The New Era in Antitrust

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ON THE SAME DAY in mid-June that the Justice Department released the long-awaited revision of its 1968 Merger Guidelines, the Federal Trade Commission released a separate "statement" setting forth its policy on horizontal mergers. Neither document changes existing enforcement policy very much. Both, however, are reminders of the substantial shifts that have occurred over the last decade in the government's approach to merger analysis. And the differences between the two documents highlight the differences between the two enforcement agencies.

The Triumph of Economics

As the Justice Department's new guidelines make clear, the analytical process by which the department evaluates mergers has become explicitly economic. The 1968 guidelines nodded generally toward economic analysis; the new guidelines incorporate numerous tests based upon elasticities, a concept that only economists could love. More important than the changed process, however, is that the substantive standards governing the enforcement decision have been eased, in some instances radically. Vertical and conglomerate mergers have been virtually immunized against challenge. Horizontal mergers will be treated more leniently than under the 1968 guidelines in unconcentrated markets, but only slightly more leniently in concentrated markets.

The Federal Trade Commission has moved in the same direction as the Justice Department, but not quite so far. While the commission's analytical process has become explicitly economic, it has not become exclusively so. Leeway for other values may remain. And some have interpreted the commission's new policy, limited by its terms to horizontal mergers, as not retrenching so substantially as the Justice Department's in the area of vertical and conglomerate mergers.

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Before examining these policy shifts in greater detail, it is useful to understand the two principal reasons they have taken place. First, economic considerations have now achieved primacy over social and political considerations as the basis for merger policy, whereas these three considerations used to receive more

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or less equal billing. The Supreme Court, for example, wrote in *Brown Shoe* (1962):

> The "dominant theme pervading congressional consideration of the [antimerger provisions of the antitrust laws] was a fear of what was considered to be a rising tide of economic concentration in the American economy. . . . Other considerations cited in support of the bill," the desirability of retaining "local control" over industry and the protection of small businesses.

The Court also quoted from Judge Learned Hand's famous *Alcoa* opinion:

> Throughout the history of these [antitrust] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.

Such populist sentiments have been deeply eroded over the last decade, as leading scholars have with increasing frequency denied the legitimacy of antitrust's social and political goals. Taking issue with Judge Hand, Robert Bork declared: "The only legitimate goal of American antitrust law is the maximization of consumer welfare." The thought was echoed by Richard Posner and William Baxter. Still others, somewhat more traditionally, contended that social and political considerations are, if not vapid and irrelevant, at least vague and unquantifiable. Economics provided decision makers with an accessible intellectual calculus leading to relatively clear results. Sociology and political science, in contrast, provided only garbled generalities with no clear policy indication.

The second reason that merger policy has shifted over the last decade is that our understanding of economics has changed. To put the issue in context, once one accepts that the goal of antitrust law is to maximize consumer welfare, the policy prescriptions for achieving that goal may vary widely, depending on the current state of economic thinking. As economic research yields new findings, merger policy should change accordingly. Advances in economic understanding on two fronts have contributed most heavily to the recent revisions in merger policy. First, it is now recognized that the relationship between concentration and noncompetitive performance is not so well defined as had been previously supposed. Some economists, such as Harold Demsetz, have argued that no relationship at all has been shown, and most economists would agree that the 1968 guidelines were too stringent and failed to take proper account of the fact that numerous economic characteristics other than concentration influence a market's competitive state. Second, it is now recognized that mergers may yield efficiencies for many more reasons and to a far greater degree than had been previously supposed. Under the older view, the principal efficiencies realized through merger were attributable to economies of scale. The newer view goes further and recognizes additional efficiencies attributable to reduction in the cost of information and creation of intra-firm "markets" for capital, labor, and other resources (see Readings, page 51).

Vertical and Conglomerate Mergers

Having touched upon the reasons for the policy shifts in the guidelines, we can now return to examine the shifts in greater depth. The Justice Department's merger policy has been revised most markedly in the area of vertical and conglomerate mergers. The 1968 guidelines presented explicit (and fairly intolerant) prohibitions against vertical and conglomerate mergers. A vertical merger between one firm having a 10 percent share in one market and another having a 6 percent share in an adjacent supplier or purchaser market might have provoked a challenge, for fear that it would foreclose access to one market by the remaining firms in the other. And a conglomerate merger might have been challenged whenever it eliminated a potential competitor, created the danger that each would deal with the other to the exclusion of third parties, or entrenched the market power of a leading firm. In practice, these provisions of the 1968 guidelines only occasionally led to enforcement actions, but they captured the attitudes of the era.

