

**GCP**

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## **New Antitrust Realism**

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**T**here is no shortage of speculation about competition policy in the Obama administration. President-elect Barack Obama criticized the Bush administration for having “what may be the weakest record of antitrust enforcement of any administration in the last half century” and promised to “reinvigorate antitrust enforcement” and “step up review of merger activity.”<sup>1</sup> Thus, for ideological and practical reasons, the Obama administration will not adopt its predecessor’s antitrust policies. So if change is afoot, what form will change take?

This essay outlines the needed transformative change in today’s competition policy. The essay proposes more empirical analysis by the U.S. competition authorities, outlines how behavioral economics can assist in this new antitrust realism, and concludes in explaining why such antitrust realism is needed.

### **I. TRANSFORMATIVE CHANGE**

For many, change means replacing the Bush administration’s more deregulatory approach with post-Chicago School theories more amenable to governmental

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<sup>1</sup> Statement of Senator Barack Obama for the American Antitrust Institute, *available at* [http://www.antitrustinstitute.org/archives/files/aai-%20Presidential%20campaign%20-%20Obama%209-07\\_092720071759.pdf](http://www.antitrustinstitute.org/archives/files/aai-%20Presidential%20campaign%20-%20Obama%209-07_092720071759.pdf).

intervention.<sup>2</sup> Although this represents change (*e.g.*, a greater concern over false negatives than false positives), the underlying neoclassical economic theories premised on rational profit-maximizers remain unchanged. For others, change means more antitrust prosecutions. Although this quantitative increase represents change, the underlying theories remain unchanged. So simply challenging more mergers with Herfindahl-Hirschman Index numbers ("HHIs") between 1800 and 3000 neither meaningfully changes nor advances competition policy. Indeed more prosecutions do not mean necessarily better antitrust enforcement.<sup>3</sup> Consequently this essay does not address the

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<sup>2</sup> This essay does not seek to diminish the efforts of the U.S. Department of Justice Antitrust Division ("DOJ") and U.S. Federal Trade Commission ("FTC"), where the agencies challenged certain anticompetitive restraints and mergers for the benefit of consumers. In addition to prosecuting international price-fixing cartels, the DOJ, for example, has recently challenged anticompetitive restraints in the real estate industry among others. The FTC, as one recent example, challenged an acquisition where prices increased nearly 1,300 percent post-acquisition for a drug treating congenital heart defects affecting babies born pre-maturely. *See* FTC Press Release, *FTC Sues Ovation Pharmaceuticals for Illegally Acquiring Drug Used to Treat Premature Babies with Life-threatening Heart Condition* (Dec. 16, 2008), *available at* <http://www.ftc.gov/opa/2008/12/ovation.shtm>.

<sup>3</sup> For example, the DOJ challenged in court 4 mergers in its fiscal year 2007. If the DOJ, under the Obama administration, challenges 20 mergers in 2009, this does not represent a five-fold success: some of the challenged mergers may be competitively neutral or pro-competitive. Even for hard-core cartels, which are presumptively anticompetitive, prosecuting more cartels is not necessarily a validation of effective antitrust enforcement. Unlike homicides, which lend themselves easier to such statistics, reliance on the annual number of criminal antitrust prosecutions can be misleading. There is no list of extant cartels, from which one can compare the number of prosecuted and outstanding cartels. Prosecuting more cartels may instead reflect ineffective antitrust enforcement elsewhere (such as permitting industry consolidation through mergers to the point where coordination becomes feasible). Different administrations may have different antitrust priorities. During the 1980s under the Reagan and Bush administrations, for example, the DOJ filed 623 criminal antitrust cases, which is significantly more than in any other decade since the Sherman Act's enactment. But during this time, the Antitrust Division lost nearly half its attorneys, and the balance prosecuted mostly localized bid-rigging cartels. Since the mid-1990s, the DOJ has focused on prosecuting international cartels, which, though fewer in number, involve a greater amount of commerce. Moreover, the DOJ, at times, may devote more resources to investigating other civil antitrust violations, such as monopolistic anticompetitive practices. One cannot simply conclude then that because 416 criminal antitrust cases were prosecuted in the 1990s, as opposed to 623 cases in the 1980s, that the Clinton administration was softer on cartels. Moreover, for comparisons in numbers to be meaningful, the probability of conviction, which is not readily quantifiable, must remain relatively constant. If the probability of conviction increases, then the number of convictions may increase (if the overall number of hard-core cartels remains constant) or decrease (if the overall number of cartels decreases as cartels members are more concerned about being caught). Similarly if the probability of conviction decreases (for example, due to a change in enforcement priorities), then the number of convictions may decline (if the overall number of cartels remain constant) or increase (as total cartel activity rapidly increases given that

majority's characterizations of change. As G.H. Hardy said, "By definition, there are plenty of others to do that."<sup>4</sup> Instead, this essay calls for transformative change, namely creating the tools to better understand the market dynamics in different industries.

Meaningful change requires a more empirically-driven examination of today's antitrust theories. For effective learning and adaptability, the competition agencies must incorporate mechanisms to evaluate routinely their actions' impact on the marketplace and whether the current competition policies are furthering the desired goals for particular industries. By undertaking regular empirical analysis of their (in)actions, the agencies can better understand different industries' market dynamics, better predict the competitive effects of certain challenged behavior in those industries, and ultimately articulate clearer, more objective rules to circumscribe anticompetitive behavior without chilling pro-competitive conduct. This antitrust realism requires more empirical analysis on the agencies' part, and here behavioral economics can assist.

