FTC Hearing #1: Competition and Consumer Protection in the 21st Century
September 13, 2018
Segment 2
Transcript

SPEAKER 1: We'll get started in a minute or so. Let people come in if they're trying to hit the 1:30 mark.

I'm just going to say welcome back, and remind people in the audience who are new people that two of my colleagues, maybe more, are collecting questions that you may write on the question card, and they'll be brought up to the panel near the end of the panel for some audience Q&A. So with that, I'm going to turn this over to Greg Werden from the Antitrust Division, and he's going to discuss with the panel whether the US economy has become more concentrated and less competitive.

GREGORY WERDEN: Thank you. I'm not a fan of introductions, so I will not introduce our speakers. They can introduce themselves if they want to spend their time that way. They have total control over time. The way we0 (w)tback for these today. So the FTC hearings two decades ago, that I just by two challenges for antitrust policy. Markets were becoming increasingly global, and innovation competition was becoming increasingly important. And today, we have an additional challenge for antitrust policy. The economic evidence has been accumulating since the 1995 hearings, and much of it from the past five years or so, that shows that market power has been growing for decades. And I think of what we are seeing as today's antitrust paradox. A conjunction of substantial and widening market power with well-established and extensive antitrust institutions. In my presentation, I'll sketch the evidence that market power has been growing over the past quarter century, and has become substantial in the United States. And I'm going to go through nine reasons, none of them is individually decisive. There are ways to question or push back on each, but their weaknesses are different. And so when you take them collectively, they paint a compelling picture of growing market power. And I'm also going to explain why the recent economic trends I point to reflect growing market power, not solely increased scale economies and temporary rents to early adopters of new technologies in competitive markets. To fit my present into the alotted time, I will say less about most of the reasons than will appear on the slides, and the very last slide will reference my forthcoming book. The first chapter of which goes into more detail on this topic, including full cites for the research that's referenced on the slides. And it will also mention criticisms of the research that I don't have time to bring up in my presentation, although I'd be happy to talk about them during our discussion later. Before I get into the nine reasons, I want to make clear what I mean when I use the term market power. Firms exercise market power in their output markets as sellers by

raising prices or by altering other terms of trade adversely to buyers, relative to what would prevail in a competitive market. Market power is not just about prices, it can be exercised on other competitive dimensions too. And market power can also be exercised in input markets, exercised by buyers. And that's defined analogously. The first of the nine reasons to think that

Fifth, the increased equity ownership of rival firms by the diversified financial investors is another reason to worry about growing market power. Rival airlines or banks or pharmacy chains or other competing firms increasingly have overlapping ownership by financial firms like

growth in productivity gains from entrants to incumbents, and a growing gap in accounting profitability between the most and the least profitable firms.

So I've interpreted the evidence in these nine categories that I highlighted as indicating growing market power. And I want to explain now why I think that's a better interpretation than the most plausible alternative-- namely, increased scale economies and temporary returns to the first firms to adopt new information technologies in competitive markets.

Now, the benign alternative has an initial plausibility because the efficient size of firms has likely grown over time in many industries as a result of the high fixed costs of investments in information technology, network effects, and an increased scope of geographic markets. That means that firms could grow larger and concentration could rise and price cost margins could increase, even if markets are competitive. And in addition, the first firms to invest in new information technologies might earn substantial rents, which should be temporary if those investments don't confer market power and their rivals follow suit with investments of their own.

But the first six reasons I gave for thinking market power is substantial and widening in the US cannot be reconciled with the benign alternative. Anti-competitive coordination, mergers, and exclusion are under-deterred. Market power is durable. And increased equity ownership of rivals by financial investors will soften competition. And governmental restraints on competition have grown.

Also, market power's a better interpretation than the benign alternative for the other three reasons. The growth of dominant platforms probably does owe a lot to scale economies and first-mover advantages. But those platforms may still have the ability to exercise market power by excluding rivals.

Scale economies and rents to early adopters of new technologies probably did contribute to rising concentration in various industries. But there's often independent evidence that the firms in those concentrated markets exercise market power, which is not surprising because the same fixed expenditures that makes scale economies and rents the first movers possible can deter entry and soften competition.

