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The Ghost of John D. Rockefeller

by Thomas J. DiLorenzo

At the Senate Judiciary Committee hearing on competitiveness in the computer industry last March, Microsoft chairman Bill Gates was compared to the infamous "robber baron" John D. Rockefeller and his company likened to the Standard Oil Company of the late nineteenth century. Federal Trade Commission chairman Robert Pitofsky made a similar analogy in a *Washington Post* op-ed, where he self-servingly argued for more money for antitrust investigations. Gates's competitors, too, are working diligently to implant the Rockefeller analogy in the public consciousness.

Even the *Wall Street Journal* has joined in this attack; reporter Alan Murray claimed in a page-one article that Gates supposedly enjoys "monopoly power" that "even John D. Rockefeller could envy."

Microsoft's critics are right. There are many similarities between Bill Gates's company and the old Standard Oil organization.

Like Gates, Rockefeller was the victim of a political assault for the "sin" of rapid innovation, a vast expansion of output, and rapidly *declining* prices—just the opposite of what the antitrust laws ostensibly police. As with Microsoft, the political attack on Standard Oil was launched by less-efficient rivals who wanted to achieve through the political process what they failed to achieve in the marketplace.

There is indeed a lesson to be learned from Rockefeller's antitrust ordeal, but it is not the one Microsoft's critics have in mind.

Rockefeller's Economic Legacy

The firm of Rockefeller, Andrews, and Flagler was formed in 1865 and was a marvel of efficiency because of Rockefeller's penny-pinching ways and the managerial genius of his brother William.[1] Even Rockefeller's harshest critic, the muckraking journalist Ida Tarbell (whose brother's firm—the Pure Oil Company—was driven from the market by the more efficient Standard Oil), described the company as "a marvelous example of economy."[2]

The efficiencies of economies of scale and vertical integration caused the prices of refined petroleum to fall from over 30 cents a gallon in 1869 to 10 cents by 1874 and to 5.9 cents by 1897. During the same period, Rockefeller reduced his average costs from 3 cents to 0.29 cents per gallon.

The production of refined petroleum *increased* rapidly throughout this period of increasing dominance by Standard Oil as well, as increased competition was provided by Associated Oil and Gas, Texaco, the Gulf Company, and 147 independent refineries that had sprung into existence by 1911—the year in which the government forced the breakup of Standard Oil.

Contrary to popular mythology, Standard Oil's market share *declined* from 88 percent in 1890 to 64 percent by 1911. Because of intense competition the company's oil production as a percentage of total market supply had declined to a mere 11 percent in 1911, down from 34 percent in 1898.

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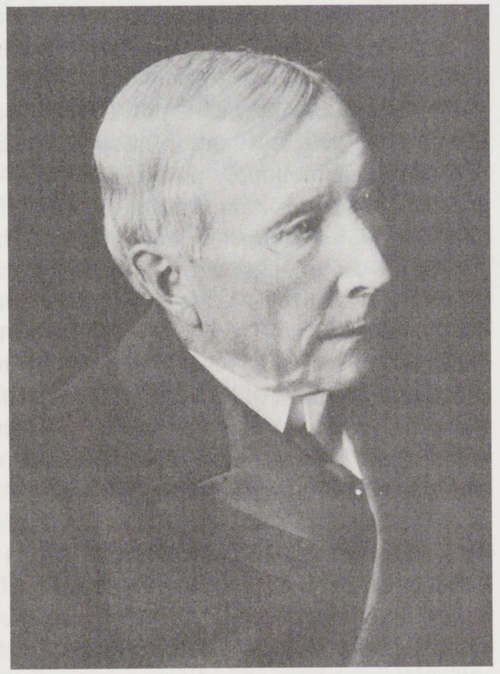

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John D. Rockefeller (1839–1937)

Moreover, Standard Oil's decades-long price-cutting was not "predatory pricing"—the theoretical practice of pricing below average cost to drive competitors from the market and establish a monopoly. Any business person would be a fool to intentionally lose money by pricing below average cost *for decades*. As economist John McGee concluded in his classic analysis of the Standard Oil case, "whatever else has been said about [it], the old Standard organization was seldom criticized for making less money when it could readily have made more" through other means.[3]

Indeed, Standard Oil never came close to cornering the market; by the time the antitrust case against it was filed in 1906, it had hundreds of competitors. Nevertheless, Standard Oil was convicted of violating the antitrust laws in 1911 and partially dissolved, despite the fact that the courts conducted no economic analysis of its conduct and performance. That is, they completely ignored the effects the company had on prices, output, and innovation in the petroleum industry, just as Microsoft's critics tend to ignore that there are tens of thousands of software development firms in the world and that during the period of Microsoft's rise to dominance the cost of computing has fallen spectacularly while product quality has soared.

Standard Oil was convicted because of a general anti-business animus stoked by socialist intellectuals and journalists such as Henry Demarest Lloyd and Ida Tarbell and urged on by the company's higher-cost and higher-priced rivals. As a result the most efficient industrial organization of the time was crippled, weakening competition and pushing prices up.

The Protectionist Roots of Antitrust

From the very beginning, the antitrust laws have been a protectionist vehicle. While in theory they guard consumers against monopoly, in reality they politically protect uncompetitive (but well-connected) businesses. In a 1985 *International Review of Law and Economics* article, I showed that in the ten years before the 1890 Sherman Anti-Trust Act, the industries accused of being "monopolized" by trusts were all *dropping* their prices faster than the general price level was falling at that time and were *expanding* output faster than GNP was growing—some as much as ten times faster.[4] The late-nineteenth-century trusts were the most innovative and fastest-growing industries of their time, which is why they were unfairly targeted by antitrust laws.

Indeed, Congress at the time recognized the great advantages of the trusts *for consumers*. Congressman William Mason stated during the U.S. House of Representatives debate over the Sherman Act that the "trusts have made products cheaper, have reduced prices; but if the price of oil, for instance, were reduced to one cent a barrel, it would not right the wrong done to the people of this country by the 'trusts' which have destroyed legitimate competition and driven honest men from legitimate business enterprises."[5] Senator George F. Edmunds