United States of America
Federal Trade Commission

Does the U.S. Economy Lack Competition, And If So What To Do About It?

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I. Introduction

Good evening, and thank you for inviting me to address this distinguished audience. It is a pleasure to be in Hong Kong and to discuss emerging issues in the world of competition law. Tonight, I will address a topical issue that has received international attention.

Specifically, does the United States have a monopoly problem? Several prominent voices have raised this concern. In two thought-provoking articles in March, The Economist wrote that American firms' profits are too high.[2] It questioned why "steep earnings are not luring in new entrants" and worried that companies may be "abusing monopoly positions[,] or using lobbying to stifle competition."[3] Among other steps, it called on the U.S. government to modernize its antitrust apparatus, loosen copyright and patent laws, and scrutinize technology platforms like

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[1] Too much of a good thing: Profits are too high. America needs a giant dose of competition, THE ECONOMIST, Mar. 26, 2016; The problem with profits: Big firms in the United States have never had it so good. Time for more competition, THE ECONOMIST, Mar. 26, 2016.

[3] Id.

Google and Facebook.[4] In short, its prescription was that "America needs a giant dose of competition."[5]

The Economist's call for greater competition is not the only one.[6] Last month, the Council of Economic Advisers (CEA) wrote that "competition appears to be declining in at least part of the economy."[7] It found evidence that industry concentration is rising, firms are enjoying higher rents, and dynamism is declining.[8] In stronger terms, Paul Krugman asserted in April that

anticompetitive behavior, but try to create more competition. They propose steps like weakening patent rights, opposing merger-driven consolidation even if anticompetitive effects are unclear, and potentially imposing mandatory-sharing duties on technology firms that have amassed more data than their rivals.[13]

The recurring theme of these critiques and proposals is that America must do more to promote competition. Collectively, these developments raise serious questions. That is especially true for those, like me, who enforce U.S. competition policy. Before coming to any sound conclusions, however, one must consider whether those claims of pervasive monopoly reflect accurate analysis of probative data. Next, even if the diagnosis of a monopoly problem is correct, do these commentators accurately identify the cause and, even more importantly, how to cure it?

Tonight, I will evaluate the factual and theoretical foundations of this commentary. I will also examine whether antitrust officials should be doing more, as some have argued. Finally, I will consider (aum)-4(t)19Pa(3(-6(t)-4(v)6(a.)5(.)-17ak(s)1()-1-2(in)-r)5nu (or)3(e)e h)-15(ye)6(2(n)2-17)-4(

and other realities conspire against the textbook model of "perfect competition," rendering it an inappropriate benchmark.[14]

A more workable approach may be, first, to identify artificial impediments to competition in today's economy and, second, to evaluate whether their benefits justify the costs imposed. There can be no question that the American economy, like many others, is laden with such restrictions, many of which protect special interests from competition. Consumer advocates should work to repeal such laws. We also need to ask hard questions about antitrust enforcement and larger economic policy, such as how to foster innovation. But, standing on its own, the claim that U.S. industry needs more competition is simultaneously true and trite.

It is more difficult, and perhaps less fruitful, to evaluate the state of competition in an economy. As I mentioned, the appropriate benchmark is not obvious. Certainly, we can look for indicia of robust, competitive processes, such as high industrial output, innovation, productive efficiencies, employment, and investment. By contrast, enduring supranormal economic rents-6C(s)1(

compliment The Economist, CEA, and others for contributing to an important conversation. We should continuously scrutinize the status quo, ask how we can stoke the economy by promoting competition, and evaluate

the acquisition of scale economics, innovation, mergers, acquisitions, and regulatory barriers to entry.[20] Like The Economist, the CEA uses industry concentration data collected by the U.S. Census Bureau.[21]

I believe that The Economist, the CEA, and other draw flawed conclusions by extrapolating the existence of monopoly power from industry concentration and accounting profits. In other words, they trace a causal relationship from consolidation to market power to supracompetitive rents. If that strikes you as familiar, it is because it reflects the Structure-Conduct-Performance (SCP) paradigm that once reigned within industrial organization (IO). Between the 1930s and 1960s, IO economists studied industries to connect (1) structure (i.e., concentration) to (2) conduct (i.e., the exercise of market power through unilateral or coordinated effects) to (3) performance (i.e., supranormal profits).

Today, that approach is discredited for several reasons. I shall briefly touch on a few of them relevant to the claims about monopoly within the U.S. economy.

