Prepared statement of

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Hearing on

"Does America Have a Monopoly Problem? Examining Concentration and Competition in the U.S. Economy"

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Chairman Lee, Ranking Member Klobuchar, and members of the subcommittee, thank you for offering me the privilege of appearing before you today.

I am currently Professor of the Practice of Law at Stanford Law School. Before joining the Stanford faculty in 2014, I practiced law for 43 years. Among other positions, I was a partner in the Washington, DC office of a multinational law firm, Acting Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, and Senior Vice President and General Counsel of Intel Corporation. Those experiences have, I believe, given me a broad and varied perspective on issues regarding competition policy and antitrust law.

The topic for today's hearing, "Does America Have a Monopoly Problem? Examining Concentration and Competition in the U.S. Economy," is important and quite broad. I will address the topic from the perspective of antitrust law. My conclusions are that the fundamental principles of antitrust law are sound but that some adjustments at the margins in the application of those principles might be desirable.

There is widespread concern about the distribution of power in America, and it seems clear that there is in America substantial and increasingly unequal distribution of income, wealth and political power. This is a serious problem, even assuming that those of us who have prospered during this period of growing inequality have earned their rewards and are entitled to them by some theory of just desserts. Large and enduring inequality undermines communities and reduces political stability.

Similarly, and perhaps related, there appears to be increasing concentration in some industries.[1] Several studies point to the conclusion that the largest few firms account for an increasing portion of sales and revenues in various industries and that an increasing portion of national income is captured by investors and a smaller portion by workers.[2] There is substantial uncertainty about the reasons for these trends. Factors that have been cited as possible explanations include growth of scale in global markets, network effects, and resulting scale economics and declining business investment. A recent paper by two Princeton economists suggests that low long-term interest rates might be responsible for increased concentration and reduced entry of new firms. Others blame suboptimal antitrust enforcement and other government failures, such as imprudent regulatory barriers to entry of new competitors.

[1] This issue and its implications for antitrust policy are discussed in Carl Shapiro, *Antitrust in a Time of Populism*, 61 International Journal of Industrial Organization 714 (2018).

[2] E.g., David Autor, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen. 2017. *Concentrating on the Fall of the Labor Share*, 107 American Economic Review 180 (2017).

Inequality and industry concentration are, however, not themselves antitrust problems. For several decades, antitrust law has been focused on prohibiting private conduct that reduces economic welfare. That is the meaning of the so-called "consumer welfare" standard, which I understand was the subject of a hearing of this subcommittee several months ago. The singular focus on economic welfare strengthens antitrust law because it provides a rigorous criterion by which to guide the evolution of antitrust doctrine. It also avoids the arbitrariness of decisions aimed at multiple and sometimes inconsistent objectives and thereby increases the accountability of antitrust decision makers, enhances the legitimacy of the antitrust laws, and promotes economic welfare.[3] Antitrust institutions are not well suited to assessing other objectives, such as reducing inequality or the wealth or political clout of large businesses or insulating jobs from market forces. Those objectives are best served by other laws.

While antitrust law is not directly concerned with concentration in industries, it is concerned with concentration in economic markets or, more precisely, with market power. A firm is said to have market power if it can profit for a sustained period by charging prices in excess of the competitive price.[4] The definition of monopoly power or monopoly is less precise, but it is generally understood to mean a great deal of market power. A firm that has market power might not exercise it by charging a high price. It might instead reduce quality or innovation or invest in strategies to exclude existing competitors or raise barriers to the entry of new competitors. All of those actions reduce economic welfare and harm customers.

Firms that face robust competition or a threat of substantial, likely and speedy entry by new competitors do not have market power because, if their prices were above competitive levels, they would lose so many sales to existing competitors or to new entrants that they would be better off reducing their prices. Economic markets are, therefore, defined with reference to competitors that constrain the prices of one another. Whether firms compete and constrain one another's prices depends on both how similar their products or services are and on the geographic areas in which they do business. As economic markets become more concentrated, there are fewer significant competitors, and firms are more likely to have some degree of market power.

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[3] These points are discussed at greater length in A. Douglas Melamed and Nicolas Petit, *The Misguided Assault on the Consumer Welfare Standard in the Age of Platform Markets*, Review of Industrial Organization (2019), available at http://link.springer.com/article/10.1007/s11151-019-09688-4

[4] This statement applies to markets in which one or more sellers have market power over customers. There are also markets in which buyers might have market power over suppliers. One such market is a labor market in which employers are the buyers and workers are the sellers. The analysis of buyer market power is a mirror image of the analysis of seller market power. For simplicity, I will refer only to seller market power except where otherwise specifically noted.