## **II. LEARNING FROM BEHAVIORAL ECONOMICS**

Antitrust's neoclassical economic theories assume that profit-maximizing market participants pursue their economic self-interest, with perfect knowledge and willpower. In my experience at the Department of Justice, firm behavior, which is deemed "irrational," is often marginalized. The belief is that rational profit-maximizing firms eliminate irrationality from the marketplace.

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administration's lax antitrust enforcement). Thus, a low (or high) number of antitrust criminal prosecutions could reflect in theory either aggressive or lax antitrust enforcement. For a recent critique on the reliance on antitrust enforcement statistics, see Kenneth Davidson, AAI Senior Fellow, *Commentary: Numerology And The Mismeasurement Of Competition Laws* (Sept. 29, 2008), available at [http://www.antitrustinstitute.org/archives/files/AAI%20Numerology%20Commentary\\_110620081816.pdf](http://www.antitrustinstitute.org/archives/files/AAI%20Numerology%20Commentary_110620081816.pdf).

<sup>4</sup> C.P. Snow, *Forward in* G.H. HARDY, *A MATHEMATICIAN'S APOLOGY* 46 (Cambridge Univ. Press 2007).

Using facts and methods from other social sciences, the behavioral economics literature over the past few decades tested the limits on neoclassical economic theory's assumptions concerning individuals' rationality, willpower, and self-interest.<sup>5</sup> Contrary to neoclassical economic theory, actual behavior—characterized as bounded rationality—may vary. Individuals may react differently depending on how the choice is phrased, elect suboptimal outcomes based on certain heuristics, or be far more charitable and fair than the rational profit-maximizer. Neither the state nor private economic agents are endowed with perfect knowledge, but adopt a “satisficing and adaptive behavior.”<sup>6</sup> Ultimately, competition occurs on various dimensions (price, quality, choice, innovation) across markets with different levels of product differentiation, entry barriers, transparency, stages of the product life cycle, demands for technological innovation, and operating at different levels of efficiency, none of which can be shoe-horned into a single

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<sup>5</sup> Long before behavioral economics, others questioned these simplistic, unrealistic assumptions of human behavior. If these assumptions were true, then market behavior is easier to predict. A state planner arguably could model any scenario using the hypothetical profit-maximizer, and centrally plan the same outcome. No reason exists to favor laissez-faire competition over a centrally-planned economy. It is precisely because of the complexity and unpredictability of the competitive process, the imperfections of human knowledge, and the variety of conditions intrinsic to or affecting markets, such as legal, cultural, and moral norms, technology, production, and service norms, that undermine economic policies premised on either rational profit-maximizing agents or central-planners. An inverse relationship exists between the two concepts: The greater the infirmities of the rationality assumptions, the less practical a centrally-planned economy becomes. For interesting surveys of the many areas of behavioral economics research, see DAN ARIELY, *PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS* (2008); RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (2008); *ADVANCES IN BEHAVIORAL ECONOMICS* (Colin F. Camerer et al. 2004); Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 *STAN. L. REV.* 1471, 1487 (1998); Robert A. Prentice, *Chicago Man, K-T Man, and the Future of Behavioral Law and Economics*, 56 *VAND. L. REV.* 1663 (2003). For a broader survey of literature attacking the conventional economic theories, see ERIC D. BEINHOCKER, *THE ORIGIN OF WEALTH: THE RADICAL REMAKING OF ECONOMICS AND WHAT IT MEANS FOR BUSINESS AND SOCIETY* (2007). At the 2007 annual meeting of the American Economic Association, the Nobel laureate George A. Akerlof also questioned the assumptions of human behavior underlying neoclassical economic theory and called for a greater focus on actual human nature and the detailed facts of experience. See Louis Uchitelle, *Encouraging More Reality in Economics*, *N.Y. TIMES*, Jan. 6, 2007, at C1.

<sup>6</sup> François Moreau, *The Role of the State in Evolutionary Economics*, 28 *CAMBRIDGE J. ECON.* 847, 851 (2004).

definition of perfect competition or rationality. Although behavioral economics is a hot area in legal and economic scholarship, neither the U.S. competition authorities nor antitrust literature, until recently, have embraced it.<sup>7</sup>

### **III. AN APPLICATION OF BEHAVIORAL ECONOMICS TO COMPETITION POLICY**

I discuss elsewhere how it appears anecdotally that some corporate behavior is (or is not) occurring that is not readily explainable under the U.S. antitrust agencies' Horizontal Merger Guidelines, which are premised on firms' behaving as "rational" profit-maximizers.<sup>8</sup> One key assumption, for example, is that anticompetitive effects are unlikely unless entry barriers are sufficiently high. Rational profit-maximizing entrants, the superheroes of consumer welfare, should swoop in and defeat the exercise of market power, in all markets except those with high entry barriers. In analyzing its past 12 years of merger investigations subject to a Second Request, the FTC noted its enforcement

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<sup>7</sup> But there are several promising signs. At its past annual meeting, the American Antitrust Institute's keynote speaker and panelists discussed the applicability of behavioral economics to competition policy. Audio available at <http://www.antitrustinstitute.org/Archives/2008conferenceaudio.ashx>. The AAI's transition report also recommends the empirical analysis to further this new antitrust realism. AMERICAN ANTITRUST INSTITUTE, THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44<sup>TH</sup> PRESIDENT 26 (cartels), 172 (mergers), 185, 200-01, 272-75 (media industries) (2008). The FTC in April 2007 sponsored a conference on behavioral economics with respect to consumer protection issues. <http://www.ftc.gov/be/consumerbehavior/index.shtml>.