Now, some of the evidence for the loss of economic dynamism could be consistent with the benign alternative of growing-scale economies and returns to early adoption of new technologies in competitive markets as well as consistent with increasing market power. And that might include the rising profit share of GDP and the growing gap in accounting profitability between the most and the least profitable firms.

But other aspects of declining dynamism cannot be reconciled with the benign alternative. The benign interpretation assumes that profits rise because markets are increasingly dynamic, with higher rates of entry investment and business failure. In competitive markets, growing-scale economies yield higher profits because entrants have a greater risk of failure when fewer firms can succeed. Early adopters of new technologies would earn profits. But they'd be temporary, competed away by new or expanding rivals making their own investments.

But the benign interpretation is inconsistent with the evidence showing the reverse

The same thing happens on the input side. It is an implication of the perfectly competitive model of wage determination that an increase in the number of firms will drive wages up. That's not evidence of monopsony power.

What Bresnahan said is that we actually have to separately consider demand and cost and competition. And we can't do that in one equation or one correlation. I think that kind of evidence, with-- by the way, did not feature greatly in Jonathan's discussion, should be down-

costly to build all of those plants near your rivals. And that's a sunk cost. And it's very hard for that to be competed away. This is a complicated story.

And what I want to finish with is a substantive hypothesis. What if this is true in broader sections of the economy? What if it's happening in broader sections, not just wholesale-- maybe IT, maybe other parts of retail, maybe broad sectors of the economy

But my read of the evidence is that the aggregated relationship between aggregated concentration and competition outputs-- we don't know much that's relevant to formation of antitrust policy. I think there are interesting questions. I think it is important for modern IO economists and for the agencies, for the FTC and the DOJ, who have great collections of IO economists inside those buildings, to engage in answering those questions. And I'd say it's great that we all get to come up here and engage in those questions. But I'm hopeful that the economists inside the agency who are experts and have access to data, things like agency predictions in individual cases that they can test against data-- that they're also an active participant in that discussion.

So I think the real challenge moving forward is if you've got data that isn't what you need to have the type of discussion that you want to have about whether it is desirable to move policy one way or another, whether it's mergers or something else, the challenge, I think, both for the Academy and for the agencies, is to invest in producing those data-producing tools, producing studies to move the ball forward in that literature, because I certainly agree there are interesting questions here that require investment and are worth the time. Stop there.

FIONA M. SCOTT MORTON: Great. Hello, everybody. And thanks to the FTC very much for being invited to contribute to this panel. I agree with both John and Steve on the IO research here. It seems very easy to run the wrong regression. To someone without a PhD, it looks tempting. We need to resist that temptation because it is, in fact, just wrong.

But we need to find another way to answer the question. That's not an excuse for not answering the question. And, as Josh said, concentration and competition are not the same thing. It's not actually, I think, very informative to learn about aggregate concentration in the United States. I'd like to know about competition in the United States. And I think, as Steve said, the markups are a good way to get there.

I think the real reason that we're-- that there is consensus among a large fraction of the people who do this work for a living and people who read the newspaper that we have a competition problem in the United States comes not from papers published in academic journals, but from two main sources. One is, for people who work in this area, the actual experience of litigating. So it took 23 years from the time the FTC first found a pay-for-delay agreement in the record to getting the Supreme Court to say, yes, under certain conditions, those could be anti-competitive, 23 years. And a pay-for-delay is when a branded monopolist pays the generic to stay out of its market.(e)4 (of)3 (l)t.orth, ťta (he3 6 (.) n((he)4w [(th)4 (t)-2 (i)-2 (t) 45.)4 (, t)-10 (.)-2 (d be)4 (ni)-2 (t)-2 (e)4

So when you look at litigation and you look at what the agencies are trying to prove in the courts, it's a really heavy lift. And as Bill Baer said when he was at DOJ, why are some of the mergers we're reviewing even getting out of the boardroom? They're just, obviously, anti-competitive. And yet we have to litigate them, anyway. So I think that's one big area that we look to for evidence as to why there are anti-competitive effects.

A second one is our experience as consumers. Look around at hospitals, airlines, beer, media, big tech. I think people in the economy walk around buying things. And the experience they have is of less competition.

