# Built to Break

***How Bad Law Undermines the Resiliency and Stability of the U.S. Industrial System***

**Testimony before the Senate Committee on the Judiciary**
**Subcommittee on Competition Policy, Antitrust, and Consumer Rights**

**Hearing on:**
**Baby Formula and Beyond:**
***The Impact of Consolidation on Families and Consumers:***

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## INTRODUCTION:

Last February, the Abbott corporation shut down an infant formula factory in Sturgis, Michigan, after the Food and Drug Administration (FDA) began to investigate contamination at the plant, which had been linked to at least four infections and two deaths. America's system for the production and distribution of infant formula has long been strained by tight supplies and localized shortages. But in wake of the shutdown, the results included severe shortages of formula across the nation, as well as soaring prices, hoarding, disruptions of normal family routines, and fear.

The shutdown also triggered a loud debate over what was the root cause of the wider shortages. Many theories have been proposed, but two potential explanations stand out. These are a) extreme consolidation in production capacity due mainly to the actions of private sector corporations, and b) poorly designed or even downright incompetent regulation by the federal government of private sector producers.

To resolve the question of who is at fault, however, it is vital to look beyond the confines of this one crisis within this one industry. Zoom out and we immediately see a far larger pattern of shortages throughout our industrial economy. It is a problem we can trace back decades, and one that has been getting dramatically worse. Further, we see that this economy-wide, systemic problem of shortages is intimately interrelated with many if not most of the other biggest threats to our security that we face today as individuals and as a nation. These include systemic inflation, the risk of catastrophic cascading collapse of vital industrial and financial systems, coercion by foreign states, even direct conflict with foreign powers including China and Russia.

By zooming out, we also see that the ultimate source of all these shortages does indeed lie in a flawed system of regulation by government. This is the radical shift a generation ago in how the United States understands and enforces competition policy.

For the first 200 years of our nation, Americans used antimonopoly law and policy to achieve a careful distribution of opportunity, power, and control, in order to achieve the goals of liberty and democracy established at the nation's founding. This distribution of power and control also resulted – all but naturally – in a wide and generally safe distribution of hence of industrial capacity. But in the 1980s, the U.S. government began to focus foremost on promoting efficiency in domestic production, even if the result was complete concentration of power, control, and capacity in the hands of a single corporation. Then in the in 1990s, the U.S government exacerbated the problem by beginning to promote the same sort of extreme efficiency in international systems.

The problem, in other words, is not that government is inherently incompetent or that corporate managers and financers are inherently greedy and mean spirited. Rather, it's that policymakers from both parties cooperated in the destruction of a system of regulation that had been designed to distribute ownership and control in ways that protect us from the avarice, will to power, or simple incompetence of any one person or corporation.

Worse, that generation of policymakers then compounded the problem by embracing a set of economic theories designed to hide these dangerous concentrations of ownership, control, and capacity, and in the process also hid the risks that were being concentrated.

The overarching result is clear. The recent breakdown of America's infant formula production system is merely a symptom of a vastly larger problem, one that poses a set of far graver – even existential – threats.

## THE TRUE EXTENT OF THE RISK

The recent shortage of infant formula has been an especially upsetting event, both for the families affected and for the American people as a whole. The manufacture of formula is, after all, a challenge we seemed to have mastered long ago. We can, for instance, trace the origins of the formula industry back almost 200 years. And more than 40 years have passed since the federal government passed a comprehensive regulatory plan for the production of formula, described at the time as "one of the most specific and detailed acts ever passed by Congress." And yet, more than two decades into the 21st century, millions of families have been forced to worry about whether they can feed their own children.

Almost as upsetting are the revelations of incompetence within Abbott, about the lack of regulatory capacity within the FDA, and about the effects of the procurement policies of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) on the markets for formula within individual U.S. states. Then there is the clear evidence that many other nations around the world do a far better job than the United States in ensuring that every family with young children has access to robust supplies of high quality infant formula at low prices.

On the surface, there is plenty of blame to share around. – both for the private corporations that dominate this business and the government agencies that oversee it. A recent *Wall Street Journal* headline summed up the problem well: "Why the Baby Formula Market is a Mess: Low Competition, High Regulation."