<sup>8</sup> Maurice E. Stucke, *Behavioral Economists at the Gate: Antitrust in the Twenty-First Century*, 38 LOY. U. CHI. L.J. 513, 527–28 (2007). I also discuss behavioral economics in assessing antitrust standards, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS LAW REVIEW (forthcoming May 2009), available at <http://ssrn.com/abstract=1267359>; monopolistic conduct, *Should the Government Prosecute Monopolies?*, 2009 UNIVERSITY OF ILLINOIS LAW REVIEW (forthcoming March 2009), available at <http://ssrn.com/abstract=1116463>; and the goals of competition policy, *Better Competition Advocacy*, 82 ST. JOHN'S LAW REVIEW 951 (2008).

inaction, even in highly concentrated industries, where the staff concluded that entry would be timely, likely, and sufficient under the Merger Guidelines criteria.<sup>9</sup>

But firms, at times, enter markets when irrational to do so under neoclassical economic theory.<sup>10</sup> Firms, at other times, do not enter markets when, in theory, entry is the profit-maximizing response. Many cartels operate in industries that appear to have moderate or low entry barriers, including turtles,<sup>11</sup> bicycle retailers,<sup>12</sup> and public auctions.<sup>13</sup> Indeed, entry does not predictably occur in the closest approximation of perfect competition, the stock market. The Efficient Market Hypothesis generally assumes that rational profit-maximizing traders through arbitrage minimize the influence of irrational noise traders. Such easy entry, in theory, readily exploits temporary arbitrage opportunities and restores stock prices to their fundamental value (the discounted sum of expected future cash flow). In theory, entry (in the form of arbitrage) should be extremely attractive in financial markets since: (i) entry involves no sunk cost (just the opportunity cost of using the funds elsewhere), (ii) financial markets have greater price transparency

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<sup>9</sup> FED. TRADE COMM’N, TRANSPARENCY AT THE FEDERAL TRADE COMMISSION: THE HORIZONTAL MERGER REVIEW PROCESS 78 (2005), *available at* <http://www.ftc.gov/os/2005/02/0502economicissues.pdf>; FED. TRADE COMM’N, HORIZONTAL MERGER INVESTIGATION DATA, FISCAL YEARS 1996-2007 Table 9.1 (Dec. 1, 2008) (noting that of the 36 mergers investigations where staff identified entry as “easy,” 32 involved highly concentrated industries (post-merger HHI exceeding 1799)), *available at* <http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf>.

<sup>10</sup> Avishalom Tor, *The Fable of Entry: Bounded Rationality, Market Discipline, and Legal Policy*, 101 MICH. L. REV. 482 (2002).

<sup>11</sup> *United States v. National Turtle Farmers & Shippers Assoc., Inc.*, Trade Reg. Rep. Summaries (CCH) ¶ 45,095, at 44,744 (D. La. 1995).

<sup>12</sup> *United States v. Michael J. Wolf*, Trade Reg. Rep. Summaries (CCH) ¶ 45,094, at 44,700 (D. Conn. 1994).

<sup>13</sup> *See Stucke, Behavioral Economics*, *supra* note 8, at 566.

and asset liquidity than many other markets, and (iii) such “an investment strategy . . . offers riskless profits at no cost.”<sup>14</sup>

But if true, why are arbitrageurs at times slow in exploiting such opportunities (or do not exploit them at all)? One possible explanation is that despite stocks’ price transparency, the costs of discovering such arbitrage opportunities are greater than the Efficient Market Hypothesis generally assumes. If so, then the search costs for potential entrants to ascertain market prices and/or entry costs presumably are greater in markets with less price transparency. Other explanations could be the existing restrictions on trading, that the number of superheroes is limited, and/or the discounted return on capital for other ventures simply is more attractive.

Another explanation may be the role of the biases discussed in the behavioral economics literature. Any meaningful entry requires some degree of adventure and risk. Entry first depends upon the company’s willingness to explore new markets, technologies, or products. Not only are there search costs for discovering such opportunities, the motivation may depend on the conditions in the potential entrant’s current market. Once the company identifies the opportunity, entry next depends upon the company’s willingness to exploit that opportunity. The way individuals perceive and react to either risk and/or uncertainty may diverge systemically from the rational choice theory’s predicted outcome. Under behavioral economics’ Prospect Theory, individuals generally are more risk adverse with respect to gains than losses. For example, test subjects generally prefer a sure gain (for example, a \$50 reward) to a gamble (50 percent

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<sup>14</sup> Nicholas Barberis & Richard Thaler, *A Survey of Behavioral Finance*, in *ADVANCES IN BEHAVIORAL FINANCE* 3-4 (Richard H. Thaler ed., 2005).



probability of winning \$100). However, the same test subjects generally are more willing to gamble a loss (opting for the 50 percent chance of paying a \$100 fine), than paying a certain penalty (\$50 fine).<sup>15</sup> Similarly, a firm, after entering a market, may more likely accept a greater risk (such as investing more money to remain in the market if there is a 50 percent probability of attaining a \$100 million in profits) than if the company is still on the edge considering whether to enter and commit those funds.<sup>16</sup>

The timeliness, likelihood, and success of entry may also depend on organizational behavior. Ideally, the larger the company, the greater the number of possibilities to exploit the economic opportunity. Organizational growth can create powerful economies of scale to tackle more complex tasks, such as making a jumbo jet airplane versus a café americano. But such “network growth creates interdependencies, interdependencies create conflicting constraints, and conflicting constraints create slow decision making and, ultimately, bureaucratic gridlock.”<sup>17</sup> As anyone planning a family event over the past holidays experienced, the more interaction and approval required from parents, siblings, in-laws, and relatives, the lesser the degree of freedom, and the greater the likelihood of standing in a parking lot arguing over a suitable restaurant for all. Because corporate cultures and hierarchies vary considerably (even within the company itself), one empirical question is how does the potential entrant internally

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<sup>15</sup> Russell B. Korobkin & Thomas S. Ulen, *Law & Behavioral Science: Removing the Rationality Assumption from Law & Economics*, 88 CAL. L. REV. 1051, 1105 (2000). Studies also show that professional traders are susceptible to these heuristics and biases. Prentice, *supra* note 5, at 1704 n.211.