Industry concentration is very different from market concentration because industry concentration often encompasses firms in the same industry that are not in the same market and do not constrain one another's pricing. Assume, for example, that an industry consists of two separate markets, one in Utah and one in Minnesota; that each market has 5 firms; and that each of the 10 firms is separately owned. Now, suppose one firm in each market merges with a different firm in the other market. In that event, each market would have still 5 different competitors, but the number of firms in the industry would have declined from 10 to 5. The industry would be more concentrated, but there would be no change in the concentration of either the Utah market or the Minnesota market. In fact, if industry concentration reflects economies of scale or scope, increased industry concentration might mean lower prices or better products in both Utah and Minnesota. Industry concentration might matter for some purposes, but it does not necessarily imply anything about market power.

The antitrust issue, therefore, is whether America has a market power problem. That issue raises two basic questions: first, is there an excessive amount of, or a worrisome increase in, market power; second, if so, is antitrust law failing effectively to promote its economic welfare objective.

1. Is Market Power Increasing?

I do not know whether market power is increasing throughout the economy as a whole. I am not sure anyone does. Studies of which I am aware, however, suggest that market power might be increasing in at least some segments of the economy.

As I explained above, studies of industry concentration do not directly measure concentration in individual markets. Still, increases in industry concentration might be correlated with increases in market concentration. One reason is that in some industries, such as some involving the provision of online services, most or all of the firms in the industry compete in the same market. Another reason is that, even where there multiple local or specialized markets, firms in an industry often compete in multiple markets. To see this, let's change the example above to imagine that competitor A in Utah and competitor A in Minnesota are owned by the same firm and that that firm merges with competitor B in Utah. In that case, the merger would reduce the number of firms in the industry from 9 to 8 and thus cause an increase in industry concentration; and, because competitors A and B in Utah would then be commonly owned and the number of competitors in that market would decline from 5 to 4, it would cause an increase in concentration in the Utah market. Note, however, that, because each of the competitors in Minnesota would remain independently owned, the merger would not increase concentration in the Minnesota market.

Other studies are also suggestive of an increase in market power. Some studies have shown increases in price-cost margins.[5] There are several possible explanations, including scale economies and increased ratios of fixed to variable costs, but one possible explanation is increased market power.

Similarly, studies showing that labor's share of corporate earnings are declining relative to capital's share and relative to productivity suggest that employers might have market power in labor markets. Here, too, there are other possible explanations, and I will leave it to others more deeply knowledgeable than I about those studies to say which explanations are most likely to be correct.

More important, I think, are market-specific studies. As I understand it, the evidence seems quite persuasive with respect to certain industries, such as hospitals[6] and airlines, that have been the subject of a large number of mergers within individual markets in recent years. Professor Kwoka has done a great deal of work analyzing merger retrospectives that examine the effects of consummated mergers and has concluded that, overall, they suggest post-merger increases in market power.[7] Some disagree with that interpretation of the data, and I will leave that debate to others.

In addition, there are individual cases and anecdotes that suggest that there are market power problems in at least some specific markets. These involve the pharmaceutical industry,[8] credit cards,[9] and airlines,[10] among others.

In short, some firms certainly have market power, and it appears likely that there has been an increase in market power in at least some important markets in recent years.

2. Does Antitrust Law Need Fixing?

Concerns about market power, like concerns about corporate power in general, often lead quickly to discussions of antitrust law. But, as explained above, antitrust law is not ultimately about dispersing power. It is about economic welfare. While antitrust law is often thought to be arcane and obscure, it is conceptually rather simple. Antitrust law prohibits anticompetitive conduct that creates or maintains market power. There are two basic elements: anticompetitive conduct, which means conduct that is not efficiency-based

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[5] E.g., De Loecker, Jan, and Jan Eeckhout, *The Rise of Market Power and the Macroeconomic Implications*, NBER Working Paper No. 23687 (2017). http://www.nber.org/papers/w23687.pdf.

[6] See Martin Gaynor, *Examining the Impact of Health Care Consolidation*, Statement before the Committee on Energy and Commerce Oversight and Investigations Subcommittee, U.S. House of Representatives, February 14, 2018.

[7] John Kwoka, *Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy* (MIT Press 2015).

[8] E.g., FTC v. Actavis, Inc., 570 U.S. 136 (2013).

[9] E.g., Ohio v. American Express Company, 138 S. Ct. 355 (2018).

