RESTORING ANTITRUST, RESTORING COMPETITION

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I. INTRODUCTION

Twenty years ago, Joel Klein – then the Assistant Attorney General for Antitrust in the U.S. Department of Justice -– declared that "our economy is more competitive today than it has been in a long, long time."[2] Klein credited aggressive antitrust enforcement as well as deregulation and increased international trade for the increase in competition. In the area of antitrust, he pointed to several major price-fixing cases, the *Microsoft* case, and tough scrutiny of mergers in accounting, airline alliances, and other consolidations.

But what Klein did not know – and of course could not have known – is that at the very time he made that assessment, overall competition in the U.S. economy had peaked and started to decline. Study after study has shown that concentration has risen throughout the U.S. economy over the past twenty years. Further evidence shows major declines in new firm start-ups and entry into markets in the U.S., as well as rising and persistent abnormal profits concentrated in the largest companies.[3] All of these trends date back to the 1990s – precisely the time when Klein offered his positive assessment.

Indeed, the very industries he cited serve as illustrations. The number of major U.S. airlines has dropped from 7 to 4, the number of accounting companies from 8 to 4. The telecom and electricity sectors that Klein alluded to as deregulated have undergone massive consolidation. And now there are four new tech giants – Google, Amazon, Apple, and Facebook – instead of just the one he cited. Moreover, over the past twenty years, these five have collectively acquired more than 600 companies.

The totality of this evidence on concentration, declining firm numbers, and rising and persistent abnormal profits leads to only one conclusion: competition in the U.S. economy has been undergoing slow erosion, from precisely the time of Klein's positive assessment. The issues to be discussed here are twofold: to what extent has policy contributed to this problem? And what should be done about it? We address these in turn.

2 Joel Klein, "The Importance of Antitrust Enforcement in the New Economy," Department of Justice, January 29, 1998.

3 For a summary of this evidence, see J. Kwoka, "Reviving Merger Control," October 9, 2018, available at https://www.antitrustinstitute.org/wp-content/uploads/2018/10/Kwoka-Reviving-Merger-Control-October-2018.pdf.

II. ANTITRUST: FROM SOLUTION TO PROBLEM

If antitrust policy was part of the solution in Klein's time, it has demonstrably been part of the problem since. Merger policy in the U.S. has undergone a profound change, becoming far more permissive since the 1990s, and contributing directly to rising concentration. The evidence for this assessment comes in the form of agency data on enforcement practices over time. For the years 1996-2011, the Federal Trade Commission ("FTC") reported on the total number of merger investigations that it conducted – about 1300 during this period – and of those, how many resulted in any type of enforcement action ("challenges," in the FTC's terminology).[4] I have reworked these data into a form (see Table 1, below) showing the fraction of merger investigations that were challenged according to the number of remaining significant competitors in the relevant market, a measure of concentration defined and determined by the FTC itself.

For the entire period, Table 1, column 1 shows that the fraction of challenged mergers has been systematically greater for those mergers resulting in fewer remaining significant competitors. So, for example, nearly 100 percent of mergers resulting in a single firm – a merger to monopoly – has been challenged, but the challenge rate is lower – about 35 percent – for mergers resulting in five such competitors. This is, of course, what one would expect.

Less expected, perhaps, is how these rates of enforcement have changed over time. The FTC issued four reports during the entire 1996-2011 period, each showing the cumulative totals of investigations and challenges beginning in 1996. Simple calculations reveal the enforcement trend. As shown in the remaining columns of this table, for mergers in the most concentrated markets, the FTC continued over time with a high rate of challenge. For mergers to monopoly, for example, that rate varies within the narrow range of 98 to 100 percent for all periods; and for those resulting in two, three, or four firms, the percent has either stayed steady or even crept up a bit.

But for mergers just below that high level, however, there has been a fundamental policy shift. Between 1996 and 2003 – the first half of that period – the FTC challenged a significant fraction of mergers that resulted in five, six, seven, or eight competitors, mergers that might be described as medium-to-high concentration cases. But, starting in 2004, the agency systematically narrowed its enforcement practice. It ceased challenging any mergers with seven remaining competitors in 2004, any mergers with six in 2006, and those with five in 2008. Thus, by 2008, the agency was literally no longer challenging any mergers that resulted in five or six or seven or more firms, effectively surrendering in the enforcement battle against this entire range of concentrations.