<sup>16</sup> Although under rational choice theory, the profit-maximizer should not be affected by sunk costs in its decisions (such as feeling obligated to go to the theater on a particular night, after purchasing a season subscription), studies show such sunk cost effects influence decision-making. See Richard H. Thaler, *Mental Accounting Matters*, in *ADVANCES IN BEHAVIORAL ECONOMICS*, *supra* note 5, at 83–86; Prentice, *supra* note 5, at 1735 n.385.

<sup>17</sup> Beinhocker, *supra* note 5, at 152.

promote risk taking?<sup>18</sup> Advertisers commonly tout their products as the safe choice for the middle-manager: “No one was ever fired for using . . . .” As the behavioral economics literature illustrates, if the mid-level executives evaluate each project individually and separately (rather than collectively), such “narrow framing” may lead to greater risk aversion. Professor Thaler, for example, asked one firm’s twenty-five executives if they would undertake a project that stood a 50 percent chance to gain \$2 million and 50 percent chance to lose \$1 million.<sup>19</sup> Only three executives accepted the gamble, whereas the company’s CEO, when asked if he would like a portfolio of twenty-five of these investments, nodded enthusiastically. Other companies may place internally a premium on such risk taking, encouraging their departments to consider alternative strategies as a hedging mechanism.

In evaluating mergers, U.S. competition authorities examine instances of recent entry. The harder question is whether the change in the market as a result of this merger alters the entry dynamics. A company may be more committed to expend resources to remain in the market than to expend resources to enter. Only by re-examining the market post-merger can one determine whether these superheroes did in fact materialize and defeat the merger’s anticompetitive effects. Economists then can use data from other

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<sup>18</sup> Indeed a survey of nearly a dozen of the most popular corporate strategy texts as well as Michael Porter’s major works found few which cite profit-maximization as the theory of the firm. Norman W. Hawker, *Antitrust Insights from Strategic Management*, 47 N.Y.L. SCH. L. REV. 67, 74 (2003); see, e.g., LANCE A. BERGER ET AL., *THE CHANGE MANAGEMENT HANDBOOK* 129–30 (1994) (company’s mission statement to its employees predicated solely on a commercial profit maximization rationale (“do it this way because it will make us commercially successful”) is unlikely to be effective, these business authors argue. Rather, rationale for desired corporate behavior should contain an ethical rationale (“do it this way because it is the right way”)); PETER BLOCK, *THE EMPOWERED MANAGER* 85–104 (1987) (discussing an enlightened self-interest).

<sup>19</sup> Thaler, *Mental Accounting Matters*, *supra* note 5, at 97.

fields, such as organizational behavior and social psychology, to identify characteristics (either of industries or firm structures) where all else is equal (under the Merger Guidelines), timely entry is more (rather than less) likely to defeat the exercise of market power.

#### **IV. ANTITRUST REALISM'S EMPIRICAL AGENDA**

Behavioral economics at its core is empirical. The literature first identifies normative assumptions underlying the prevalent economic theories; second, empirically tests these assumptions and considers alternative explanations; and third, uses the anomalies to create new theories that are further empirically tested.<sup>20</sup>

One cannot assume that such empirical testing and learning will arise independently within competition policy. The Supreme Court and lower courts have not undertaken such empirical testing. Nor can they. Their view is limited to the evidence the parties supply; nor do the courts unilaterally revisit that particular industry to assess the impact of their decision. Nor can academia and the private bar fulfill this mission. Division of labor and increased specialization have further dispersed knowledge within today's society. This dispersal "requires a complex structure of institutions and organizations to integrate and apply that knowledge."<sup>21</sup> Collecting information on how markets work, and the impact of different restraints on those markets, entails high costs. Moreover, the relevant information at times is nonpublic. Consequently, the U.S.

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<sup>20</sup> Colin F. Camerer & George Loewenstein, *Behavioral Economics: Past, Present, Future*, in BEHAVIORAL ECONOMICS, *supra* note 5, at 7.

<sup>21</sup> DOUGLASS C. NORTH, UNDERSTANDING THE PROCESS OF ECONOMIC CHANGE 99 (2005).

competition authorities in the next administration must undertake this empirical testing and learning.

The FTC occasionally, and the DOJ infrequently, publish studies of different industries.<sup>22</sup> Most notably in the 1930s, the congressional Temporary National Economic Committee investigated the state of competition in various industries. As the DOJ later reported, this empirical analysis was helpful. The factual data from this effort “revealed the urgent need for a vigorous attack on monopoly power and concentration of economic resources and gave added impetus in 1938 and subsequently to the effort to reverse or at least check the trend toward concentration which had prevailed for most of the preceding half century, and to overcome some of the obstacles to effective enforcement of the antitrust laws.”<sup>23</sup> From time to time, the U.S. competition agencies, among others, proposed *ex post* merger review to provide “needed insight into the effectiveness of antitrust enforcement,”<sup>24</sup> but failed to undertake regularly such self-assessments.

