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# Reviving Antitrust

## Why Our Economy Needs a Progressive Competition Policy

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By Marc Jarsulic, Ethan Gurwitz, Kate Bahn, and Andy Green     June 2016



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# Contents

- 1 Introduction and summary**
- 3 Market power**
- 6 Tangible effects of reduced competition**
- 11 The evolution of antitrust policy**
- 14 Reinvigorating antitrust policy**
- 22 Conclusion**
- 23 About the authors**
- 24 Endnotes**

# Introduction and summary

*“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”<sup>1</sup> —Adam Smith, *The Wealth of Nations**

Income inequality is rising, middle-class incomes are stagnant, and much of the current economic policy debate is centered on finding ways to counter these trends. A renewed focus on antitrust enforcement could make a significant contribution toward accomplishing this goal.

When firms with dominant market power are able to elevate the prices they charge and earn supra-normal returns—which are economic rents—they simultaneously lower the real incomes of those who buy from them. In other words: The seller benefits when market power elevates the price of hospital care or raises the price of an airline ticket, but the buyer has less income for other needs. Moreover, the tendency of monopolies to restrict output combined with reduced competitive pressure to invest can translate into reduced employment.

Market power is once again a headline issue. As journalist David Dayen recently noted in *The American Prospect*:

*Executives and Wall Street traders make astronomical incomes, while wages are squeezed. Post-merger price increases, from health care to cable TV service to airline tickets, translate into a decline in real wages. Big mergers also encourage reduction in actual wages, when consolidations produce layoffs and limit avenues for employment.<sup>2</sup>*

As this report highlights, there is systematic evidence—ranging from the disconnect of corporate profits and corporate investment to evidence of persistent supra-normal profitability—that points to an increase in rent extraction in the U.S. economy. And while large rent extraction is a primary outcome of unchallenged market power, there are additional and equally undesirable results. For example, the entry of new firms in the market can be blocked; innovation can be stifled; product quality can be degraded; the prices paid to workers and suppliers can be reduced; and influence with government officials can be increased.

Fortunately, there are policy tools—created by statutes such as the Sherman Antitrust Act, the Clayton Act, and the Federal Trade Commission Act—that can be used by enforcement agencies to reverse these developments. For instance, enforcement agencies and courts can block mergers that are likely to result in significant price increases and challenge conduct that would increase the clout of a firm that already has considerable market power.

However, these enforcement tools have not been deployed vigorously enough over the past few decades. Concentration-increasing mergers, many of which have gone unchallenged by antitrust authorities, have too often been followed by increased prices. Moreover, there have been few challenges to unilateral actions to expand or preserve market power by those who have it.

This report outlines a series of reforms designed to revitalize the use of antitrust authority. Doing so would be a step in the direction of restoring competition and opportunity in important parts of the economy.

# Market power

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## Evidence of reduced competition in the U.S. economy

When firms exercise market power, such as the ability to set noncompetitive prices for the goods and services they purchase and produce, there is potential for several kinds of economic harm. Higher prices and reduced supply translate into reduced real incomes for households.<sup>3</sup> Moreover, the ability to extract economic rents is also likely to lessen the incentive to invest and innovate among incumbent firms or their suppliers. All these outcomes have negative implications for employment. For these reasons, evidence of a declining level of competition among firms is a troubling sign for any market economy.

There are, unfortunately, several markers consistent with diminishing competition in parts of the U.S. economy.

First, there are indications that some sectors of the U.S. economy are becoming more highly concentrated; that is to say, the share of revenue earned by larger firms in the sector is increasing. These sectors include wireless providers, finance, agriculture, hospitals, and railroads.<sup>4</sup> A recent analysis by *The Economist* found that between 1997 and 2012 more than two-thirds of around 900 industry sectors analyzed had become more concentrated. Of those, the market share of the top-four firms in each sector grew, on average, by nearly one-quarter.<sup>5</sup>

While high levels of market concentration in and of themselves are no guarantee of noncompetitive outcomes, there are well-defined circumstances in which they do produce them.<sup>6</sup> For example, increased concentration is embedded in the *Horizontal Merger Guidelines*, an outline of the methodology and criteria used by the U.S. Department of Justice, or DOJ, and Federal Trade Commission, or FTC, to evaluate the competitive effects of mergers between firms competing in the same market.<sup>7</sup>

Additionally, it is worth noting that financial market practitioners recognize the ability of market concentration to raise returns. Take for example a 2014 Goldman Sachs report that analyzed what was termed the “path to consolidation” of six industries that ranged from beer to containerboard.<sup>8</sup> For nearly all of the cases reviewed, the report found that stock market performance and overall profitability tracked with increased market concentration. In the words of the Goldman analysts:

*Oligopolistic market structure can turn a cut-throat commodity industry into a highly profitable one. Oligopolistic markets are powerful because they simultaneously satisfy multiple critical components of sustainable competitive advantage—a smaller set of relevant peers faces lower competitive intensity, greater stickiness and pricing power with customers due to reduced choice, scale cost benefits including stronger leverage over suppliers, and higher barriers to new entrants all at once.*<sup>9</sup>