But the problem we see here goes far beyond mere private avarice or governmental incompetence, or any failure by Congress to adequately fund oversight by the FDA. That's because this breakdown is simply the latest in a long and fast growing list of similar breakdowns of the production and distribution systems on which the American people depend.

Just over the last two years, this includes:

- Extreme shortages of facemasks and other personal protection equipment during the early months of the Covid-19 pandemic, resulting in thousands of avoidable infections and deaths.

- Empty meat cases in supermarkets across America following the shutdown of extremely concentrated systems for the slaughter, processing, and distribution of beef and other staples.

- Deep shortages of high-end semiconductors due to capacity constraints at TSMC, Samsung, and Intel, which in turn resulted in the shut down of assembly lines for automobiles, medical devices, electronics and other goods, as well as skyrocketing prices for rental cars and used cars.

- The freezing up of container ship, railroad, port, and truck transportation systems, and the resulting disruption of thousands of manufacturing and construction operations across America and around the world.

- The breakdown of gasoline distribution across the entire southeastern United States, following a cyber attack.

- The breakdown of the electricity distribution system in Texas following a predictable spate of winter weather.

- Deep Structural shortages of fuels, grains, cooking oils, fertilizer, and other essential goods after Russia's invasion of Ukraine disrupted trading systems.

Worse, the breakdowns of the last two years are simply in keeping with a pattern that has played out repeatedly over the last 20 years. This includes:

- The near breakdown of food supply systems in New York City following Hurricane Sandy in the fall of 2012.

- Deep, persistent, and widespread structural shortages of specific drugs in the U.S. pharmaceutical systems.

- The near breakdown of the Big 6 automobile production system in the United States in 2009 and the subsequent bailout of General Motors and Chrysler.

- The cascading breakdown of the Japanese automobile production system following the Tohoku earthquake of 2011, the Wall Street Crash of September 2008, and the Niigata earthquake of 2007.

- The collapse of the U.S. system for the production of cat food after melamine contaminated the main contract manufacturer, in 2007.

In every instance, the immediate cause of the shutdown was the concentration and choke pointing of industrial capacity and the lack of any large-scale back-up systems.

Worse yet, there are the many intimately interrelated disruptions and threats that are also caused by this same concentration and choke pointing of capacity. This includes:

- The fragility of entire industrial and financial systems, and the potential for small disruptions in supply or demand to trigger widespread and even catastrophic cascading collapses of essential production and services.

- Direct dependence on China, Russia, and other autocratic and antagonistic regimes for essential goods, components, and services, in ways that expose America as a whole and individual businesses and citizens to coercion, extortion, and control.

- Lack of capacity to produce weapons and other items essential to national defense in a timely and efficient manner.

- Direct dependence on China, Russia, and other autocratic and antagonistic regimes for materials and components needed to produce weapons and other items essential to national defense.

- Inflation driven by corporations forging and exploiting manufacturing and processing chokepoints, such as in semiconductors and meat processing.

- Inflation driven by monopolists taking opportunistic advantage of the supply crisis to jack up prices, as we have seen in recent days with the airline and credit card industries.

- Cascading structural inflation in markets downstream from these chokepoints; in the case of semiconductors, for instance, this includes the cost of new cars, rental cars, and used cars.

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- The suppression of production technologies and techniques that would lower costs and boost real efficiency, by monopolists exploiting their control of capacity and patent chokepoints and/or simple brute power over markets.

- A wide variety of political effects, including increasingly extreme concentration of wealth, power, ownership, control, and debate.

In short, there is overwhelming evidence that the American people face a systemic threat, one that is built into the regulatory coding of our entire political economy.

**AMPLE WARNINGS AND A ROBUST ALTERNATIVE TRADITION**

None of these threats are new and none should surprise us today. I myself first detailed the growing fragility of international industrial systems – and America's growing exposure to the power of China and other nations – in a cover article in *Harper's* magazine in June 2002, titled "Unmade in America: The True Cost of a Global Assembly Line."