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<sup>22</sup> One FTC economist, as a recent example, did a retrospective study of a hospital merger in the San Francisco Bay Area, which the California Attorney General unsuccessfully sought to enjoin. Collecting transactional data through the FTC’s program of hospital merger retrospectives, the study’s author found that the merger led to a large price increase at one of the two non-profit hospitals. Steven Tenn, *The Price Effects of Hospital Mergers: A Case Study of the Sutter-Summit Transaction*, FTC Bureau of Econ. Working Paper No. 293 (Nov. 2008), available at <http://www.ftc.gov/be/workpapers/wp293.pdf>.

<sup>23</sup> U.S. DEPARTMENT OF JUSTICE, A STUDY OF THE DEVELOPMENT OF THE ANTITRUST LAWS AND CURRENT PROBLEMS OF ANTITRUST ENFORCEMENT, SUBMITTED TO THE U.S. SENATE SUBCOMMITTEE ON MONOPOLY 9 (May 23, 1952).

<sup>24</sup> GAO, REPORT TO THE U.S. CONGRESS: CLOSER CONTROLS AND BETTER DATA COULD IMPROVE ANTITRUST ENFORCEMENT 13 (1980) (noting agencies’ proposals to study markets where a successful case was brought to determine effect on prices or for mergers whether competition has been restored). Many, including FTC Chairman William Kovacic, have proposed some form of *ex post* merger review. Kovacic observed that the “desirability of devoting greater resources to *ex post* evaluation of completed matters was a consistent theme of competition policy experts who testified at the FTC’s hearings in 1995 on innovation and international competition. William E. Kovacic, *Evaluating Antitrust Experiments: Using Ex Post Assessments of Government Enforcement Decisions to Inform Competition Policy*, 9 GEO. MASON L. REV. 843, 855–56, (2001) (collecting statements); see also Timothy J. Muris, *GTE Sylvania and the Empirical Foundations of Antitrust*, 68 ANTITRUST L.J. 899, 906–07 (2001) (agencies should fill merger policy’s void by testing post-merger existence of anticompetitive effects); Fed. Trade Comm’n, *Empirical Industrial*

Conspicuously absent from the United States' amicus brief in *Leegin* was any empirical analysis undertaken by the antitrust agencies in the past twenty years in support of resale price maintenance's costs and benefits.<sup>25</sup> Consequently, to assist the courts in determining the proper legal standard for evaluating certain restraints, the competition authorities must better comprehend how markets operate and evolve. This learning entails critically testing their current economic theories to determine the extent to which anomalies exist.

Competition authorities can use many inter-disciplinary avenues to improve their understanding of the different market dynamics across industries. This essay addresses two avenues: post-merger and post-conviction review. The U.S. competition authorities devote considerable resources investigating *ex ante* the merger. But they examine only half of the picture, namely the state of competition several years before the merger. Now it is time for them to review systematically what actually happens post-merger. Under an antitrust realism approach, the competition authorities would expend more resources to review post-merger the industry where a Second Request was issued but in which they:

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*Organization Roundtable* 115–41 (Sept. 11, 2001), available at <http://www.ftc.gov/be/empiricalioroundtabletranscript.pdf> (discussing the value of ex post evaluation of mergers). Likewise, the American Bar Association and AAI in their transition reports for the incoming administration endorsed retrospective analyses of the agencies' civil enforcement efforts. See *American Bar Ass'n, Transition Report on the Current State of Federal Antitrust and Consumer Protection Enforcement* 26-28 (Nov. 25, 2008), available at <http://www.abanet.org/antitrust/at-comments/2008/11-08/obamabiden.shtml>; AAI Transition Report, *supra* note 7, at 26 (cartels), 172 (mergers).

<sup>25</sup> Justice Breyer noted that “both Congress and the FTC, unlike courts, are well-equipped to gather empirical evidence outside the context of a single case. As neither has done so, we cannot conclude with confidence that the gains from eliminating the per se rule will outweigh the costs.” *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S.Ct. 2705, 2737 (2007) (Breyer, J., dissenting). The United States' amicus brief cites one 1983 and one 1984 FTC study. See Brief for the United States as Amicus Curiae Supporting Petitioner at 14, 20 n. 2, 3, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, (U.S., No. 06-480) (Jan. 2007), citing Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* (FTC 1983); Ronald N. Lafferty et al., *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases* (FTC 1984).

(i) took no enforcement action; (ii) permitted the merger in part to be consummated pursuant to a consent decree; or (iii) challenged the merger in court, but lost. Two to five years after such merger was consummated, the antitrust agency (or other designated entity) would examine, and publicly report, the state of competition in that industry, including not only pricing levels but also non-price components such as innovation, productivity, services, and quality, to the extent observable.<sup>26</sup> Where competition significantly diminished, the agencies would report whether other variables, besides the merger, might explain the price increase or reduction in innovation, productivity, services, and quality. For those companies identified as potential entrants in the original merger review, the reviewing agency would analyze, based on its interviews with these identified entrants, why they chose not to enter; or if they did enter, why they were ineffectual. The reviewing agency would publicly report which, if any, of the merging parties' efficiencies it could verify post-merger, the magnitude of the efficiencies, and the extent that consumers directly benefited from such efficiencies.