In addition to evidence of greater market concentration, there is evidence to suggest sustained, supra-normal profits in certain sectors of the economy—on its face, a noncompetitive outcome. A recent review of returns on invested capital, or ROIC, that contains a comparison of median returns by industry from 1965 to 1995 and 1995 to 2013, shows that returns in normally high-profit industries have begun to pull dramatically away from those in other industries.<sup>10</sup> The authors of the research note:

*For the higher-ROIC industries, ROICs have increased in recent years. Not surprisingly, industries with the highest ROICs, such as pharmaceuticals, medical devices, and IT-related businesses are those with sustainable competitive advantages. In the case of pharmaceuticals and medical devices, this is due to patent-protected innovation. In IT-related businesses, it is due to increasing returns to scale and customer lock-in. The consumer staples sector has high returns due to customer loyalty based on brand strength.*<sup>11</sup>

What is left unexplained is the rising rate of return to competitive advantages that existed from 1965 to 1995 as well as during the current period. Why have high rates of profit not stimulated sufficient entry by new competitors to force profit rates to converge rather than diverge?



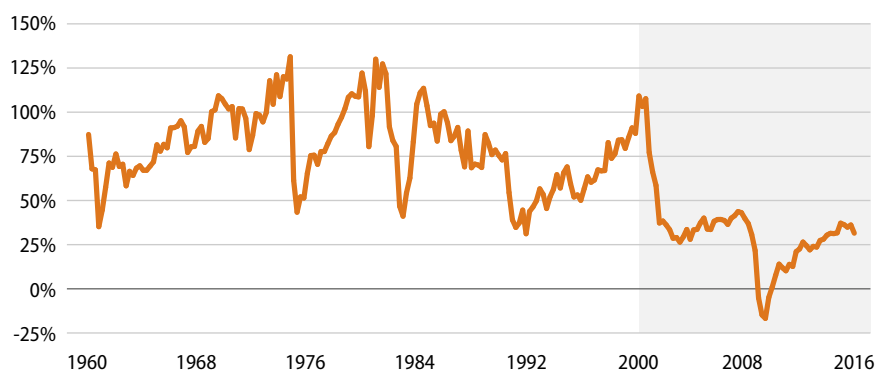
In addition to this, the White House Council of Economic Advisers, or CEA, has noted a remarkable decline in the net creation of new firms, which may be an indicator of increased barriers to entry in the overall economy.<sup>12</sup> For much of the period between 1977 and 2012, the rate of entry of new firms in the economy exceeded the rate of exit. But the difference in rates narrowed measurably over that period, and now the two rates are more or less equal. The reduction in net entry may signal a more difficult environment for small businesses formation and an increased ability of established firms to exclude competitors.

Finally, at the aggregate level, since around the year 2000, with after-tax corporate profits continuing to trend up, the ratio of investment to profits has declined sharply. (see Figure 1) Since this is a marked departure from economic behavior in recent decades and precedes the effects of the financial crisis of 2008, it raises the question of why high profitability has not produced proportionate new investment by existing firms and new competitors.

**FIGURE 1**

### Since 2000, profits have been rising while investment has been stagnating

Net domestic business investment as a share of corporate profits after tax



Sources: Authors' analysis of Federal Reserve Economic Database, "Corporate Profits After Tax with Inventory Valuation Adjustment (IVA) and Capital Consumption Adjustment (CCAdj)," available at <https://fred.stlouisfed.org/series/CPATAX> (last accessed June 2016); Federal Reserve Economic Database, "Net domestic investment: Private: Domestic business," available at <https://fred.stlouisfed.org/series/W790RC1Q027SBEA> (last accessed June 2016).

Although each of these markers could be explained by factors other than increased market power, taken together they are certainly consistent with that hypothesis.



# Tangible effects of reduced competition

So, how did this happen? Firms can employ many strategies to support and enhance market power, including merging to eliminate competition and raise prices, using their dominance to create barriers to entry, and buying influence to protect rents. The cumulative effect of this exercised market power can mean reduced innovation, poorer product quality, reduced output, and lower wages for those employed by dominant firms. These outcomes contribute to an economy that advantages those with market power, but harms workers, small businesses, and consumers. The following section discusses some of those strategies and the effects that market power has on the operation of the economy.