That article was immediately covered in great depth in the first annual report of the U.S.–China Security Review Commission, in July 2002. In 2005, Doubleday published my book *End of the Line: The Rise and Coming Fall of the Global Corporation*, in which I described all these threats in depth, and tied them directly to the overthrow of antimonopoly law in the 1980s and 1990s. My thesis in *End of the Line* was studied in great depth by the Treasury Department, Commerce Department, Department of Defense, and Central Intelligence Agency, as well as the World Bank, International Monetary Fund, the Organisation for Economic Cooperation and Development (OECD), the U.K. Ministry of Defense, and Japan's Ministry of Economy, Trade, and Industry (METI).

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I was not alone. Many others delivered similar warnings. The well-known epidemiologist Michael Osterholm, for instance, in *Foreign Affairs* in July 2005 described how a pandemic would disrupt highly concentrated supply chains, including for such items as the facemasks we need to protect ourselves against the disease itself. In 2010, a World Bank study of the effects of the financial crash of 2008-2009 concluded that concentration within international production networks has an "inherent magnification effect" on shocks. In 2012, Japan's Ministry of Economy, Trade, and Industry published a study of the Tohoku earthquake of 2011 in which it detailed how concentration within the supply chain had created a "diamond structure" of industrial organization that posed existential threats to production systems. In 2014, MIT's top Supply Chain expert Yossi Sheffi wrote that the rise of "systemic supply chain risk" had created the threat of "systemic supply chain disruptions" that can cause "the widespread sustained shortage of a product or service with no alternatives or substitutes available."

We see this even in the case of infant formula. In one 1996 study, titled "Women and Children Last: Anticompetitive Practices in the Infant Formula Industry," the author describes the formula production system as a "market whose structure makes it ripe for anticompetitive behavior which drives up prices and denies mothers and their infants the choice of products that a more competitive market would bring."

Just as important, there is ample historical literature available that describe how Americans have traditionally designed many U.S. regulatory regimes to ensure – among other goals – the redundancy and resiliency of all essential systems on which we depend. These include

- Two wars - the Revolutionary War and the War of 1812 - to ensure the full independence of the United States from the British imperial trading system.

- Subsidization of keystone U.S. industrial capacity through long-term tariff protections and direct subsidy.

- Robust antitrust enforcement against international chemical and other cartels.

- The establishment of a “Rule of Four” to guide the enforcement of competition policy within U.S. industrial systems.

- Routine embrace by private manufacturers of dual and triple sourcing industrial strategies.

- A long-term government strategy to break dangerous concentrations of control in the international systems on which we rely for the supply of oil and gas, through direct support for developing new sources of supply, even sometimes through war.

- The establishment of a U.S. strategy during the Second World War to target manufacturing chokepoints – such as the Schweinfurt ball bearing complex – to paralyze industrial production in Germany and Japan.

- A long-term government strategy to ensure a wide physical distribution of U.S. based factories during the Cold War, to ensure resiliency in the case of nuclear attack.

- The design of modern communications technologies and networks – notably the Internet itself – to avoid any single point of failure.

- The enforcement of a complex suite of sanctions on Japan in the mid 1980s – including tariffs, quotas, and other restrictions – to disrupt that country's attempt to capture control over the computing industry.

- The structuring of risk within banking systems to eliminate single points of failure and to avoid any risk of cascading collapse.

- The use of highly targeted industrial sanctions against China's technology industry and Russia's defense industry to target threats to the United States and its allies, under the Trump and Biden administrations.

In every one of these instances, the goal was to use law, policy, and regulation to engineer resiliency into the essential systems on which Americans depend, or to exploit the failure of other nations to build such resiliency in their own systems.

All these efforts to use law and policy to engineer redundancy, resiliency, and stability into industrial systems were further reinforced by the American system of political antimonopoly established in the earliest days of the nation.

Indeed, it is safe to say that the core goals of the U.S. Constitution – that all systems of governance guard always against concentration of power and risk in one – also helped to protect our production systems from the avarice, will to power, or simple incompetence of any one person or company. Hence helped to ensure the sort of healthy competition necessary to avoid shortages and shut downs in the industrial systems on which we most depend.

**THE SOURCE OF THE PROBLEM**

The first big question we must answer, then, is how did this happen? Is this problem something inherent in capitalism? Something inherent in the American system of regulation?