First, it is wrong to infer a causal relationship between industry structure, market power, and profit. In its classic form, the SCP literature supposed that higher concentration gives incumbent firms more market power, which they exercise to enjoy supranormal profits. But there is little empirical support for such a one-directional causal relationship.[22]

Yet, those proclaiming an absence of competition today seem to fall prey to those earlier errors. The articles and op-eds that I have discussed observe that U.S. firms have high accounting profits and that U.S. industries (loosely defined) are becoming more concentrated. They infer that high profits reflect a lack of competition associated with market structure. That is the same fallacious reasoning to which the classic SCP approach succumbed. Notably, only the CEA alluded to

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policies that reduce concentration by increasing the number of firms. Their worst prescription is mandatory sharing through prescriptive ex ante regulation, which may reduce innovation and lead to a reduction in dynamic competition. That “solution” is none at all.

A. The FTC and DOJ Effectively Enforce Competition Law

What about antitrust? Some critics argue that the FTC and DOJ must enforce competition law more aggressively.[27] Optimal enforcement, however, must reflect the competitive realities of each market in which a restraint, practice, or merger arises. That means not intervening when an investigation reveals a lack of harm to competition, despite what reporters or professors might say later.

Some commentators suggest that antitrust should prevent merger-driven consolidation in itself.[28] But banning a merger on antitrust grounds simply because the firms are big would be to pursue a goal other than protecting competition. The era when antitrust promoted populist goals, typically at consumers’ expense, is rightly behind us. Efficiencies are real and, depending on the industry, scale can be critical to effective competition. In short, better enforcement does not always mean more enforcement.

An equally problematic argument is that the FTC and DOJ should challenge every merger that involves some worrisome horizontal overlap, instead of agreeing upon divestitures that remedy the potential loss of competition.[29] Such calls are unrealistic. To sue to enjoin every merger that involves a competitive overlap would require enormous resources. The agencies

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[27] See supra notes 2, 9-10; see also infra note 31.

[28] See id.

[29] See Khan, supra note 12 (arguing that “the agency should commit to blocking anticompetitive mergers outright, rather than trying to fix them by regulating conduct or forcing merged companies to divest parts of their businesses as has been the trend in recent decades”); David Balto & James Kovacs, Health Insurance Merger Frenzy: Why DOJ Must Say No, LAW360 (Aug. 17, 2015, 5:59 PM) (observing that “the antitrust enforcement agencies have remedied anti-competitive mergers though cut and paste divestitures, requiring spinoffs of assets where there are competitive overlaps” but arguing—if only the context of health insurance mergers—that “limited divestitures are inadequate and the right course is simply to block the merger”); see also JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY (2014) (questioning the efficacy of the agencies’ divestiture orders in protecting against post-merger price increases).

must also prevail in court, which is unlikely when the merging parties could point to a simple fix that would remove the competitive issue.

More generally, in my view, properly calibrated divestitures are effective mechanisms both for protecting competition and for allowing merging parties to realize efficiencies. The agencies closely scrutinize the effectiveness of their remedies. Indeed, the FTC is currently doing a retrospective study of its remedial orders in ninety mergers between 2006 and 2012, building on its 1999 divestiture study.[30] The FTC will continue to refine the sophistication of its antitrust

I am proud of the agency's achievements, which are too lengthy to recount here. To offer but a brief example, I suggest one consider the FTC's Section 6(b) study of healthcare mergers in 2002, following a spate of losses in the area for both antitrust agencies.[35] With the benefit of its findings, the FTC launched a period of extraordinarily successful antitrust challenges to allegedly anticompetitive healthcare mergers.[36] Its only setback since 2002 occurred just last month, when a district court refused to enjoin a merger between Pinnacle's and Hershey's healthcare systems in Pennsylvania.[37] That matter is presently on appeal to the Third Circuit.

Even beyond healthcare mergers, the FTC has done much to protect competition in the life-sciences industry. The agency fought for years to challenge pay-for-delay agreements, ultimately resulting in the Supreme Court's rejection of the scope-of-the-patent test in *Actavis* in 2013.[38] The Commission continues aggressively to challenge anticompetitive conduct in the pharmaceutical industry. Its most recent action in a pay-for-delay case came just two months ago in *Endo*.[39]

Perhaps most importantly, the FTC has opposed private restrictions on competition cloaked as government action. It has done so, in part, through successive wins at the Supreme

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Court in Phoebe Putney and North Carolina Dental.[40] Both decisions, of course, narrowed the state-action-immunity doctrine. And where governments contemplate anticompetitive legislation, the FTC's advocacy program is a powerful voice for consumers.

