

# **Economics in Antitrust: A US Perspective**

AEI/Brookings, Brussels



# OUTLINE

- I. Economists: use and organization
- II. Merger Enforcement R&D
- III. Vertical Enforcement R&D
- IV. Merger Simulation
- V. Price Discrimination

# I. Economists: Use and Organization

# What Good are Economists?

The development and implementation, competition policy requires the perspective and discipline of economics.

- Formulating policy
- Making enforcement decisions
- B

When economics is ignored by  
policymakers

When policy gets ahead of economics

# Formulating Policy

Industrial organization economics is the intellectual foundation of competition policy.

Sound policy formulation entails a restatement of mainstream economic principles, while properly accounting for legal and practical constraints.

Enforcement R&D

## Development of better theories

- And TESTING them
- Must be practicable

## Study enforcement actions and non-actions

- Merger retrospectives
- Non-merger retrospectives



## Organization: Functional vs. M-form or “Divisional”

- Functional expertise vs. faster decision making

Functional Organization: Requires strong senior management because economists often reach different conclusions than attorneys

- DOJ and FTC

Divisional Organization: making economists report to attorneys reduces functional expertise.

- GAO
- FTC (1953 to 1961)

## II. Merger Enforcement R&D



Combination of marketing and refining assets of two major refiners in Midwest

First of recent wave of petroleum mergers

– January 1998

Not Challenged by Antitrust Agencies

Change in concentration from combination of assets *less* than subsequent mergers that were modified by FTC



# Baby Food Merger

2000: FTC Blocks \$185 MM Merger Deal

– Efficiency claims vs. 3 2 merger

2002: Heinz sells off several branded product lines to Del Monte – Natural Goodness baby food included

Ultimate fate of Natural Goodness brand remains a question mark.

# Baby Food Shares Since Merger

US Baby Food Market Shares		
Firm	Market Shares mid 2000	Market Shares late 2003
Gerber	73	80
Heinz (Del Monte after 12-02)	11	7
Beech-Nut	13	10

# III. Non Merger Enforcement R&D



1977 “Preemptive Capacity Expansion” Michael Spence, Bell Journal, 1977

- Not testable, built on “virtual” parameters

1978-80, TiO<sub>2</sub> case built on “possibility theorem,” i.e., there exists a theory that would fit these facts

Pro-competitive alternate explanation: Dupont had most efficient technology, logical one to expand.

Is there a way to tell them apart?

- Who bears burden of proof?

# Is Policy on Vertical Restraints “Ahead” of the Economics

The so-called “post-Chicago” literature is very good at generating possibility theorems

– But not very good at testing them

Science of economics requires testing to move forward

# Evidence on Vertical Integration

Natural Experiment across US States with and without “divorcement laws”

- Gasoline “divorcement” laws restrict vertical integration of gasoline refiners and retailers.

Experimental group (with divorcement)

- Six states (Hawaii, Connecticut, Delaware, Maryland, Nevada, Virginia), and DC

Control Group (without divorcement laws)

# Evidence on Vertical Integration (continued)

Divorcement raises the price of gasoline by about 2.7¢ per gallon (loss of \$100 million in consumers' surplus annually).

Vertical integration REDUCES price

Michael Vita (FTC), “Regulatory Restrictions on Vertical Integration ... ,” *J. of Regulatory Economics*,” 18 (2000), 217-33).

# IV. Merger Simulation

# Litigation Poses Difficult Questions

What would profits have been absent some illegal behavior?

- Patent infringement
- Antitrust violation

Will this merger raise price?

How much did this conspiracy raise price?

These questions compare two states of the world, but only one is observed

# How Do We Predict the Unobserved State of the World?

## Natural experiments

- Only as good as the data

## Classroom experiments

- FCC used experiment to predict effects of ATT-Comcast

## Structural models

- Driven by behavioral assumptions





Can focus investigation by identifying:

- “What” matters, “why,” and “how much”
- Offer way to weigh efficiencies against anticompetitive effects

But if don't fit the facts

- Misleading predictions
- Divert attention from more probative analysis



## Ten years building merger models

- Focus on methodological innovation

## Dave Scheffman critique

- “fit accompli”: Does the model fit the facts?
- Makes cases too easy to bring (false positives)
- Huge logical leap from retail elasticities to upstream price increases

What about intermediate steps?

# From Vanderbilt to the FTC

	Academic	Practitioner
Concern	Methodological innovation	How well is methodology applied to case
Outcome	Demonstrate policy tradeoffs	Need an answer
Check & balance	Peer review	Adversarial litigation

## “A Daubert Discipline for Merger Simulation”

- Gregory J. Werden, Senior Economic Counsel, U.S. Department of Justice
- David Scheffman, LECG & Adjunct Professor at Vanderbilt

If you use models, must fit facts of case

Every assumption should be:

- supported by evidence, or
- subject to sensitivity analysis

Mergers vs. Damages

# Misuse of Structural Models

Finding facts to fit the model

- Beware of answers looking for questions
- Looking under street lamps for lost keys

Inadequate data

Unsupported assumptions that drive results

Point estimates with no sensitivity analysis

Not appropriate in many cases