The simple answer is no. As recently as 25 years ago, there was little to no danger of cascading collapse within any of our industrial or financial systems. And shortages of vital goods within specific sectors were rare and fleeting

The answer to how this happened is obvious once we turn our eyes to antimonopoly law, and competition policy

It's hard to overstate the importance of antimonopoly law and policy in shaping the U.S. political economy. From the first days of America, antimonopoly law and policy was the foundation of our political economics. And in enforcing these laws and policies, the peoples' goals were never economic foremost, as we understand that term today. Rather the goals were mainly political and social. Indeed, we can view antimonopoly law and policy as the main way the American people extended principles and methods of the Constitution throughout the political economy as a whole. And as with the Constitution, the main aim was to protect individual liberty, our common democracy, our communities, and our ability to build a better world.

Importantly, the goal was never simply to promote more competition. American antimonopoly law and policy is based on the belief that competition is inherent in all human society, and that the main job of good government is to shape that inevitable competition among people in ways that empower them to be fully independent and constructive members of our society.

Over the two centuries after the founding, Americans developed an incredibly robust set of antimonopoly tools. To the extent there was any technical goal, it was to ensure that where big was not necessary, it was blocked. And that where big was necessary, it was regulated in ways that made that power safe. For the first 100 years in our nation, most antimonopoly law and policy was enforced by local and state officials. It was only after the Civil War that Congress brought the power of the  federal government to bear in the regulation and breaking of monopoly.

The result was one of the great political successes in human history. Over the course of two centuries – despite the rise of numerous new technologies capable of being used by corporations to concentrate power – the Americans people used Antimonopoly law and policy to keep themselves safe, and to shape the sort of good society they wanted to live in.

America's antimonopoly system also proved to be remarkably successful economically. Strong laws backed by strong enforcement created the foundation for the greatest period of prosperity and economic equality in human history. At same time, these laws also empowered the American people to design and build the most advanced system of production and technological advance, one that long kept the American people safe from all foreign threats.

Unfortunately, beginning 40 years ago, a small group of ideologues pushed through the most radical change in political economic philosophy since the founding, with little oversight by the American people.

In 1981, the Reagan Administration embraced a new theory of antitrust – promoted by the writer Robert Bork. This held that to use antimonopoly law and policy to protect liberty and democracy was wasteful, and that we should instead aim at "productive efficiency."

Then in the 1990s the Clinton Administration embraced a new theory of international trade – promoted by the economist Larry Summers. This held that to use trade policy to protect us against foreign concentrations of power was also wasteful, and that here too we should aim solely at efficiency.

The Clinton Administration – again under Summers guidance - also extended this line of thinking into how it regulated specific economic sectors, such as banking, energy, news media, telecommunications, and the defense industrial base.

Congress also played a big role during these years, and not merely by turning a blind eye to the actions of the Executive. In the late 1970s, for instance, Congress embraced idea that one way to drive down prices was to allow chain stores to concentrate power over suppliers and workers. Then in the early 1990s, Congress extended this concept of using "buyer power" to drive down prices to other areas, such as the procurement of medical devices through the establishment of Group Purchasing Organizations.

Finally, both the Executive and Congress worked closely together to change the overarching systems for how we govern the action of corporations. Rather than regulating corporations to ensure that they make good products and treat their employees well, Americans instead began to regulate corporations in ways that required them to focus foremost on delivering cash to investors.

In combination, this series of radical changes in how we regulate competition within our society resulted, over the course of only a few decades, in a revolutionary restructuring of almost every corner of the  U.S. political economy. The results include:

A) Extreme consolidation of power and control, initially to a duopoly and even monopoly within the United States, and ultimately to duopoly and even monopoly at the global level

B) The offshoring of vast swaths of the U.S. production system, including even the most vitally important industrial capacities, such as the chemicals we use in farming and food processing and the active pharmaceutical ingredients we use to make drugs.

C) The rise of ever more extreme forms of monopsony power, which has been brought to bear on suppliers, workers, communities, common infrastructure, and the environment, in a form of routinized strip mining of all factors within our production system.

D) The concentration of ever more extreme amounts of political power – over our local, state, and federal governments – in ever fewer hands, increasingly including foreign governments.

**THE SOURCE OF THE BLINDNESS**

Our second big question is how did we miss this? Here again the answer takes us swiftly back to Robert Bork and the introduction of Chicago School thinking into antimonopoly law and policy in the early 1980s.