[10] E.g., United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003).

competition on the merits, and a resulting increase in market power or preservation of market power that would otherwise be diminished.[11]

An increase in market power does not violate the antitrust laws if it is the result of efficient conduct, like improving product quality, innovating, reducing cost, or reducing prices (as long as the prices are not below cost). There are good reasons for this principle. If antitrust law prohibited gaining market power by efficient conduct, it would reduce the incentives for firms to engage in the kind of aggressive competition that the antitrust laws are intended to promote. It would punish firms for being successful at precisely what we want them to do. If antitrust law were used to prevent firms from engaging in efficient conduct or to break up firms that achieved their position by such conduct, it would impose real costs on the economy by disrupting the most efficient means of doing business.

One can imagine in theory a different antitrust rule that called for no-fault antitrust intervention in the case of certain types of enduring monopolies. The intervention could take the form of restrictions on the conduct of monopoly firms or requirements that they divest certain assets or lines of business. Such a rule could in theory be consistent with sound antitrust principles if it were determined that the harms to economic welfare from permitting the monopoly to persist would exceed the harms from intervening in the absence of anticompetitive conduct. Similar rules have been suggested in the past, but they have not been adopted. One reason is that such a rule would be hard to reconcile with the statutes, which prohibit anticompetitive conduct – unreasonable "restraint of trade,"[12] monopolizing or attempting "to monopolize" a market,[13] and acquiring stock or assets under some circumstances[14] -- not just possessing monopoly power.

Another reason is that no one to my knowledge has set forth administrable criteria that would identify the rare case in which no fault intervention would be warranted and would increase economic welfare. Absent such criteria, no fault intervention would be a recipe for arbitrary and perhaps politically motivated decisions and antitrust interventions that reduce economic welfare by impairing, and reducing incentives for, innovation and efficient forms of commerce.

In short, I see no basis to abandon or alter the two basic elements of an antitrust violation, anticompetitive conduct and a resulting increase in market power. Antitrust law is sound in principle.

Saying that antitrust law is sound in principle, however, does not necessarily mean that antitrust law does not need improvement. If the merger studies that have been

[11] See A. Douglas Melamed, *Antitrust Law Is Not That Complicated*, 130 Hark. L. Rev. F. 163 (2017).
[12] Section 1 of the Sherman Act, 15 U.S.C. § 1.
[13] Section 2 of the Sherman Act, 15 U.S.C. § 2.
[14] Section 7 of the Clayton Act, 15 U.S.C. § 18.

discussed demonstrate that merger enforcement has sometimes been too lax and the experience with litigated cases suggests that courts have not been sufficiently receptive to antitrust claims, then antitrust law ought to be adjusted. The adjustment should focus, not on the basic principles of antitrust law, but on how those principles are applied in practice.

The basic antitrust statutes are short, imprecise and more than 100 years old. Their meaning has evolved by a common law-like process, by which legal doctrine changes in response to new experience and new learning. As you know, there was a major change in the antitrust laws roughly 40 years ago that was spurred by the so-called "Chicago School" of economists and lawyers. They made many important and enduring contributions to antitrust law. They also embraced a number of factual and economic propositions that have not stood the test of time.[15] For example, leading Chicago School advocates believed in the 1970s that vertical agreements could never harm competition and that they could be presumed to be efficient. We have learned since then that that is not correct. The courts, I am afraid, as is perhaps typical in a common law process, have been slow to accept the new learning.

I want to focus on one such proposition that I think is central to the question whether antitrust law needs fixing. Before I do so, I want to make explicit a fact about which I think there is little dispute: Most antitrust matters require decisions about which there is real uncertainty. Some antitrust cases are simple -- for example, a price fixing case regarding past conduct proven by unequivocal evidence – and involve little uncertainty. But most cases require decisions in the face of uncertainty about such important questions as whether firm A will compete with firm B in the future, whether a contract will make innovation more likely or less likely, whether firm C is likely to decline, whether a new product design actually improves the product or is just a contrivance to harm a competitor, and so on. Antitrust law often uses shorthands and presumptions to resolve such issues, but the uncertainty usually cannot be entirely eliminated.

The Chicago School proposition that I think is so important is the notion that false positives – mistaken determinations that the conduct or transaction in question was anticompetitive – are more serious than false negatives – mistaken determinations that the conduct or transaction was not anticompetitive. The basis for the proposition, to oversimplify, is the belief that false positives entail government decisions that are final but false negatives entail creation of market power that will soon be eroded by new entry and other forms of competition.[16]

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[15] *See generally* Jonathan B. Baker, *Taking the Error Out of 'Error Cost' Analysis: What's Wrong with Antitrust' S Right*, 80 ANTITRUST L. J. 1 (2015) (hereinafter "*Error Cost*").