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## Price increases from increased concentration

When it comes to market consolidation, one of the clearest ways to identify the impact is to look at prices before and after mergers. A growing body of research has looked retrospectively at mergers, finding a fairly consistent relationship between increasing market concentration and increasing prices.<sup>13</sup>

In *Mergers, Merger Control, and Remedies*, John Kwoka reviews studies of concentration-increasing mergers, over the past three decades, finding a “clear tendency toward anticompetitive outcome.”<sup>14</sup> His review covers 29 retrospective studies, assessing price effects for 42 mergers and 101 products affected by a merger.<sup>15</sup> Nearly two-thirds of the products reviewed resulted in price increases, with an average post-merger price increase of more than 9 percent.<sup>16</sup>

Kwoka analyzes the same set of mergers at the transaction level—the average price outcome across all products produced by the merged entity. Consistent with the product-level analysis, he finds that more than three-quarters of the mergers resulted in price increases, the average of which is more than 10 percent.<sup>17</sup> Only a little more than one-third of the mergers reviewed were challenged by the FTC or DOJ.<sup>18</sup> Of the mergers that went unchallenged by the FTC or DOJ, the average transaction-level price effect was an increase of nearly 11 percent.<sup>19</sup>

Finally, Kwoka looks at group merger studies—studies analyzing large sets of concentration-increasing mergers which include some effects beyond price.<sup>20</sup> His data include 19 studies, which yield 41 product-level observations. Less than one-third resulted in procompetitive effects. The product-level results show that on average prices increased, research and development, or R&D, declined, and quality decreased.<sup>21</sup> In particular, R&D—where observations were limited to the biotech and pharmaceutical industry—decreased on average by just less than 10 percent.<sup>22</sup> Moreover, the group mergers resulted on average in cost reductions and efficiencies, indicating, as Kwoka notes, that cost savings were unlikely to be passed onto consumers.<sup>23</sup>

Another review by Orley Ashenfelter, Daniel Hosken, and Matthew Weinberg reaches similar conclusions.<sup>24</sup> Reviewing studies of mergers that were considered close calls but were allowed to close without challenge, the authors found “overwhelming” evidence that these mergers frequently cause price increases.<sup>25</sup> This outcome holds across a set of industries, including banking and airlines.<sup>26</sup>

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## Exclusion of competitors

Firms can sometimes use dominant positions as sellers to exclude competitors from a market.<sup>27</sup> Consider, for example, the case brought by the FTC against computer chip manufacturer Intel Corporation in 2009.<sup>28</sup> Intel had long dominated the market for both central processing units, or CPUs, as well as graphic processors, or GPUs, with more than 80 percent of the CPU market and 50 percent of the GPU market.<sup>29</sup> In late 2009, the FTC charged that Intel “engaged in a number of unfair methods of competition and unfair practices to block or slow the adoption of competitive products and maintain its monopoly to the detriment of consumers.”<sup>30</sup>

According to the FTC’s complaint, such anticompetitive tactics focused in particular on computer manufacturers and included threats of price increases, limited tech and marketing support, and reduced partnership for computer manufacturers that collaborated with other chipmakers. Additional strategies reportedly included discounts for manufacturers that either purchased solely, or near solely, from Intel; manipulating Intel-designed software in complementary markets to inhibit the functionality of rival chips; and incentivizing other software and hardware players to “limit their support of non-Intel CPU products.”<sup>31</sup>

In addition, the FTC alleged anticompetitive action in the GPU market. According to the FTC, Intel initially engaged GPU makers in partnerships, in which the GPUs would rely on Intel's CPU platform. However, when Intel concluded that these partners could become potential threats, Intel created interoperability issues with their GPUs and prohibited them from connecting to future CPU platforms.<sup>32</sup>

Taken together, the FTC determined that these actions were deliberate attempts to reduce competition. According to the FTC, these strategies resulted in enhanced market power for Intel, fewer choices for consumers, and reduced innovation in the overall chip market. In 2010, the FTC settled with Intel.<sup>33</sup> Intel notably did not admit fault.<sup>34</sup> The settlement put into place a set of provisions to “open the door to renewed competition and prevent Intel from suppressing competition in the future.”<sup>35</sup> Additionally, private settlements were reached between Intel and rivals Advanced Micro Devices and Nvidia for \$1.25 billion and \$1.5 billion respectively.<sup>36</sup>

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## Reductions in wages

Monopsony power—through which buyers can influence the prices of the goods and services they purchase—can, like monopoly power, produce significantly anticompetitive outcomes.<sup>37</sup> Take, for example, a 2007 case under Section 1 of the Sherman Act brought against the Arizona Hospital and Healthcare Association, or AzHHA, a statewide association of hospitals, health systems, and affiliated health care associations in Arizona.<sup>38</sup> In 1988, AzHHA created a group purchasing organization, or GPO, called the AzHHA Registry Program, to represent AzHHA hospitals in setting rates and terms for temporary and per diem nursing services.