And I think also, consumers can get easily confused between what is regulated and what's not. So for instance, pharmaceutical prices and cable prices are not fundamentally something that antitrust can do a lot about. And yet those things are exhibiting less competition, also for the reason that Jonathan covered in his talk about lobbying to get government protection.

So what's my response to this emerging consensus? We need to revisit the economics. And I will say this slowly because it's worth saying 25 times. And I don't have that long. So I'll just say it once slowly. Economic analysis is not the same thing as less enforcement.

Chairman Simons said it exactly right this morning. Economics is a tool. If you feed a set of facts into the economic analysis box, you can come out this merger is competitive or this merger is anti-competitive. It works beautifully.

But what happened in 1975 is we applied economics to antitrust. And we got the pendulum swinging down. Arguably, we had too much disorganized enforcement. The pendulum swung down. And now we have these things as sacred texts. And the answer is always, if you believe in the sacred text of Chicago, to enforce less.

Obviously, if you enforce less for 30 or 40 years in a row, you're eventually going to pass the optimum. And that's what we've done, I think. And we need to recognize-- I, luckily, was too young to be part of that project. And so it's perhaps easier for me to see that we've well overshot the optimum and that we need to go back and look at the economics fresh and try to get the right answer.

And let me remind you all that there's a big drumbeat of dollars in favor of keeping those sacred

But I think it is a burden on the agencies and on the Academy in these areas. We like to publish journal papers and whatnot, but engage on these questions, both the fight against oversimplified fixes that will probably do more harm than good, but also to subsidize investment in more knowledge to do a better job designing and calibrating policy with these questions.

GREGORY WERDEN: Anybody else?

FIONA M. SCOTT MORTON: Yeah. I would disagree. I think we have the tools. I don't think we need to spend 10 years developing new tools. I think we could start now. There isn't anything wrong with our existing standards or economic analysis. I think the problem comes when you try to apply it.

So if you're in court and it's-- and the judge is taking the view of recent cases that we have seen, which is either ignoring the facts or ignoring the economic principles or not applying the horizontal merger guidelines, for example, in terms of our efficiencies-- merger-specific, are they verifiable, are they cognizable-- I think that's where the problem comes. And of course, if an agency is confronted with-- at the end of the day, they disagree with the firms and they have to go to court, that's the outside option. And if you have a very weak hand when you go to court, then there's not much you can get as a settlement. So I don't actually think we have a problem with the economics. I think we're ready to go there.

JOSHUA D. WRIGHT: Greg, I don't know the rules on random intervention. So I'm going to make one in the absence of a rule. So the thing that I have in mind in terms of getting the-- and I think we're all for getting the economics right. But for example, some of these areas go the other way.

So it's not a Chicago text. But in 1968, Oliver Williamson wrote a pretty well-known paper on efficiencies and mergers. 50 years later, there's not a single federal court decision-- no merging parties have prevailed on an efficiencies defense. 50 years is a heck of a good winning streak. I agree, parties sometimes do a bad job presenting efficiencies. I've been inside an agenco n5-i501 aTJ 0
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JONATHAN B. BAKER: So the answer is not, per se. A large and profitable firm's size and success alone doesn't mean antitrust had failed. Firms can and do grow large and become successful by providing customers with valuable products and services. And that includes large technology companies. We want to encourage firms to grow successful and profitable by offering better and cheaper products and services. But we should also be concerned if firms, including large and successful ones, exercise market power and some other major markets are threatened to do that through exclusionary conduct or collusive conduct or merger.

Now, I pointed to the growth of dominant information technology platforms as a reason for

enforcement analytics to fit the market structure, as Steve suggested. So let's take, for example, the presence of network effects. Network effects are when the value of the product rises in the number of users. So a social media platform is more valuable to me the more other people are on it.

What do we get when we have network effects? We get concentrated market structures. Everybody wants to be on the same network because all their friends are there. So we get market shares that go 99% and 1%, or a few little epsilons. We don't see market structures of 70-30 or 50-50 in a world with network effects. So we necessarily are going to see concentrated markets.