[16] The classic statement of this proposition is Frank Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. 134 (1984). The proposition is criticized in *Error Cost* at note 15 above.

Current antitrust law embodies that proposition in many different ways, both explicitly and implicitly. Some aspects of legal doctrine are shaped explicitly to reduce the likelihood of finding an antitrust violation when the fact-finder cannot be certain about the facts. These include the law regarding predatory pricing and unilateral refusals to deal. More generally, and more importantly, antitrust courts sometimes demand that plaintiffs prove key elements of their case with a precision that is literally impossible because the facts that are supposed to be proved directly are not observable.[17] It is at least a bit ironic that we can convict someone of murder on the basis of circumstantial evidence, but courts often seem unwilling to find that a firm engaged in anticompetitive conduct on the basis of circumstantial evidence.

This unwillingness is illustrated by the recent Supreme Court decision in the *American Express* case.[18] The district court in that case found that the defendant had increased price on numerous occasions with no material loss of or offsetting benefits to cardholders or merchants and had imposed restraints that diminished competition between the defendant and its competitors. But the 5-Justice majority in the Supreme Court held that those findings were not sufficient to permit an inference that the defendant had market power and that the plaintiffs were required also to define and prove the boundaries of the market in which the defendant did business. Similarly, the majority held that findings by the district court that the restraints reduced incentives for price competition, led to higher prices by both defendant and its competitors and caused customers of defendant's competitors to pay part of the cost of the services provided by defendant to its customers were not sufficient to permit an inference that the restraints were anticompetitive. The kinds of proof that the majority required made it all but impossible for the plaintiffs to prevail.

Decisions like this, I believe, reflect an unwillingness to run any meaningful risk of a false positive even in the face of a much greater risk of a false negative. That unwillingness not only drives the outcome in litigated cases but also influences enforcement decisions by government agencies and private parties, who naturally avoid bringing cases that they think will fail in court, even if they believe them to be well-founded.

I think it is time to consider recalibrating the relative tolerance of the antitrust laws for the risk of false positives and the risk of false negatives, either in general or with respect to certain types of industries or certain aspects of antitrust law such as horizontal mergers. One might conclude after careful study that antitrust law should in some or all respects be less tolerant of the risk of false negatives even if that means an increased risk of false positives. Such a conclusion might be based on findings, for example, that false negatives

[17] See, e.g., United States v. AMR Corp., at note 10 above.
[18] See note 9 above.

are costlier than previously thought because entry barriers are greater and market power is longer lasting or on findings that antitrust enforcement has fallen short, and false negatives are more common than previously thought, in certain markets or with respect to certain kinds of conduct. Or the conclusion might be based on findings that the costs of false positives are relatively insubstantial in some circumstances because parties are able to find other means to achieve genuine efficiencies or that the likelihood of false positives is less than previously thought because of improved tools to assess horizontal mergers or an improved understanding of the economic effects of certain types of vertical agreements.

Horizontal mergers might be an especially fruitful area for such an inquiry. This is so for three reasons. First, there are studies that suggest underenforcement, i.e., false negatives, in the past. Second, there are studies that suggest parties often fail to realize anticipated efficiencies from mergers and, thus, that the costs of false positives might be less than previously thought. Third, merger enforcement is largely a matter for the expert enforcement agencies, and adjusting the legal standards for merger enforcement is therefore less likely to lead to abuse by private litigants.

Antitrust law has ample tools to implement such a recalibration. Courts could do so by, for example, adopting presumptions such as the presumption regarding horizontal mergers set forth by the Supreme Court in *United States v. Philadelphia National Bank*[19] or evidentiary shortcuts like the Court's decision that an antitrust violation can be proven without defining a market in certain kinds of cases.[20] Or courts might relax evidentiary requirements with respect to certain matters where direct proof is almost never discoverable.

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I want to close with a note of caution. Antitrust law has served this country very well. Its most important benefit is found, not in the litigated cases, but in the multitude of anticompetitive actions and transactions that have not taken place because they were deterred by the antitrust laws and in the multitude of efficient and welfare enhancing transactions and actions that have occurred and have not been deterred by an overly broad or ambiguous antitrust law.

The matters we are discussing today are at the margins of antitrust enforcement. Antitrust law should be adjusted, if at all, only after careful study and only at the margins.

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[19] 374 U.S. 321 (1963). See, e.g., Herbert Hovenkamp and Carl Shapiro, *Horizontal Mergers, Market Structure, and Burdens of Proof*, 127 Yale L. J. 1996 (2018).

[20] E.g., FTC v Indiana Federation of Dentists, 476 U.S.447 (1987).