According to the complaint filed against the AzHHA by the DOJ and the State of Arizona, the GPO had tremendous market power over buyers, largely as a result of its market share.<sup>39</sup> In 2005, for example, the complaint alleges that the hospitals participating in the registry for per diem nurses administered around 80 percent of beds in the Phoenix and Tucson, Arizona, areas respectively.<sup>40</sup> It was a similar story for travel nurses, with participating hospitals representing nearly 80 percent of all hospital beds in the state.<sup>41</sup>

With 90 percent of sales for travel nursing services, for example, occurring through the registry, this market power did not go unnoticed by nurse staffing

agencies.<sup>42</sup> According to the complaint, the sheer size of the GPO and the resulting coordination proved to be anticompetitive, resulting in depressed wages for per diem and travel nurses. The AzHHA itself estimated that its rates were 12 percent below what they would have been under competitive market conditions.<sup>43</sup> Participating hospitals reduced nurse staffing agencies' payments by \$10 million to \$12.7 million.<sup>44</sup> Beyond these depressed rates, the complaint argues that the GPO got rid of weekend-weekday rate differentials for per diem nurses, lessened overtime, and lowered holiday bill rates. Hospitals that chose to leave the arrangement, even those who entered into competing GPOs, saw higher bill rates. At the same time, staffing agencies that stopped working with the AzHHA saw reduced sales.<sup>45</sup>

In September 2007, the U.S. District Court approved a settlement decision. AzHHA and its for-profit subsidiary, the AzHHA Service Corporation, could no longer set uniform bill rates nor establish “competitively sensitive contract terms” in their agreements with hospitals and staffing agencies, effectively ending AzHHA’s monopsony.<sup>46</sup> As part of the settlements, AzHHA did not admit to any wrongdoing.<sup>47</sup>

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## Depressed innovation

Intuition suggests that market power is likely to limit innovation and investment. After all, when reduced competition allows a firm to earn supra-competitive returns, there is less incentive to introduce new products or find ways to reduce costs. This intuition is borne out by evidence from the pharmaceutical industry.

The pharmaceutical industry is highly dependent on the discovery of new chemical entities that can provide safe and effective treatment for disease. Over the past three decades, the industry has seen a merger wave among large companies producing patented drugs.<sup>48</sup> A 2009 study of the post-merger innovation inputs and outputs of merged firms between 1988 and 2004, as measured by R&D expenditure, patents, and research productivity, shows statistically significant declines relative to a control group of similar firms.<sup>49</sup> These empirical results cast doubt on the view that mergers in pharmaceuticals produce significant increases in innovation, and on the possibility that large dynamic efficiencies can offset possible anticompetitive effects.

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## Political support for rent seeking

Finally, economic weight conveys privileged access to government policymakers. When firms succeed in restricting competition and earning supra-competitive returns, they have extra resources and incentive to defend and expand their position by influencing political and regulatory decisions.

Consider, for example, the financial sector, which earns nearly one-quarter of all corporate profits and in the process extracts a healthy amount of economic rent.<sup>50</sup> Contributions to federal political campaigns from the financial sector during the 2012 election amounted to around a nontrivial \$690 million, which suggests that the financial sector has a significant influence over who runs for office.<sup>51</sup> That year, there were around 2,400 lobbyists working for the financial sector, or more than four lobbyists for each member of Congress.<sup>52</sup> Thus, legislators and regulators were nearly certain to hear financial sector views on legislation or rules that affected the interests of finance. Moreover, the prospect of the so-called revolving door appointments to private-sector employment may have increased the impact of the lobbyist messages.

Tracing causal connections between contributions and lobbying and particular legislative or regulatory outcomes is not easy, given the number of actors and interests involved in any significant decision. However, statistical analysis by Atif Mian, Amir Sufi, and Francesco Trebbi, for example, shows that between 2002 and 2007, sponsorship and voting patterns on legislation affecting subprime mortgage lending were jointly influenced both by mortgage industry campaign contributions and the presence of subprime borrowers in Congressional districts.<sup>53</sup> As others have noted, the political clout of the financial sector led to a “shifting conventional wisdom” that made deregulation of the sector seem like a good idea, raising returns and thereby increasing its influence further.<sup>54</sup> In doing so, it also helped create the conditions for the financial crisis of 2008, the effects of which persist today.

# The evolution of antitrust policy

To understand the current situation, it is important to first review how the nation got here. Around the beginning of the 20th century, a growing wariness of the economic and political power of monopolies and trusts had spurred a movement and, with it, particularly aggressive antitrust policies.<sup>55</sup> Using authorities that had been enshrined principally in three acts—the Sherman Act and, later, the Clayton Act and Federal Trade Commission Act—government began to counter the growing power of industrial goliaths from railroads to oil.

In the late 1930s, government began to take on market power and concentration in a way that would be difficult to recognize today.<sup>56</sup> Enforcers started to actively focus on concentrated industries, seeing such concentration as a principal source of anticompetitiveness. This approach intensified during the 1950s and 1960s, when mergers that resulted in relatively moderate concentration would often be successfully challenged.<sup>57</sup>

However, around the 1970s, the analytical framework of antitrust policy began to shift.<sup>58</sup> Influenced by the views of scholars such as Oliver Williamson, George Stigler, Robert Bork, Aaron Director, and Richard Posner, concerns about concentration began to erode.<sup>59</sup> Among the concepts promoted was the idea that “mergers cannot be harmful unless they result in a reduction in output.”<sup>60</sup> Factors such as efficiency gains and likelihood of potential entrants began to be weighed against the effects of increased concentration.<sup>61</sup>