Is that a problem? No. As we've said already, that, per se, just that fact-- that's not a problem. But we need to recognize that the locus of competition has shifted. Competition in that market does not display itself in the market. The 30% is not competing with the 70%. No. It's competition for the market. Who is going to be the winner take all? Who is going to get to be the 99%? There are some firms that start out together. And one of them gets ahead. And the market tips. And that winner gets 99%.

So now that we know that the locus of competition is for the market, not in the market, how would we do antitrust? We would care an awful lot about entry. We would care an awful lot about potential competition. We would care an awful lot about acquisitions by the 99% of a teeny little epsilon percent. Why? Because that epsilon percent doesn't have a lot of share. But that's where the competition's coming from. That 99% guy is are afraid the epsilon is going to become 1% and attract all the teenagers and there's going to be a flip.

So we care a lot about that little epsilon. And that's where the competition's coming from. And we need to dust off our theories of harm when it comes to potential competition. We need to stop investing so much importance in market share. The market share of the little guy is not big. And when you calculate the Herfindahls, nothing's going to happen when you do this-- when you analyze this merger.

Does that mean there was no competitive significance to the little player? Quite the contrary. All those little players are the only ones that are making the 99% pedal faster and work harder to keep consumers because they're all potentially able to overthrow the incumbent. So that's a way in which we have standards lessening competition and so on that work perfectly well in an internet platform or a network effects market.

But we need to think about focusing our enforcement efforts at the place where the competition is, which is a little bit different in some of these markets than it would be historically in, say, automobiles. So I think there are big implications for antitrust enforcement. And I would point people in that direction.

GREGORY WERDEN: Do you want to weigh in, Josh?

JOSHUA D. WRIGHT: I think I agree with probably everything in that in terms of the description of that and other contexts being appropriate to worry less about the shares and worry more about the competitive constraint imposed by the rival. I think that's a common theme,

But there's another thing that I think Jonathan suggested, which is it's not a descriptive matter of entry and exit. It's a question of whether the economy is delivering important innovations to consumers in the form of lower costs that are actually passed through to lower prices and/or better products. And it's possible, as with our last question, that you have a set of really big, great innovative firms who protect their position by being very innovative. In that sense, we have a lot of innovation and not much turnover. And I don't know if that's dynamism or not.

It does make me think hard, though, about Fiona's point about potential competition. And I think maybe this is what Jonathan is getting at. If there are firms who got where they are by being innovative, how do we ensure that the innovation continues? Surely not by seizing their intellectual property, for example. That seems bad. But do we take more seriously potential competition? Is the data that Jonathan's referring evidence of a lack of potential competition? I'm a little confused by that. It's more actual entry and exit.

But these are always first-order questions. These questions about innovation are always first-order questions. And I think if we accept that we have these very large, very profitable, certainly firms that got where they were by innovating, again, I would say, well, let's start from where we are and ask how we move forward. And I don't know that we have this positive evidence. But it seems like important question.

FIONA M. SCOTT MORTON: Yeah. I would agree with everything Steve just said. And I think then the purpose of antitrust enforcement is to ensure that the large firm that got where it initially got on the-- by innovating and serving consumers continues to do that. If there isn't effective antitrust enforcement, then you have the possibility of entrenchment and monopoly profits and a decline in the innovation and price competition that we would like to see.

So it's very important that we have effective antitrust enforcement in this sector so the-- and if we do and we continue to have high concentration, then they're competing hard. And we're getting what we want as a society. But if we don't enforce here, then I think we can't be sure that we will.

JONATHAN B. BAKER: And I'd like to just respond by reminding you that I talked about six different indicators of declining dynamism. And really, only one or two depend on the data set that Greg is worried about. I was talking about a secular slowdown in business investment and rising profits, the share of GDP, at a slowed rate at which firms expand when they become more productive and shifting growth and productivity gains from entrance to incumbents and the growing gap in accounting profitability between the most and least profitable firms, and then also a declining rate of start-ups, which is more about the deficit Greg is emphasizing.