There is other evidence of changing enforcement standards and practice but these data – the agency's own – would seem dispositive. U.S. merger enforcement practice has dramatically narrowed, contributing directly to the rise in concentration in the economy.

III. RESTORING ANTITRUST

The question raised by this evidence is what needs to be done in order to revive antitrust policy and thereby strengthen competition in the U.S. economy. While there are a number of policy reforms that should be taken, here we will focus on three proposals, as follows.

A. Structures and Presumptions

First, the erosion of merger enforcement needs to be stopped and reversed. As just described, one antitrust agency ceased enforcement against a wide range of mergers starting in the early 2000s. This permissiveness was not the result of new court rulings, new economic findings, or new guidelines, but rather a matter of policy choice by the antitrust agencies. That permissiveness can therefore can be reversed by them. It requires a renewed commitment to the Merger Guidelines as written, a determination to bring (and convince the courts of) all the cases that should be brought, and a level of resources sufficient to this mission.

4 FTC, Horizontal Merger Investigations Data, 1996-2011. "Challenges" include abandonments of proposed mergers, substantial modifications to satisfy antitrust concerns, and those resolved with remedies.

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All of these have recently been lacking and must be restored. The issue of resources deserves further comment. Agency budgets over the past decade have actually declined in real terms, even as the number of filed mergers has risen by more than 75 percent and the costs of investigations have grown substantially. Not surprisingly, therefore, the fraction of mergers that the agencies subject to serious investigation has fallen over time. A straightforward solution to the agencies' resource constraints would be to increase merger filing fees and then to have those fees go directly to the agencies' budgets, in contrast to current practice where fees simply offset congressional appropriations.

A corollary aspect of this problem is the high burden of proof that the agencies face in their investigations and challenges. At present, the agencies analyze essentially every merger for its unique competitive threat, regardless of how high its concentration, regardless of how obvious the competitive problem, and regardless of how difficult it may be to prove the exact mechanism by which harm will occur. This approach is legally unnecessary because the Supreme Court long ago ruled that high-share high-concentration mergers were so inherently likely to be anticompetitive that they could be stopped without "without elaborate proof of market structure, market behavior, and anticompetitive effects."[5] The agencies have not relied sufficiently on this tool handed to them by the judiciary.

Full analysis of each merger is also unnecessary from an economic point of view. since there is now both theory and evidence supporting use of such a presumption. Theory makes clear that a presumption may be superior to full-blown analysis even if it makes some errors, since the policy choice depends also on the error rate of full analysis, together with the costs of each type of error and the incremental cost of full analysis.[6] Taken together, these considerations readily make a case for an appropriately structured presumption.

Other work has suggested that the error rate resulting from a well-chosen presumption would be at worse modest. I have examined the characteristics of all mergers whose outcomes have been analyzed in high-quality economic studies–about 60 in all.[7] I can then calculate the fraction of mergers above various levels of concentration that actually resulted in price increases. For mergers among very few firms – going from three firms to two, for example – all of those mergers in fact are found to result in price increases. But the same is true for mergers resulting in three, four, or five remaining competitors. That is, all of those have been found to be anticompetitive. Indeed, for those with six remaining firms, 80 percent were anticompetitive. And even half of those with seven remaining firms. What this evidence shows is that an appropriately chosen concentration level for a structural presumption – on the order of five remaining competitors – would in fact make few errors as well as saving on enforcement costs.

There is, in short, good reason for greater reliance on a "structural presumption." It would place the burden of proof squarely on the parties to these high-concentration mergers, relieving the agencies of proving the obvious. And if designed correctly, its error rate would be quite modest, and not obviously greater than that from full-blown analysis.

B. The Potential of Potential Competition

Another important antitrust doctrine that has not been sufficiently utilized by the agencies is "potential competition." This refers to a merger or acquisition by an existing firm of another firm that is not presently producing the same product but is in a position to do so quickly. Since any incumbent firm prices with an eye toward possible entry, a merger or acquisition that eliminates that potential competitor removes that constraint on the existing firm's pricing and other behavior.