That brief account, of course, says nothing of the DOJ's active enforcement of the antitrust laws. This year the Justice Department stopped the Halliburton-Baker Hughes deal,[41] challenged United Airlines' proposed acquisition of various takeoff and landing slots at Newark Airport from Delta Airlines,[42] and prevailed in its controversial action against Apple and five book-publishing companies for conspiring to fix the price of e-books.[43] Prominent examples from last year include the DOJ's case against American Express's anti-steering rules[44] and preventing the GE-Electrolux, C(t o)6(h)c4pu33 0 Td [5Bc185 0 Td (-)Tj -0.0Tmce D Wst4 Tc Tw 0.,d [(

Looking at the FTC's and DOJ's recent antitrust enforcement, I see expert agencies that aggressively litigate cases, scrutinize mergers to protect competition and to facilitate efficiencies, and rigorously identify anticompetitive effects. The agencies' analysis today is data-driven, empirical, and nuanced. The agencies act with discretion, closing cases when a careful assessment of the facts reveals no harm to competition. But neither agency shies away from bringing difficult matters, where there is reason to believe an antitrust violation has occurred and where intervention is in the public interest.

In Steris last year, for example, the FTC failed in challenging a merger based on a loss of potential competition.[54] The court did not accept the quantum of evidence presented about the likelihood of entry but for the merger. And in Lundbeck the agency lost on narrow market definition grounds its case against the acquisition of a patented drug that preceded a 1300% price increase.[55]

What to make of losses like Steris and Lundbeck? Setbacks of that nature reflect a healthy enforcement agenda. The DOJ and FTC have grown to be sophisticated enforcers precisely because the courts hold them to their proof. I welcome the high standards set by the judiciary and relish the challenge of litigating against some of the country's finest lawyers. Sometimes the courts will get it wrong and so, too, will the agencies. But the critical point is that an optimal system of agency design and appellate review will inevitably produce a win rate of less than 100% for the FTC and DOJ. It also bears noting that the federal courts have been instrumental in injecting U.S. antitrust law with an economic sophistication that was fully absent before the 1970s.

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[54] FTC v. Steris Corp., 133 F. Supp. 3d 962 (N.D. Ohio Sept. 24, 2015).
[55] FTC v. Lundbeck, Inc., 650 F.3d 1236 (8th Cir. 2011).

C. Proposals to Weaken Intellectual-Property Laws Are Misguided

I have explained why the government should not expand antitrust liability to solve a claimed monopoly problem. Beyond antitrust, however, critics also blame the patent system for entrenched monopoly.

The Economist, in particular, calls for "a loosening of the rules that give too much protection to some intellectual-property rights."[56] Finding a disproportionate share of abnormal profits flowing from the healthcare industry, the newspaper questions the "patents that allow firms temporary monopolies on innovative new drugs and inventions."[57] And it queries the FTC's and DOJ's capabilities to remedy inadequate competition because they "cannot consider whether the length and security of patents is excessive in an age when intellectual property is so important."[58]

Those proposals are troubling. It has become popular to question the IP system. But I fear that stakeholders who would benefit from diluted patent rights have effectively leveraged some legitimate grievances into something larger.[59] Some critics even call for outright abolition of the patent system.[60]

In an article forthcoming at the Harvard Journal of Law and Technology, I find abundant evidence consistent with the proposition that a strong patent system encourages R&D investment

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[56] Too much of a good thing, supra note 2.
[57] Id.
[58] Id.
[59] To be sure, some firms have abused the patent system. On occasion, the FTC has intervened to bring such abuse to a close. See, e.g., In re MPHJ Tech. Investments, LLC, File No. 142-3003, https://www.ftc.gov/enforcement/cases-proceedings/142-3003/mphj-technology-investments-llc-matter; Press Release, Fed. Trade Comm'n, FTC Approves Final Order Barring Patent Assertion Entity from Using Deceptive Tactics (Mar. 17, 2015), https://www.ftc.gov/news-events/press-releases/2015/03/ftc-approves-final-order-barring-patent-assertion-entity-using.
[60] See MICHELE BOLDRIN & DAVID K. LEVINE, AGAINST INTELLECTUAL MONOPOLY (2010); see also ADAM B. JAFFE & JOSH LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT N40 9.96 23 (,)Tj 8.0R0.006 Tw 8.04 0 0 8.04 1 Tm 8 0 0 8.04 272.641d [( )-179 Tw 8.0

and economic growth.[61] The econometric and survey literature in the field finds that patents are indispensable to innovation in the life-sciences industry, which makes The Economist's issue with drug patents odd.[62] In some industries, factors like first-mover advantage and trade secrecy are sometimes more important to some inventors than patents, but the evidence shows that many inventors in those fields regard patents as important appropriation mechanisms, too.[63]