Any publicly-held company that seeks to rely on an efficiency defense before the agencies and/or the courts should be also required to report its claimed efficiencies in its SEC filings. For each year post-merger (for the period that it claims the efficiencies will be realized), the company should report the actual amount of efficiencies realized versus the projected amount. This should temper the company executives from inflating the claimed efficiencies, and hold them accountable to the shareholders for pursuing a

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<sup>26</sup> I discuss elsewhere the limitations on focusing solely on price, see Stucke, *Behavioral Economics*, *supra* note 8, at 546-49, and the limitations of a static equilibrium model, Stucke, *Monopolies*, *supra* note 8. For an interesting recent discussion of the importance of preserving competitive structure, see Eleanor M. Fox, *The Efficiency Paradox*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK* (Robert Pitofsky ed., 2008).

growth-by-acquisition strategy, while informing the agencies on those efficiencies for particular industries that are more likely to be cognizable and substantial. The competition authorities also would publicly report annually what specific actions, if any, they are undertaking with respect to this data, including how they are incorporating the findings from this data in their merger review.<sup>27</sup>

Likewise, for any successful cartel or monopolization prosecution, the competition authorities should report two to five years after the completion of the prosecution the state of competition in that industry, as described above. With criminal cartel prosecutions, the DOJ typically seeks fines and incarceration; whether these measures were sufficient to restore competition and deter recidivism should be assessed.

Finally, the U.S. competition authorities should make publicly available a computerized database identifying all civil and criminal antitrust consent decrees, pleas, or litigated actions under section 1 of the Sherman Act. The database should include certain industry characteristics, such as: (i) the number of conspirators (and best estimate of their market shares); (ii) the length of conspiracy; (iii) the product or services market in which collusion occurred; (iv) the number of competitors (and their market shares)

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<sup>27</sup> One outstanding issue is the Antitrust Division's subpoena authority in conducting such general post-merger review. The Division's subpoena authority in civil investigations comes from the Antitrust Civil Process Act, 15 U.S.C.A. §§ 1311–1314 (West 2004 & Supp. 2006). The Act defines an antitrust investigation to premerger activities or suspected antitrust violations. *Id.* at § 1311(c). The FTC, on the other hand, has broader statutory authority to gather information on the effects of its enforcement measures. *See* 15 U.S.C.A. § 46 (West 2004 & Supp. 2006). The DOJ can condition approval of a merger on the parties' compliance post-merger with these data requests. Although this is a good start, the merging companies may not always faithfully comply (requiring the court to enforce a contractual obligation for documents), some critical non-public industry data may be in the hands of third parties (not subject to this contract), and the agencies' reporting efforts would be *sua sponte*, rather than mandatory. Consequently, Congress should expressly provide the federal antitrust agencies with subpoena authority for non-public information to conduct such post-merger review. This subpoena authority should be sufficiently broad to enable the antitrust agencies to test (and eliminate) other explanations as to why competition (which includes important parameters beyond price) increased or diminished post-merger.



who were not part of the conspiracy; (v) the number of entrants (and their market shares) during the period of the conspiracy; and (vi) the nature of the conspiracy.<sup>28</sup> After securing its criminal convictions, the DOJ should inquire and publicly report how cartels with many members or competitors were able to collude. Did they act as many profit-maximizer game theories would predict, or were they more trustful and cooperative than these theories' predicted outcome? If so, why? As the number of cartel members increases, were there other specific factors that enabled them to successfully collude? What, besides its amnesty program, can the government do to deteriorate that trust and cooperation among price-fixers (without adversely affecting other legal rules that foster socially beneficial trustful relationships)? The agencies should also determine whether any cartel member or monopolist had acquired any competitor, large customer, or supplier in the affected industry in the five years before, or at any time during, the alleged violation. If so, the agency should report what action, if any, antitrust enforcers had taken in reviewing that earlier acquisition, identify the reasons for not challenging it, and what impact, if any, that earlier acquisition had on the industry's state of competition.

## **V. WHY ANTITRUST REALISM IS NEEDED TODAY**

Coinciding with the Reagan administration's view of government institutions as a necessary evil, competition advocacy for the past 28 years underscored how governmental interference in the market likely causes greater harm, in inhibiting the market's efficient allocation of scarce resources, than good. Self-regulating market forces promote economic efficiency and social progress, and work for the good of humans.

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<sup>28</sup> See Stucke, *Behavioral Economics*, *supra* note 8, at 581-82; AAI Transition Report, *supra* note 7, at 26.



Now with the financial meltdown, Americans awaken from this ideological slumber with little to show for it. The dividend from our economic growth over the past 30 years has not been reinvested in infrastructure (such as education or energy independence) or improving the safety net (such as health care). We awaken to find our economic system broken on several levels.

First, on the consumer level, even before our financial system collapsed, many were being left further behind. Although worker productivity increased during the Bush administration, most workers did not share in the benefits: the inflation-adjusted median family income increased between 2000 and 2007 by only 0.4 percent.<sup>29</sup> Americans are deeper in debt.<sup>30</sup> The average personal saving rate since 2005 has hovered around zero.<sup>31</sup> Many workers approaching retirement age have insufficient amounts in their 401(k) accounts to maintain their lifestyle,<sup>32</sup> and the value of their most significant asset, their homes, has dwindled.<sup>33</sup> Foreclosures, unemployment, and the number of Americans living in poverty are increasing.<sup>34</sup> Although the disparity between the rich and poor has widened globally, reported the OECD, “nowhere has this trend been so stark as in the

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<sup>29</sup> John Schmitt & Hye Jin Rho, *The Reagan Question: Are You Better Off Now than You Were Eight Years Ago* 4 (Center for Economic and Policy Research Sept. 2008), available at [http://www.cepr.net/documents/publications/2008\\_Better\\_Off.pdf](http://www.cepr.net/documents/publications/2008_Better_Off.pdf).