This proposition is analogous to the case of a merger between existing firms, which eliminates the threat of competition between the two incumbent firms, and results in enhanced market power. And indeed, there is good empirical evidence that a merger eliminating a threatening potential competitor results in a price increase as well. In the airline industry, for example, a merger between an incumbent and a carrier poised to enter has been found to result in a significantly higher price, although (of course) not as high as for the same merger between incumbents.[8]

5 *U.S. v. Philadelphia National Bank,* 374 U.S. 321 (1963).

6 Steven Salop, "The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach," Antitrust Law Journal, 2015.

7 J. Kwoka, "The Structural Presumption and the Safe Harbor in Merger Review: False Positives or Unwarranted Concerns," Antitrust Law Journal, 2017.

8 For a summary of evidence, see Kwoka, *supra,* note 3.

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Despite the close analogy between actual and potential competition, the legal standard in the U.S. for challenging a merger eliminating a potential competitor involves a higher threshold of proof. Specifically, it requires the agency to show evidence that the outside firm had "in fact tempered oligopolistic behavior" by incumbents.[9] This need for proof of actual past effect is quite different than for mergers between incumbents, and considerably harder to establish. The effect of this high standard has been to sharply limit use of this doctrine. That in turn has permitted numerous mergers and acquisitions that have eliminated potential rivals to major companies, relieving them from the constraints they pose.

One setting where this effect has been evident in the tech sector. As already noted, there have been literally hundreds of acquisitions by Amazon, Apple, Facebook, Google, and Microsoft, most of which have been harmless. In some cases, however, these have swept up smaller firms that might have evolved into more significant competitors to the dominant companies. In the U.S., Facebook's acquisitions of Instagram and WhatsApp have drawn critical attention, as have Google's acquisitions of Doubleclick, YouTube, and ITA, among others.

The key policy question is, of course, not whether in hindsight these mergers and acquisitions have proven anticompetitive, but whether the agencies could – and should – have been able to discern their anticompetitive potential at the time. This is admittedly a much more difficult issue than the conventional case of a potential competitor. In the case of tech companies, the fungibility of technology, the speed and unpredictability of transformation, and the asymmetry of information between the companies and the antitrust agency likely make conventional analysis of potential competition inadequate. A blunter policy instrument is required. This might, at a minimum, involve shifting the burden of proof to the parties to demonstrate the benefits of an acquisition, or redefining the standard to be "possible competition" rather than "potential competition." More aggressively, there may well be grounds to prohibit a wider range of mergers and acquisitions by tech companies, on the grounds of irreversible losses of possible competition.

C. Fixing Remedy Policy

A third major area of merger policy that needs reform concerns remedies. Remedies are an appealing alternative to the polar opposites of banning a merger outright or clearing it in its entirety. They would seem to allow much (or even all) of a merger to proceed, while surgically resolving the specific competitive problems it may pose. Thus, a divestiture remedy may involve the spinoff of only the overlapping operations of two companies that otherwise present no competitive problems by merging. A conduct remedy may prohibit a certain specific anticompetitive behavior by the merged company, which otherwise is competitively benign.

As the use of remedies has increased and evolved, however, concern has grown that they have significant limitations in design and implementation. Many of these arise due to informational and incentive issues. Even the most straightforward remedy – a simple divestiture – requires the agency to examine issues not in its area of special competence. These include the business capability of the buyer, the adequacy of the assets to be divested, and so forth. If these are not examined sufficiently carefully, the remedy may well fail. Conduct remedies are more problematic still, since they seek to prevent the merged firm from engaging in specific, enumerated anticompetitive actions. Unfortunately, such enumeration is almost inevitably incomplete, overtaken by events, or defeated by actions of the parties, which after all have every incentive to avoid and evade the constraint. In addition, this type of remedy requires on-going oversight of a regulatory nature by the antitrust agency, a task for which they are not well equipped.