Starting with the 1982 revision of the DOJ *Horizontal Merger Guidelines*, antitrust agencies began to incorporate these economic arguments, resulting in a more acquiescent approach to horizontal mergers—which are mergers between so-called rival suppliers.<sup>62</sup> The 1984 *Horizontal Merger Guidelines* formally included cost-efficiencies arguments into merger analysis and placed the burden on the government to rebut any efficiency defense offered by the merging parties.<sup>63</sup> The 2010 *Horizontal Merger Guidelines* increased the numerical concentration thresholds that help to determine whether a merger has the potential to produce anticompet-

itive effects.<sup>64</sup> By raising the measured concentration thresholds used as guides for determining agency challenges to mergers and taking seriously difficult-to-verify claims that mergers will result in cost-reducing efficiencies, *Horizontal Merger Guidelines* have come to reflect a more permissive view of market concentration.

This period also saw an acceptance of the view that vertical integration is generally procompetitive.<sup>65</sup> Over the past few decades, challenges to vertical mergers have been notably few.<sup>66</sup> Moreover, the 1984 DOJ *Vertical Merger Guidelines*, which remain in force—take the general benign view that vertical mergers, say between firms along a supply or production chain, are “almost always efficiency enhancing.”<sup>67</sup> These guidelines do not systematically develop a modern analysis of situations in which vertical integration can facilitate collusion, help foreclose new entrants, or raise competitors’ costs in an anticompetitive manner.<sup>68</sup>

As the agencies adopted these approaches to the analysis of mergers, so did the federal courts. They began to require the agencies to provide both a theory of and evidence for economic harms to show that entry or expansion by competitors would not prevent those harms, and to show that efficiencies claimed by merging parties would not counteract potential price increases.<sup>69</sup> Some scholars have argued that the burden of proof now placed on antitrust enforcers is too onerous.<sup>70</sup>

The courts went on to limit the ability of the DOJ to address the unilateral conduct of firms that already have acquired market power. For example, court interpretations of Section 2 of the Sherman Act have emphasized both the possibility of so-called over-deterrence because of a failure to distinguish between competitive and exclusionary behavior and the supposed benefits flowing from efficiencies produced by dominant firms.<sup>71</sup> A 2008 DOJ report on standards for enforcing Section 2 embraced these hurdles to enforcement.<sup>72</sup> As economist and legal scholar Jonathan Baker has persuasively argued, the economic arguments about over-deterrence are seriously flawed and have produced noninterventionist bias.<sup>73</sup> And while the current administration went on to repudiate the DOJ report, the court precedents remain.<sup>74</sup>

Finally, beyond the evolution of merger guidelines and court processes, there was a shift in actual enforcement. Baker and Carl Shapiro note the low enforcement rate of the DOJ Antitrust Division during the second term of the Reagan administration, calling it the empirical and anecdotal “low point for modern merger enforcement.”<sup>75</sup> This pattern continued during the George W. Bush administration, with the DOJ having “identical” merger enforcement rates to those of the Reagan administration’s second term.<sup>76</sup>



Moreover, recent research has shown that there has been a sharp change in the distribution of enforcement toward only the most concentrated industries.<sup>77</sup> At the lower bound of the current *Horizontal Merger Guidelines* concentration thresholds, it appears that a de facto so-called safe harbor has been established. The data demonstrates that the FTC has virtually abandoned challenges of mergers where concentration is below the upper threshold. This is the case even as preliminary evidence shows mergers falling below current concentration thresholds can still result in price increases.<sup>78</sup>

On top of this, merger enforcement agencies have increasingly relied on divestiture and conduct remedies, many of which seem to do little to seriously alter the anticompetitive effects of a merger.<sup>79</sup> This is especially true of conduct remedies—such as price controls, firewalls, mandatory licensing, and anti-retaliation provisions—which, in addition to doing nothing to preserve the number of competitors in the marketplace, also require substantial agency supervision.<sup>80</sup> Kwoka's research finds that mergers subject to conduct remedies result in an average price increase of 16 percent, while mergers subject to divestitures result in an average price increase of 7 percent.<sup>81</sup>

## The limitations of divestiture

The merger between health care insurers Humana and Arcadian Management Services provide a good example of the limitations of divestiture remedies. In consenting to the merger, the DOJ required the entities to divest 15 plans located in five states.

<sup>82</sup> These plans, covering nearly 13,000 Medicare Advantage members in 51 counties, were sold to three competitors. However, as an analysis by the Capital Forum and the Center for American Progress make clear, the divestitures have not been proven effective.<sup>83</sup> Counties experienced premium increases and the majority of the divested plans ended up being exited by the acquiring firm, leaving Medicare Advantage consumers with less choice.<sup>84</sup> The analyses found, "The acquiring partners exited more than half of the affected counties by 2015, only 2 of the 15 divested plans are offered today, and premiums increased for more than half of the divested plans by 44 percent, on average."<sup>85</sup> In addition, by selling the plans to competitors, the divestitures actually failed to secure future potential competition for the market.