JOSHUA D. WRIGHT: One small point on the relationship between business dynamism, I think, for this purpose, however we defined it in antitrust, is that, of course, there are issues to explore here on potential competition. But a point of agreement with John is public restrained scenario, where the FTC has been very active. State or locally imposed barriers to entry that reduce the ability for entry are a big deal here and an area I don't think the FTC needs to be convinced that it is worth spending time on. It is done for a really long time. It is done in a bipartisan and consensus-oriented way for a really long time.

My own view is that areas probably, if we're looking for an area to agree on for more cases to bring-- I think those cases have legal issues with state action defense and whatnot. But if you want to target the resources of the agency, that stuff you know is anti-competitive, state barriers to entry, including occupational licensing, is pretty good stuff and stuff that I think the agency would be well served. We do lots of competition advocacy-- but used to be an area where we brought a few more cases.

GREGORY WERDEN: Should we go after the lawyer monopoly first? I think we can get an agreement right here. That's the one that's really problematic.

JOSHUA D. WRIGHT: I'm in, Greg.

JONATHAN B. BAKER: You're asking economists that question.

GREGORY WERDEN: Yeah.

[LAUGHTER]

They know. Anybody want to say more about dynamism or are we done? OK. Good. So my final prepared question for the panelists is a broad policy question. If the plan is to somehow ramp up antitrust and the solution is not just to spend more money at the agencies, which, of course, is always welcome, what should be done and by whom-- Congress, the courts, the agencies? And in particular, I ask, what one change in substance or procedure do you recommend? And what one change would you most strongly caution against? And I'm going to start with Jonathan.

JONATHAN B. BAKER: So in the book that I mentioned that's coming out next spring, I talk about a number of substantive presumptions for ramping up antitrust that I'd like courts to adopt. But I don't want to do the equivalent of picking a favorite child. And I can't really describe them all here. So instead, I'm going to give you two cautions rather than one of each.

So on substance, I would caution against presuming that vertical conduct is pro-competitive, and I think I talked about why in my presentation. And on process, I would caution against introducing direct political influence into antitrust enforcement.

GREGORY WERDEN: So why don't we just go down? Steve-- next.

STEVEN BERRY: So I really wanted to hear the practitioners talk to this more than I wanted to hear myself talk about it.

GREGORY WERDEN: You can pass if you want.

STEVEN BERRY: But let me just say one quick thing, which is-- and it follows up on this last point. I think, in general, the state of the evidence, and I think this is even consistent with Josh's
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antitrust policy. There are 100-some PhD economists between the agencies. And I guess I'm not allowed to raise the number to 200 without firing some lawyers, which will not be popular here. But I think there are ways to more deeply involve economists inside the agency in these discussions. I think the more of that, whether it is through 6(b)s at the FTC, whether it is-- there are a lot of ways to do that. And I think the more of that, the better.

JONATHAN B. BAKER: I'd like to comment on something that Josh and Fiona were talking about, about the-- I really don't think-- sure, there are public restraints that are harmful and appropriate to be concerned with if you want to enhance competition. But I don't think the idea of reallocating the FTC and DOJ budgets towards public restraints is necessarily a good idea.

What I'm worried about is that a lot of the public restraints-- there are other mechanisms that are outside of the antitrust laws-- legislative and --h Fp

let's say, dominant technology platform and it's proposing to buy some nascent competitor that might come up with the next greatest idea or might have it already, but hasn't got it to market, how do you know whether to think this is bad because this threat to the incumbent monopoly is being squelched or this is good because this is the way that this new idea will come to market?

FIONA M. SCOTT MORTON: So here, I think, we rely on John and his error cost framework to think about this. If you don't know whether the acquisition's going to be pro-competitive or anti-competitive, you have to think of the harms you're creating by getting it wrong. And if under-enforcement creates tremendous harm because the dominant technology platform has lots of market power and that's going to be a huge problem, then we have to make sure we're weighting that risk appropriately. And it may be that we don't have very much information about, or as much as we would about, the potential competitor as we do in markets where we're assessing whether a 15% share should be allowed to buy a 20% share.

But there's a lot more information about the products, about the way competition arises, about the prices, and so forth when you have competitors already in the marketplace. When it's potential, the problem is much more difficult. Does that mean there's less welfare at stake? Not at all. So just because there's less information doesn't mean we get a free pass to do nothing about it.