For these reasons, recent research has shown that remedies have not generally been effective in preserving competition. Rather, too often they have allowed price increases similar to what otherwise would have occurred, as research has shown. I have examined the outcomes of about sixty carefully-studied mergers and researched the policy actions by either the FTC or DOJ for each of them.[10] This permits relating agency policies like remedies to the actual outcomes of the mergers. While the numbers of observations are small, the implication is clear: Remedies overall are associated with price increases of 7.3 percent. Divestitures result in slightly lesser increases – 5.6 percent – whereas mergers "resolved" by conduct remedies (though few in number) end up permitting price increases of 13.4 percent.

9 *U.S. v. Marine Bankcorporation*, 418 U.S. 602 (1982).

10 Kwoka, *supra*, note 3.

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Based in part on this research, the heads of both U.S. antitrust agencies have now declared their disapproval of the record of merger remedies and taken actions to limit their use. But they remain in use – notably, in the recent Sprint/T-Mobile merger – and too often substitute for what is really required, namely, challenging anticompetitive mergers. Based on past experience and evidence, it seems clear that unless a remedy has a demonstrably high likelihood of succeeding, of thwarting the parties' incentives, and not enmeshing the agency in long-term regulatory action, the appropriate policy response for predictably preserving competition is indeed to challenge such mergers.

For all these reasons, remedy reform is on the short list of actions necessary to reform and revitalize merger control.

IV. RESTORING COMPETITION

These three reforms – the structural presumption, potential competition, and remedies – would significantly strengthen competition policy in the U.S. Buttressed by additional resources and a few other reforms, these would ultimately strengthen competition itself – an increasingly urgent policy goal.

There is another implication of the above analyses, however, this one involving process rather than substance. Much of what we have learned about the effects of mergers and the effectiveness of policy has been laboriously pieced together by academic researchers, occasionally aided by data from the antitrust agencies. More expansive reporting requirements – by merging firms and also by the agencies – would substantially improve understanding of merger control policy and yield useful insights for how it might be strengthened.

Accordingly, an important reform of merger control practice would be for the agencies to require parties to merger investigations (or at least those subject to remedies or challenge) to provide post-merger data that would allow the agencies to evaluate their past policy choices. Over a period of time, this would result in the creation of a large and comprehensive data set of experiences for the agency, and for outside observers, to analyze. Illustrative of the value of this type of program was the FTC's initiative with respect to hospital mergers. In order to improve enforcement, the FTC conducted retrospectives on several consummated hospital mergers, the findings from which served to significantly strengthen enforcement against subsequent mergers in the health care sector.

In addition, the agencies should be required to publicly provide some information on their own policy decisions so that interested outside observers can examine agency decisions. As one example, the FTC horizontal merger investigations data series has proven informative about its choices and actions. A constructive response would be for the agency to re-examine some of the mergers that it increasingly has cleared in order to see if the outcomes have in fact been as predicted, and certainly to continue to report such data publicly. Unfortunately, instead of taking those actions, the agency has ceased releasing updates at all.

All of these measures – more disclosure of agency enforcement data, more retrospectives on past mergers, and more data production from mergers currently being reviewed and resolved – should be part of a comprehensive reform of merger control policy and practice. Collectively, these would constitute the basis for continuous improvement in merger control and ultimately help restore lost competition in the U.S. economy.

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TABLE 1

Merger investigations resulting in enforcement actions

Number of remaining significant competitors	Percent enforced				
	1996-2011	1996-2003	2004-2005	2006-2007	2008-2011
1	98.0	96.2	100.0	100.0	98.4
2	89.2	84.8	89.3	94.7	95.7
3	77.3	76.1	50.0	86.7	91.9
4	64.1	61.5	57.1	69.2	72.7
5	35.2	40.6	28.6	44.4	0.0
6	12.0	20.0	16.7	0.0	0.0
7	24.0	50.0	0.0	0.0	0.0
8	0.0	0.0	0.0	0.0	0.0
Total	**78.6**	**77.0**	**78.7**	**70.8**	**89.0**

Source: Federal Trade Commission, Horizontal Merger Investigations data, Fiscal Years 1996-2011 (January 2013). available at https://www.ftc.gov/sites/default/files/documents/reports/horizontal-merger-investigation-data-fiscal-years-1996-2011/130104horizontalmergerreport.pdf

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