# Reinvigorating antitrust policy

As the evidence reviewed in this report shows, there are a growing number of indicators that sectors of the U.S. economy have become less competitive, thereby increasing prices, reducing innovation, dampening wages, and degrading the quality of goods available. Similarly, antitrust law has become more difficult to enforce and antitrust agencies have until recently been less aggressive in using the tools they have available. These changes have produced measurable harm for ordinary households and have potentially significant implications for the longer-term course of innovation and productivity growth in the U.S. economy. To help reverse these trends, the Center for American Progress proposes a set of reforms designed to reinvigorate competition policy and increase the real incomes of ordinary American households.

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## Change the strategy for merger enforcement

### Enforce presumptions about concentration and shift the burden of proof in favor of competition

Over the past several decades, the nation has moved from a strong distrust of mergers toward a general presumption that mergers can be procompetitive. This has been followed by a change in the evidence required for merger reviews from a once dominant focus on market concentration toward a greater inclusion of decidedly pro-merger factors such as efficiencies.<sup>86</sup> With these changes, much of the onus for making a case that a merger is harmful shifted from merging firms to enforcement agencies.<sup>87</sup> This led to broad calls that presumptions be refined. Baker and Shapiro, for instance, called for an increased reliance on “presumptions that allow the government to establish a prima facie case, which the merging parties can only rebut with strong evidence.”<sup>88</sup> And in 2010, the revised *Merger Guidelines* did include language articulating an anticompetitive presumption.<sup>89</sup>

However, retrospective evidence shows that enforcement has been more permissive than the guidelines would lead us to expect. Recent empirical analysis finds that mergers that produce market concentrations—which are measured using the Herfindahl-Hirschman Index, or HHI—above the upper threshold in the DOJ and FTC *Horizontal Merger Guidelines* are likely to produce anticompetitive outcomes.<sup>90</sup> Of the 21 mergers analyzed that exceeded the guideline threshold, more than 85 percent resulted in higher prices.<sup>91</sup> The evidence is even clearer when looking at a different, but related, measure of the number of competitors in an industry. Of industries with six or fewer remaining competitors post-merger, nearly 95 percent of mergers resulted in anticompetitive outcomes.<sup>92</sup>

A strong presumption that concentration indices provide important information about potential anticompetitive outcomes seems warranted. When actively enforced, existing *Horizontal Merger Guidelines* presumptions would help establish factual predicates against anticompetitive mergers that the merging parties would then be able to counter.<sup>93</sup> Aggressively enforcing presumptions would provide further clarification of agency behavior for relevant stakeholders and ensure a more efficient and accurate process. Additionally, it would help shift the burden of proof back to merging parties, helping rebalance what has become a tendency toward permissiveness on the part of enforcement agencies and courts.<sup>94</sup>

### End safe harbor for mergers that fall below the guidelines upper threshold

Over the past two decades, challenges for mergers with HHI's less than 3000 have declined dramatically. The average rate of enforcement for all investigated mergers having HHIs less than 3000, went from nearly 70 percent from 1996 to 2003 to just approximately 12 percent from 2008 to 2011.<sup>95</sup> No enforcement actions have been taken against any mergers that resulted in six or more significant competitors.<sup>96</sup> Unfortunately, there is evidence that mergers in relatively concentrated industries whose HHI fall below current *Merger Guidelines* thresholds are not uniformly competitively benign.<sup>97</sup> As such, the current safe harbor treatment of these mergers should be reexamined.

## Require verifiable efficiency arguments

Merging entities should be forced to do more than just identify hypothetical efficiencies. Instead, it should be clear how savings from efficiencies will be passed along to consumers. Efficiencies have come to play major roles in merger review but, as Kwoka's group merger data shows, increased efficiencies are not always followed by price reductions.<sup>98</sup> Requiring merging parties to demonstrate how savings will be passed along to consumers will allow enforcement agencies to better understand and predict the consequences of a proposed merger and more effectively weigh the often imprecise tradeoffs that result from mergers.<sup>99</sup> Moreover, enforcement agencies should consider binding consent decrees subject over reasonable periods for approved mergers in order to enable decisive post-acquisition enforcement if the combined entity behaves anticompetitively.

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## Revise the DOJ and FTC guidelines for vertical agreements

Vertical mergers—along supply or production chains—have the potential to create market power by establishing barriers to entry or raising rival's costs. However, as is noted by Steven Salop and Daniel Culley, the *Vertical Merger Guidelines* have not been updated since 1984, making them unrepresentative of both present economic thinking as well as current enforcement agency practice.<sup>100</sup> This leaves the enforcement agencies without a sufficient analytic framework to conduct reviews of vertical agreements.<sup>101</sup>

There is a growing body of evidence showing that vertical integration has the capacity to produce anticompetitive exclusion, collusion, and other competitive harms.<sup>102</sup> In particular, it is important to enable the competition agencies to prevent anticompetitive conduct in a digital, networked economic environment. When network effects are strong, or interoperability is competitively important, as they are in many digital products and platforms, the anticompetitive effects of vertical integration can be large.<sup>103</sup>

There is no question that mobile phones and corresponding mobile operating systems are, as economist and antitrust expert David Evans notes, “central to a vast ecosystem that enables people to obtain various products and services through mobile devices.”<sup>104</sup> Given the increasing importance of digital commerce and data, as well as the centrality of platforms to this sector of the economy, vertical

integration and its effect on competition is likely to become more important in the future. The *Vertical Merger Guidelines* ought to be revised to reflect up-to-date antitrust analysis, and then vigorously applied.