<sup>30</sup> Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress* 9-10 (Feb. 27, 2008), at <http://www.federalreserve.gov/boarddocs/hh/2008/february/fullreport.pdf>.

<sup>31</sup> *Id.* at 9. Personal savings declined from about 2.3 percent of disposable personal income in 2000 to 0.6 percent in 2007. Schmitt & Rho, *supra* note 29, at 5.

<sup>32</sup> In 2006 (before the stock market crash), the average balance for workers in their 50s with between 20 and 30 years of contributions was \$192,000. Hannah Glover, *US Experience Shows System Is No Panacea*, FIN. TIMES, Oct. 6, 2008, at 20.

<sup>33</sup> Jack Healy, *November Home Sales Fell Faster Than Expected*, N.Y. TIMES, Dec. 23, 2008, at <http://www.nytimes.com/2008/12/24/business/economy/24housing.html?8au&emc=au>.

<sup>34</sup> The number of Americans living in poverty increased from about 31.6 million in 2000 to 37.3 million in 2007 (12.5 percent poverty rate). Schmitt & Rho, *supra* note 29, at 4.

United States.”<sup>35</sup> It is ironic that today’s income disparity may exceed the levels of the era of robber barons when the Sherman Act was promulgated.<sup>36</sup> Not surprisingly, one study found of 25 indicators of economic well-being and performance, 23 are worse in 2007/2008 than in 2000.<sup>37</sup>

Second, our system is broken on a national level. The United States’ GDP has dramatically shifted from a manufacturing to a financial services economy.<sup>38</sup> Now many of these sprawling financial institutions, deemed too big to fail, are seeking government rescue. As Ron Chernow recently wrote, “Behind the razzle-dazzle of trading desks and the esoteric finance lay the inescapable fact that these [Wall Street] firms had shed their original reason for being: providing capital to American business.”<sup>39</sup> Americans are wondering how these institutions under our competition laws became too big to fail, and how further concentration will alleviate the problem.

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<sup>35</sup> OECD, *Country Note: United States in GROWING UNEQUAL?: INCOME DISTRIBUTION AND POVERTY IN OECD COUNTRIES* (2008) (noting the “United States is the country with the highest inequality level and poverty rate across the OECD, Mexico and Turkey excepted”), at <http://www.oecd.org/dataoecd/47/2/41528678.pdf>. Interestingly, the income divide between 1948 and 2007 trended upward during Republican administrations and downward during Democratic administrations. LARRY M. BARTELS, *UNEQUAL DEMOCRACY: THE POLITICAL ECONOMY OF THE NEW GILDED AGE* (2008).

<sup>36</sup> Peter H. Lindert, *When Did Inequality Rise in Britain and America?*, 9 J. INCOME DISTRIBUTION 11, 13 (2000); Jared Bernstein, Elizabeth McNichol & Andrew Nicholas, *Pulling Apart: A State-by-State Analysis of Income Trends* (Center on Budget & Policy Priorities Apr. 2008) (analyzing income trends nationally and by state between the late-1980s to mid-2000s), available at <http://www.cbpp.org/4-9-08sfp.pdf>. Senator Sherman identified this inequality of condition, of wealth, and opportunity as the greatest threat to disturbing social order: This inequality “has grown within a single generation out of the concentration of capital into vast combinations to control production and trade and to break down competition.” 21 CONG. REC. 2455, 2460 (1890) (statement of Sen. Sherman), reprinted in 1 THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES 113, 122 (Earl W. Kintner ed., 1978).

<sup>37</sup> Schmitt & Rho, *supra* note 29, at 8.

<sup>38</sup> For the implications of this shift, see KEVIN PHILLIPS, *BAD MONEY: RECKLESS FINANCE, FAILED POLITICS, AND THE GLOBAL CRISIS OF AMERICAN CAPITALISM* (2008).

<sup>39</sup> Ron Chernow, *The Lost Tycoons*, N.Y. TIMES, Sept. 28, 2008, at 12 (Week-in-Review).

Finally, the global economy is imperiled. In 1890, when the Sherman Act was enacted, there was concern about the inability of individual state governments to address the concentrated power of trusts and monopolies and growing wealth disparity. The state governments simply could not catch up with the growing interstate economy, spurred in part by the technological innovations in railroad transportation. Now a century later, national governments cannot catch up with the growing global economy, and address unilaterally global competition policy issues. Risks in subprime mortgage lending in Arizona not only affect consumers in New York, but investors across the globe. “In hindsight [] lax macroeconomic and regulatory policies may have allowed the global economy to exceed its ‘speed limit’ and may have contributed to a buildup in imbalances across financial, housing, and commodity markets,” wrote the International Monetary Fund recently. “At the same time, market flaws, together with policy shortcomings, have prevented equilibrating mechanisms from operating effectively and allowed market stresses to build.”<sup>40</sup> Thus the greater challenge is to expand and coordinate cross-border legal institutions to better regulate the global economy.

Antitrust cannot shoulder many of these issues. But antitrust cannot operate in a vacuum, with its focus on outdated, empirically questionable assumptions (a world of rational profit-maximizers) and questionable goals (maximizing output under a static price equilibrium model). Competition policy focused solely on maximizing output is meaningless if only a few benefit. Utilitarian welfare economics and many antitrust

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<sup>40</sup> INT’L MONETARY FUND, WORLD ECONOMIC OUTLOOK (WEO): FINANCIAL STRESS, DOWNTURNS, AND RECOVERIES xv (Oct. 2008), at <http://www.imf.org/external/pubs/ft/weo/2008/02/pdf/exesum.pdf>.

economists are agnostic about distributional effects from the exercise of market power.<sup>41</sup> Under social contract theory, individuals may consent *ex ante* to a competition policy if the gains and losses are distributed somewhat evenly. But as the income gap widens, the middle class and poor have less incentive to perpetuate the prevailing competition policies. Instead, a more empirically-based competition policy must be coordinated with other social policies to correct the ailments on an individual, national, and global level.