America is the world's most innovative economy. A strong patent system lies at the heart of its innovation platform, even enjoying explicit constitutional recognition.[64] Leading studies find a positive correlation between patent protection, private firm R&D, and macroeconomic growth, at least in developed countries.[65] And it is clear that firms respond to changes in patent protection.[66] Patent scope and innovation may have an inverse relationship,[67] but given what we know it would be r-( )]TJ22(a)4(nd i)-2(nnova)4(t)-2(i)f( )]TJ 0.00ha scope9J -0.004 Tc 0.0h62 Tc 0

percentage of patent claims that it had deemed worthy to review.[69] Further, the Supreme Court has taken many patent cases recently to rein in perceived abuses. Its Alice decision, in particular, limited the patentability of computer-implemented processes.[70] That decision has resulted in the invalidation of many abstract, software-related patents that were popular with patent-assertion entities.[71] Collectively, such developments represent a sea change for patentees. It would be wise to let these steps' collective effects work their course before adopting radical policy changes.

There is every reason to think that the U.S. patent system is an important driver of R&D and hence competition. But if patents work effectively in a given industry, the result may well be higher concentration. Far from a symptom of sickness, high concentration in a relevant market due to important patents may reflect dynamic efficiency and competition in the laboratory.

The Council of Economic Advisers, for its part, recognizes that "[a]llowing firms to exercise the market power" flowing from a worthy patent grant can "promote long term economic growth."[72] I agree with its view that patent assertion may not be socially productive "if a firm's business model is to earn profits by asserting royalty rights to patents it knows to be invalid under threat of costly patent litigation."[73] The extent to which that theoretical danger materializes in the real world, however, is unclear. Rhetoric has too often crowded out evidence,

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[69] The implications of the high invalidation rate before the PTAB are subject to competing interpretations. See, e.g., Rochelle Cooper Dreyfuss, Giving the Federal Circuit a Run for its Money: Challenging Patents in the PTAB, 91 NOTRE DAME L. REV. 235, 250-56 (2015).

[70] Alice Corp. v. CLS Bank Int'l, 134 S. Ct. 2347 (2014); see also Octane Fitness, LLC v. ICON Health & Fitness,

especially given broad attacks against so-called "patent trolls." In that respect, I look forward to the FTC's forthcoming Section 6(b) study on PAEs.[74]

IV. What Is the Right Way to Promote Competition?

To recap, claims of abundant monopoly derive from faulty analysis, and demands for more aggressive enforcement are unrealistic at best and damaging at worst. Nevertheless, the U.S. economy can benefit from more competition. What, then, is the appropriate policy response? We are already clamping down on price-fixing cartels, anticompetitive mergers, and predatory conduct. And our IP laws fuel America's uniquely successful innovation economy. To my mind, an obvious hole in competition policy lies in government itself, and that is where I propose further procompetitive efforts should focus.

As an FTC Commissioner, and in my former role as Director of the FTC's Office of Policy Planning, I have opposed unjustified, state limits on entry. Anticompetitive laws and regulations arise in two distinct settings. In "Mother, May I?" cases, the government controls entry into a profession or trade. One danger is political capture, whereby incumbents influence the passage of protectionist laws. But even well-intentioned regulations can reduce consumer welfare. That is most likely to occur whe

they act via a designated state agency.[79] And if states wish to limit competition, they must do so

dispassionately at the empirical evidence, and recognizes the economic activity that relies on patent-related investments, there are good reasons to favor strong patent protection.

Finally, a loophole in today's antitrust enforcement is government restrictions on entry. Well-crafted regulations inform and protect consumers, but too often they become overbearing and, sometimes, blatantly exclusionary. Governments and consumer-advocacy groups should take a hard look at occupational-licensi(r)n thes and cnd (nd0 Tw 22.2)-4(mp)(ic)6at th a5(ic) th l (r