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## Increase focus on anticompetitive conduct by dominant firms

Dominant firms can act to preserve their market power through a variety of unilateral strategies. For example, they can refuse to deal with customers of rivals in order to weaken the rival, exclude rivals from participating on platforms they control, or refuse to deal directly with rivals when that interaction would allow for effective competition.

While these and other exclusionary or predatory strategies may help preserve the profitability of dominant firms, they keep prices elevated and stand in the way of innovation and technical progress.

In 2009, the DOJ recognized the increased importance of confronting the negative effects of unilateral conduct.<sup>105</sup> It rejected earlier DOJ efforts to emphasize the risks of so-called over deterrence, the possible efficiencies produced by dominant firms, and the presumption that monopoly markets are generally self-correcting. However, between 2009 and 2014, the DOJ brought only one unilateral conduct case.<sup>106</sup>

With insufficient data to explain the dearth of enforcement actions, one can only conjecture that the complexity of identifying exclusionary or predatory behavior, together with the hurdles erected by court precedents that favor doing nothing, have created significant obstacles.

However, there appear to be ways around these roadblocks. The successful case brought against Intel, described above, shows that vigorous use of Section 5 of the FTC Act, which may have a broader reach than Section 2 of the Sherman Act, provides the FTC with a way to address these issues.<sup>107</sup> In addition, the DOJ has the option to set helpful precedent—such as *Lorain Journal Co. v. United States*, *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, and *Microsoft Corporation v. United States of America*—against precedent emphasizing over-deterrence and efficiencies.<sup>108</sup> Neither tactic may work perfectly, but the potential benefits make it important for both the FTC and DOJ to try them.

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## Make antitrust enforcement more transparent

### Incorporate a so-called network of experts

More eyes are needed to help assess the consolidation and anticompetitive practices that have been occurring across industries. Take for example the efforts of the U.S. Food and Drug Administration, or FDA. Similar to the workload of enforcement agencies, the FDA, specifically an office called the Center for Devices and Radiological Health, or CDRH, reviews and approves pre-market medical devices, making a determination if the devices are safe and effective enough to come to market.<sup>109</sup> Much like mergers, reviews of new products of often complex, requiring specific supplemental expertise. CDRH is in the process of creating a Network of Experts to help expedite the medical review process and potentially reduce search costs associated with finding the right expert.<sup>110</sup>

The FTC and DOJ should establish a similar network for preliminary reviews of mergers and noncriminal cases. Under the Hart-Scott-Rodino Act, mergers of a given size must notify the FTC and DOJ of a pending merger.<sup>111</sup> This is followed by a 30-day waiting period for review. If a merger raises questions upon preliminary review, a “second request for information” is made and additional evidence is requested. Following second requests for information, agencies should do a targeted release of relevant information about the merger to appropriate and qualified outside experts from a pre-vetted network of experts. Any such information should be reviewed prior to release to ensure its publication does not compromise the competitiveness of the merging entities.

Creating such a network would allow the FTC and DOJ to more easily engage outside experts and researchers to help assess mergers and provide public comment, strengthening oversight and allowing for a more rigorous review. As Beth Noveck, former United States deputy chief technology officer, has stated in reference to the work of regulatory review, “using expert-network platforms can only democratize what are now comparatively closed processes that typically rely on the same people to participate.”<sup>112</sup>

## Require companies to submit post-merger data for a three- to four-year period

Federal agencies need to reform their approach to measuring policy effectiveness. While academic and agency-led retrospectives have allowed policymakers to examine, albeit in limited capacity, the efficacy of agency approaches to mergers, a more formal process of measuring outcomes should be established. The FTC and DOJ should require merging parties to submit data post-merger for a set number of years. This will enable the agencies to institutionalize a process by which they can evaluate efficiency claims made at the time of the merger, price effects of the merger, the outcomes of divestitures and conduct remedies, and other information. This comprehensive dataset can then be used to judge the effectiveness of agency actions and policy.

## Disclose more data on agency actions

In addition to releasing data on specific mergers, the FTC and DOJ should also regularly provide more data on their enforcement actions, along with divestitures, conduct remedies, and decisions not to act. The FTC is currently working on a report that examines 90 orders between 2006 and 2012 to “evaluate the effectiveness of the Commission’s orders in past merger cases where it has required a divestiture or other remedy.”<sup>113</sup> This is based on a previous study from 1999 on the Commission’s Divestiture process.<sup>114</sup> Similarly, agencies such as the Small Business Administration and the Securities and Exchange Commission should use their data collection abilities to provide insight on the market access challenges posed by market concentration and anticompetitive practices.