JONATHAN B. BAKER: And I wanted to add, going back to the original question about-- where they were talking-- which was asking about static and dynamic competition-- some people have the idea that competition is somehow bad for innovation and that when we are acting as antitrust enforcers, and that's who we are. To increase competition, we're just going to benefit the buyers at lower prices. But somehow, we'll impede innovation-- and that there's some-- a trade-off. And that's not necessarily right. And it probably isn't right on average.

There's lots of evidence that competition spurs productivity, lots of economic studies. And on innovation particularly, I read the literature saying the motive that firms had to innovate by escaping competition is probably stronger on average in the data than the motive to innovate that comes from appropriating more returns on the margin. And it's not surprising because firms that are making major R&D investments always-- usually have a lot of reasons other than preexisting market power to appropriate sufficient returns to-- even if there's some imitation. And successful incumbents may be discouraged from developing new products because they're-- that would cannibalize their existing rents and because, as Steve and a few other been emphasizing, firms with market power can discourage new competition with exclusionary conduct. And so there's every reason to think that more competition is good for society, for dynamic, innovation-oriented productivity reasons, not just for static price and quality reasons.

JOSHUA D. WRIGHT: So long as we are including the-- maybe the caveat or the definition that-- in John's claim that more competition is good, that we're not equating competition to the number of firms, I get nervous about these discussions when they convert to policy because the temptation is, when I've got a really, really hard policy problem to figure out-- is that acquisition of the nation or a small competitor a good or bad thing on net, on welfare? The trade-offs are really difficult to figure out. And it is sometimes tempting.

And I think history teaches us, and certainly in antitrust, that there is a temptation that is often succumbed to by agencies to cling to those bright-line presumptions because you can do them. And that, I think, is something that, in that area, we certainly don't have enough empirical evidence or economic theory to do. It involves-- this may be an area I think Fiona and I disagreed some about whether we've got all the tools we need in. And I think we probably agree we've got most of what we need. But I think there are areas where we could do better. And even if that means, doing better means, learning more about the distribution-- and potential competition's one of those areas.

FIONA M. SCOTT MORTON: But here's the problem, Josh. If you say we don't know enough to draw a line, I'm fine with that. But that's not the same thing as saying, because we don't know anything, we're going to decide all the cases so that it's fine for the big firm to buy the potential competitors.

JOSHUA D. WRIGHT: You certainly didn't hear the latter claim out of me. I voted these cases,
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GREGORY WERDEN: When you get to a case, you're going to have information that a researcher wouldn't have, a lot of it. And it can be very useful. And we have tools for analyzing it. I think that where the question was coming from is, as a researcher, as a policymaker, if you're looking at the whole big picture, what is it you should look at?

JONATHAN B. BAKER: So I'm such a micro guy, I find it hard to move past the aggregation as the sum of its components. I think it's very hard to do at the broad aggregate level. Broad evidence on markets, broad evidence on profits are interesting. And they do not particularly get to the whys. I think they're a flag of interest, I would say.

FIONA M. SCOTT MORTON: The field of IO is a micro field. So we're just really bad at answering this question. And if you look at John's list of sites, a lot of those people are in finance or macro or labor that have come into this empty space that we generated, which is how do we describe the economy as a whole, because our field doesn't do that. And so that's partly why we have these conflicting methodologies.

JONATHAN B. BAKER: Don't you wish we had some occupational licensing here?

[LAUGHTER]

STEVEN BERRY: In all honesty-- I said this before-- it's actually excellent that those papers are raising these questions. That's an excellent thing, that these questions are being raised by those papers. And I think people deserve a response. I

GREGORY WERDEN: Apart from regulating monopolies, which is an old, but still good, idea, is there anything else you would suggest?

STEVEN BERRY: Well, I do think when people talk about the tech companies, they-- and this is a good question for the FTC-- is that people are sometimes talking about data and other forms of social relationships that I think are difficult to handle outside of the existing antitrust framework and may be subject to different kinds of regulation. And I think sometimes, when people talk about old-fashioned antitrust, they're also talking about, for example, political power. And I think

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