To promote their pro-monopoly vision of competition policy, Bork along with allies such as the legal scholar and later judge Richard Posner, did many things. They changed the political goal of the law, so that the aim was now the "welfare" of the "consumer." They changed the technical goal of law, from the distribution of power to the concentration of power. They changed our understanding of economic process, from being something that is entirely within the control of human reason to something that is largely natural and even inevitable. They changed how we measure concentration, from simple restrictions on the number of actors within a market and on the behaviors of corporations, to extremely arcane measurement of pricing effects.

But perhaps the single most revolutionary change was to replace the role of facts and reason, as assessed by elected representatives of the American citizenry, and lawyers trained in certain forms of law and regulation, with purely economic assessments of the effects of different market and corporate structures on prices to consumers, as measured by professional economists.

It is almost impossible to overstate how radically these changes affected our ability to identify and manage risk within our industrial societies.

To fully understand the intellectual effects of what Bork and Posner did, it may help to consider one key section in the economist Thomas Piketty's 2014 book *Capital in the Twenty-First Century*. Piketty wrote the book to detail how extreme inequality had become across Europe and the United States. But its real importance for us today lies in the fact that Piketty mounts one of the most powerful critiques of the American economics profession in recent times.

"[T]he discipline of economics has yet to get over its childish passion for purely theoretical and often highly ideological speculation," Piketty wrote early in the book.
"This obsession with mathematics is an easy way of acquiring the appearance of scientificity without having to answer the far more complex questions posed by the world we live in."

Such mathematical models, Piketty added, "are frequently no more than an excuse for . . . masking the vacuity of the content." Piketty then concluded by assailing mainstream American economists for "their absurd claim to greater scientific legitimacy, despite the fact that *they know almost nothing about anything*."

And so Bork, Posner, and the other lawyers who imported American style economics into the law left us with a two-part problem.

First, belief in the “market as machine” or the “market as biological being” has radically shrunk or even destroyed much of our ability to see power, hence to protect ourselves from the political and economic effects of concentrated power.

Second, this positing of an all-governing mechanism, or organism undermines our ability to understand how the real systems, and the real machines, work.

For more than a century now, since the days of the Progressive Era, the American people have battled to bring law into alignment with the building and running of complex financial, communications, transportation, and industrial systems, in ways that promote not merely our basic safety but a wide prosperity.

It is now clear that—over the course of but a few years—the subjugation of law to the idea of efficiency, and to a false science designed to promote and measure efficiency, has undermined even the most basic forms of human security.

**HOW DO WE FIX THE CRISIS?**

This hearing is titled “Baby Formula and Beyond: The Impact of Consolidation on Families and Consumers.” By any fair analysis, the lessons of the infant formula production debacle of the last three months is that America’s “families and consumers” – along with the nation as a whole – today face a long and growing list of threats, an increasing number of which are existential in nature.

It is far too easy today to imagine all sorts of catastrophic events that would deprive us of drugs, basic foods, fuels, and information, and perhaps even trigger a cascading lights-out event.

So what practical stems can we take immediately, today?

First, restore a structural “bright-line” approach to antimonopoly enforcement, in keeping with the basic system of checks and balances established in the Constitution. We should do so for political reasons. We should do so also to ensure the resiliency and stability of our most vital industrial systems. President Biden last year did an excellent job of starting the process, with his statements in support of his Executive Order on Competition. It is now up to us to speed and expand that work.

Second, we need to identify all dangerous chokepoints, at every level within every supply chain on which the American people depend for essential goods and services. Here again, the White House has done a good job of launching these efforts. But Congress can certainly help the Administration speed and expand this work.

Third, we need to rebuild what has been destroyed over the last generation, due to our failure to enforce and update our antimonopoly laws and policies to protect the systems of industrial production on which we depend for vital goods and services. Here again the Biden Administration has made a good start, this time in tandem with Congress, with the CHIPS for America Act.

Fourth, rebuild the capacity of all government agencies, both at the federal and state level, to use antimonopoly law and policy to break dangerous concentrations of capacity and other chokepoints, and to understand once again how to use antimonopoly law and policy to promote the security of the United States and of the American people.

Fifth, stockpile machines and skills, not finished goods.