by the unrivaled U.S. financial system; and the attraction of supplying the world's largest mass of affluent households and profitable businesses.

The examples provided by the domestic economies of potent rivals like Germany and especially Japan also justify confidence that greater domestic competition can satisfactorily take the place of much foreign competition in America. After all, these countries have created dozens of world-class industries precisely by permitting fierce domestic competition while excluding most foreign rivals. True, prices have been high—but so have wages.

Finally, the U.S. economy itself historically excelled at creating innovative, high quality, affordable goods (and services) long before encouraging import competition. Even in recent decades, in the absence of serious foreign rivals, myriad American industries have delivered top-notch value and generated numerous breakthrough offerings—think aerospace, pharmaceuticals,

finance, software and internet services, entertainment, and high-value agricultural goods. More effective spurs to domestic competition could greatly multiply the number of these world-class industries, and the employment and income opportunities they generate.

Competition is unmistakably needed for lasting national prosperity. But foreign competition has no outsized importance. Especially in an economy as immense and diverse as America's, prioritizing domestic competition can keep ensuring low costs, high quality, and innovation. It can reduce the role of budget-busting government spending and tax cuts as engines of growth. And it can prevent excessive concentrations of political power. President Trump has begun the process of limiting foreign competition. Now it's time for Washington to achieve the best of all worlds and unleash an era of greater domestic competition.

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