An annual or biannual performance report should also be composed by an independent body such as the Joint Economic Committee of Congress, or JEC, or by the Government Accountability Office, or GAO. Going beyond divestiture, this reporting effort should examine the respective agencies’ agendas, enforcement decisions, rationales for passing on merger challenges, as well as details on recent trends in market structure and barriers to entry. Any such report would include retrospective analyses of mergers, performed by either the JEC or GAO, or contracted out via research grants. This would provide Congress, as well as the FTC and DOJ, a thorough review of processes, potential gaps, and successes in enforcement. It will also allow the public to be kept abreast of the agencies’ activity.



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## Increase executive branch focus on competition policy

### Create executive branch competition advocates

While many federal agencies have no mandate to promote competition, they have experts who know particular industries and are well-placed to identify anticompetitive developments. For example, at the U.S. Department of Health and Human Services, there are analysts who monitor, among other analytics, noncompetitive trends in the hospital industry. Other executive branch agencies without competition mandates should have competition advocates who serve as resources to the enforcement agencies. To assure that the competition advocate would have unfettered access to an agencies' experts and information—while also respecting and supporting independent enforcement mandates of the DOJ and FTC including over regulated industries—the staffer should have legal status similar to that of an inspector general.

### Appoint a deputy director for competition policy at the National Economic Council

The competition advocates in individual agencies should work closely with a deputy director of the National Economic Council, whose job it would be to coordinate efforts across executive branch agencies and direct useful information related to anticompetitive developments to the DOJ and FTC. This position will keep the president and NEC director abreast of economic trends, push policies beyond antitrust enforcement to ensure strong competition, and leverage the president's convening power to promote a more robust and competitive market for American businesses. Although this policy will enhance the administration's focus on competition, the NEC deputy will be independent of and have no ability to intervene in the operations of the FTC or DOJ on antitrust decisions.

### Pick strong leaders at the FTC and DOJ

Antitrust leadership matters. From actively making the case for essential resources, including more funding and more staff, to spearheading a robust enforcement agenda, to outlining a reformed analytical framework for approaching both old and new problems, there is no question that strong,

knowledgeable leadership is an essential component for reviving competition policy. The next president must enlist able antitrust experts with strong vision and awareness of the costs of permissive enforcement.

### Increase antitrust enforcement staffing at DOJ and FTC

The FTC and DOJ need bigger budgets and larger staffs if competition policy is to play a more robust role. Thurman Arnold, head of the DOJ Antitrust Division under President Franklin D. Roosevelt, accomplished a great deal, but he did not do it alone. When Arnold became head of the division, he more than tripled his staff lawyers, allowing their caseloads to dramatically increase.<sup>115</sup> Moreover, many of the staffers brought in under Arnold gained the training and know-how to sustain the policy efforts long after his tenure had ended.<sup>116</sup> The DOJ has estimated that it needs nearly 100 more lawyers in the antitrust division.<sup>117</sup> A fully staffed Antitrust Division should be a priority for the next administration.

# Conclusion

The accumulation of market power is not a good thing. It distorts the distribution of income and the allocation of resources, reduces incentives for innovation, and underwrites rent-seeking manipulation of political and regulatory systems. Only those with market power applaud it.

There is, unfortunately, significant evidence that market power is increasing in parts of the U.S. economy. The long-run divergence in profit rates, the divorce between profitability and investment, the increasing concentration in many industries, and other data all point in this direction.

There is also evidence that antitrust enforcement, the intended safeguard against the growth of market power, has not functioned well in recent decades. Swayed by years of argumentation from conservatives, courts have erected hurdles to enforcement, and antitrust agencies themselves have become less aggressive. Retrospective studies of concentration-increasing mergers over that past couple of decades have shown that these mergers have often increased market power and led to higher prices.

To counter these developments, CAP advances a set of proposals designed to reinvigorate antitrust enforcement. To that end CAP has identified ways to increase executive branch focus on competition policy, improve merger review and enforcement, take a new approach to vertical combinations, and limit the expansion of market power by dominant firms, while at the same time making the process of antitrust enforcement more transparent to the public.

None of the changes proposed in this report require new statutory authority. They can be executed by vigorous leadership at the DOJ antitrust division, the FTC, and the White House. Given the potential gains, CAP believes there is a strong case for implementing these proposals.

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## Our Mission

The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action. Our aim is not just to change the conversation, but to change the country.

## Our Values

As progressives, we believe America should be a land of boundless opportunity, where people can climb the ladder of economic mobility. We believe we owe it to future generations to protect the planet and promote peace and shared global prosperity.

And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

## Our Approach

We develop new policy ideas, challenge the media to cover the issues that truly matter, and shape the national debate. With policy teams in major issue areas, American Progress can think creatively at the cross-section of traditional boundaries to develop ideas for policymakers that lead to real change. By employing an extensive communications and outreach effort that we adapt to a rapidly changing media landscape, we move our ideas aggressively in the national policy debate.

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