Some may argue that this new antitrust realism is too ambitious. Today's market failure recalls the Great Depression. One temptation is to discount antitrust's concerns on the belief that greater concentration is necessary to avert, in the short-term, further economic decline. It is more important to preserve jobs than competition. Thus, companies, which are too big to fail currently, need to get bigger to survive. Steeped in the Great Depression, the FDR administration initially viewed cooperation with businesses, not antitrust, as the priority: "[i]ndustries were organized under codes of 'fair competition' with their representatives empowered to adjust supply to demand, to stabilize prices within limits, to regulate wages, and to otherwise institute self-government under Government supervision."<sup>42</sup> But as the FDR administration later realized, antitrust enforcement is not a luxury reserved for more prosperous times. Cartels and monopolies flourished in pre-war Germany, President Franklin D. Roosevelt observed, because of the absence of antitrust laws and popular distrust of the

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<sup>41</sup> Eleanor M. Fox, *Economic Development, Poverty And Antitrust: The Other Path*, 13 Sw. J. L. & TRADE AM. 211, 219-20 (2007) (proponents of this perspective on aggregate efficiency or wealth do not answer the deontological questions of power and how opportunity is distributed).

<sup>42</sup> U.S. DEPARTMENT OF JUSTICE, A STUDY OF THE DEVELOPMENT OF THE ANTITRUST LAWS AND CURRENT PROBLEMS OF ANTITRUST ENFORCEMENT, SUBMITTED TO THE U.S. SENATE SUBCOMMITTEE ON MONOPOLY 9 (May 23, 1952).

concentration of power and monopolies.<sup>43</sup> Industries in pre-war Germany enlisted the state through compulsory cartel laws to complete their market power.<sup>44</sup> Inevitably, as with any autocrat, once economic power was consolidated, these monopolies and cartels became “governmental instrumentalities to achieve political ends.”<sup>45</sup> Moreover, unlike 1933, when few other nations had antitrust laws, antitrust policy today, like competition in many sectors, is global. The International Competition Network, for example, has today 102 competition agency members from 91 jurisdictions. Thus, even if the Obama administration, like the early FDR administration, deemphasizes antitrust enforcement, other nations will continue the global intellectual debate on the direction of competition policy.

Consequently to revitalize competition, the incoming administration must do more than challenge a few more mergers or incarcerate a few more price-fixers. Empirically testing and refining the neoclassical economic theories underlying much of antitrust policy have several benefits. The antitrust realism promotes effective learning by creating feedback about the relation between the situational conditions and the appropriate response.<sup>46</sup> Such built-in mechanisms for feedback are lacking in antitrust

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<sup>43</sup> John H. Crider, *Roosevelt Calls For Cartels Curb: In Letter To Hull He Says Types Of 'Trusts' Used By Reich Must Be Ended*, N.Y. TIMES, Sept. 9, 1944, at 1. Wilhelm Cohnstaedt, *Germany's Cartels and State Control: A Revealing Study of the Reich's Post-War Industrial Monopoly Organizations*, N.Y. TIMES, May 19, 1935.

<sup>44</sup> F.A. HAYEK, *THE ROAD TO SERFDOM* 93-94 (Univ. of Chicago Press 2007). An estimated 550 to 600 German cartels existed in 1911, about 1000 in 1922; 1500 by 1933; and 1800 by 1938. John M. Kleeberg, *German Cartels: Myths and Realities*, at [http://www.econ.barnard.columbia.edu/~econhist/papers/Kleeberg\\_German\\_Cartels.pdf](http://www.econ.barnard.columbia.edu/~econhist/papers/Kleeberg_German_Cartels.pdf).

<sup>45</sup> Crider, *supra* note 43, at 1 (quoting President Roosevelt).

<sup>46</sup> Amos Tversky & Daniel Kahneman, *Rational Choice & the Framing of Decisions*, in *RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS & PSYCHOLOGY* 90-91 (Richard M. Hogarth & M.W. Reder eds. 1987). Two recent business articles, for example, highlight this information flow. Hirotaka Takeuchi

analysis today. Antitrust realism reduces the likelihood of false negatives and positives in merger review and promotes more effective antitrust enforcement. It increases transparency of the merger review process, and makes the federal agencies and their political appointees more accountable for their decisions. An empirically-driven competition policy may temper the claims of partisanship in antitrust enforcement, which have increased over the past quarter century.

Competition policy is too vital to our democracy and dynamic economy to do nothing, either for fear of crippling our economy or by continuing to adhere to the flawed theories of the past. “[N]o new findings will ever be made if we rest content with the findings of the past.”<sup>47</sup> Instead, we must awaken with a new antitrust realism.

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et al., *The Contradictions That Drive Toyota's Success*, HARV. BUS. REV., June 2008, at 96, 101 (encouraging experimentation and learning from successes and failures); Gary L. Neilson et al., *The Secrets to Successful Strategy Execution*, HARV. BUS. REV., June 2008, at 61, 63 (based on a survey of over 20,000 people in 31 companies; among the more important traits to implement strategy are promoting information flow and feed-back of decisions' consequences on bottom-line).

<sup>47</sup> LUCIUS ANNAEUS SENECA, LETTERS FROM A STOIC 81 (Penguin 2004).