

Antitrust and the Paper Industry: Lessons from History

November 2004

Professor Steven W. Usselman

School of History, Technology, and Society

Center for Paper Business and Industry Studies

Georgia Tech

How has Antitrust Shaped the Industry?

- Has it mattered, and if so, how?
- Has it reinforced market forces, or distorted them?
- Has it promoted innovation and generated social returns?

Methodology

- No rigorous counterfactual test
 - ✓ *Antitrust has been a persistent feature of the industry since the 1890s*
- Case studies of critical moments
 - ✓ *Assessment of how antitrust influenced strategic behavior at firms*
 - ✓ *Reflections upon questions identified earlier*

1897-1920

■ Highlights

- ✓ *Clear Prohibition on Sales Pools*
- ✓ *Emergence of International Paper (IP) as a “Dominant Firm” in Sulphite Newsprint Industry and Antitrust Response*

Sales Pools Prohibited

- American Writing Paper Co. (illegal 1903)
- Wall Paper (declared illegal, 1906-1909)
- General Paper (illegal, 1906)
 - ✓ *Kimberly-Clark responds with tight merger*

Patented Niches in Conversion

- US Envelope (1898) most profitable firm of the era
- Drinking cups, 1909-1915
- Paper towels (through dispenser patents)
- Fiber boxes (in small niches)
- Corrugated boxes
- Paper Bags

Key Issue for Courts: Patent Scope

- Courts more accepting of niche strategy built around a core patent, rather than a pooled collection of lesser patents
- Doctrine articulated in several key antitrust disputes involving paper
 - ✓ *Paper bags (1907-08)*
 - ✓ *Corrugated board (1908-09)*

International Paper (IP)

- IP a party to the disputes over bags and corrugated board
- IP itself under scrutiny from antitrust for its dominance of sulphite newsprint trade, prosecuted in 1909
 - ✓ *IP emerged as “dominant firm” in 1897*
 - Overinvestment in new, capital-intensive process, followed by drop in demand
 - Horizontal combo to restore price stability

Theory of Dominant Firm

- If it has a cost advantage, it can set price at a level that keeps new firms from entering, so long as it lets other existing firms produce as much as they like
- Such cost advantages will likely erode in the long run, without barriers to entry

Example: US Steel

- Formed in 1901
- Persists because it acquires ore lands that give it a barrier to entry in the form of long-term cost breaks for its fabricators
- Pursue dominant-firm pricing strategy
- Courts allow the vertical integration into ore lands, and they do not object to market dominance of US Steel because its competitors do not testify against US Steel

IP Barriers to Entry?

- Core Patent in Sulphite Machinery
 - ✓ *Challenged by competitors (St. Regis and Great Northern)*
 - ✓ *Questioned by antitrust, which refuses to extend patent control when fundamental patent expires in 1909*
- Efficiencies of production through integration and scale in several niches
- Acquire timber lands

Net Result?

- IP not a true dominant firm a la US Steel
 - ✓ *Newsprint leaves for Canada by 1920 (aided by tariff reductions)*
- Most profit and innovation occurs in niches
- IP competes in several of those niches but does not dominate them
- FTC monitors market segments, blocks any move toward consolidation (e.g. corrugated board in 1921)
- Firms like Hinde and Dauch pursue product innovation (e.g. refrigerator insulation)

1920-1940

- IP reasserts dominant firm strategy with sulphate process in South, later coupled with bleaching
 - ✓ *Becomes low-cost producer, giving it a temporary cost advantage that enables it to set prices*
 - ✓ *Government tolerates cartel during depression*
- Wisconsin firms pursue niches with sulphate process and high-grade pulp

Key Departure

- IP relies on purchased technology, especially with rise of stationary furnaces, bleaching plants, and continuous pulping
- Key potential barrier to entry – proprietary technology – not available

Antitrust Reversal

- Government reverses field, declares sulphate cartel illegal in 1938-40
- 1940, declares container cartel (National Container) illegal
- Result: conversion of many firms in high-volume integrated production of corrugated board; shake-out after war with 50 firms reduced to 15, many associated with “forest products” firms

1950s and 1960s

- With shakeout, FTC takes steps to preserve some market segmentation
 - ✓ *Defines a western regional market and blocks horizontal merger of Crown-Zellerbach within it*
 - ✓ *Lets IP enter that market but stipulates it must sell board to independent convertors*
 - ✓ *Blocks Westvaco, pursuing aggressive strategy of vertical integration, from acquiring US Envelope*
 - ✓ *Blocks Scott, the towel and tissue giant, from integrating backward into pulp production*
 - ✓ *Breaks Up Container Corp. of America (1969)*

Net Outcome?

- Firms converge on common strategy, based largely on control of timber assets and on incremental improvement and efficiency gains (but not proprietary designs)
- Government suspicious of firms that deviate from pattern, either by acquiring large market shares or by seeking to leverage an advantage up or down the vertical supply chain