Those attitudes have changed. The new guidelines merely caution that "nonhorizontal" mergers will be challenged only where they have substantial anticompetitive horizontal effects. The guidelines tell us that the proscribed effect may, in theory, be anticipated in four instances—if the merger eliminates a potential competitor, creates barriers to entry, facili-

tates collusion because of vertical integration (likely only in some limited circumstances), or enhances the ability to evade rate regulation. One gets the definite sense, however, that the necessary and sufficient prerequisites to a challenge will rarely be found.

Why the radical change? First, the efficiencies that may be generated by vertical and conglomerate mergers are more pronounced than had been realized in 1968, largely because those efficiencies are of the "information cost" and "internal markets" varieties which had not been well identified when the old guidelines were written. Second, the costs of vertical and conglomerate mergers fall largely into the social and political realm and are therefore disregarded in the new guidelines. (The "unifying theme" of these guidelines, we are told at the outset, "is that mergers should not be permitted to create or enhance 'market power' or to facilitate its exercise," where market power is defined as the ability to maintain price profitably above competitive levels. This is strictly an economic concept.) Insofar as vertical or conglomerate mergers impose economic costs, they may be attacked under the guidelines.

The policy of the Federal Trade Commission (FTC) is less clear to the outside observer, because the commission's mid-June policy statement was limited by its terms to horizontal mergers. Some have read this to signal that the commission is abandoning enforcement against vertical and conglomerate mergers, but it seems more likely that some of the members of the commission would sharply disagree with the Justice Department's approach. While the commission has predominantly and increasingly focused upon economic values, it has not followed the Justice Department in discarding the last vestiges of social and political values. If a vertical or conglomerate merger were to impose severe social or political costs with few offsetting economic efficiencies, the commission might still bring an enforcement action. Nonetheless, its position has softened over the last decade (although perhaps not so much as the Justice Department's). Where it once would have sprung to action, it is now likely to proceed slowly and cautiously.

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Horizontal Mergers

The FTC and the Justice Department differ slightly as to horizontal mergers as well, but here the difference seems more procedural than substantive. Both the department's new guidelines and the commission's statement view horizontal mergers as posing a clear threat to consumer welfare and thus something that must still be scrutinized closely. The enforcement standards have, however, been modified (quite explicitly in the guidelines and more implicitly in the statement) to take account of the current understanding of the relationship between concentration and market performance. In unconcentrated markets, virtually any merger is likely to pass muster, whereas the 1968 guidelines would have prohibited a merger between two parties controlling as little as 5 percent of the market apiece. In moderately and highly concentrated markets, however, the market share standards have been relaxed only slightly from the 1968 levels. In addition, the new guidelines take explicit notice of a long list of additional market characteristics that may color the government's judgment, including product homogeneity, transaction size and frequency, and pricing structure. The importance of such characteristics is now recognized as being greater than previously thought.

The chief difference between the agencies is how to weigh these numerous decision factors against one another. The Justice Department's guidelines establish strong presumptions based on concentration levels and the parties' market shares; other factors are to be taken into account only in close or exceptional cases. The Federal Trade Commission's statement, in contrast, suggests that all factors are to be considered in every instance, with none providing a presumptive basis for an enforcement decision. The commission has traditionally been amenable to a broader line of argument than the Justice Department, and its horizontal merger statement suggests that it continues to be.

The agencies also differ substantially over the treatment of efficiencies. The Justice Department is unreceptive to the argument than an otherwise unlawful merger should be permitted because it will yield sizable economic efficiencies. In the department's view, the guidelines' market-share thresholds were set high enough to allow the realization of available efficiencies "in the overwhelming majority of cases." The efficiency defense is considered so difficult to administer—as the department notes, "efficiencies are far easier to allege than to prove"—that enforcement resources should not be wasted solely for fear that the guideline thresholds might prove too low in a few isolated instances. Besides, most efficiencies can be realized through internal growth just as easily as through merger.

At the antipodal extreme stands FTC Chairman James Miller, who believes that "scale-type efficiencies should be considered as part of the legal analysis" of proposed horizontal mergers. The commission itself takes something of an intermediate position: efficiency arguments are appropriate for the agency to consider in exercising its prosecutorial discretion, but are too ambiguous to be treated as a legally cognizable defense. This is distinctly more receptive than the Justice Department's view, but it does raise very interesting questions about the proper standards for agency decision making. Is it appropriate for an agency to invite arguments to be weighed in the exercise of its prosecutorial discretion to initiate an administrative proceeding, but then refuse to listen to those same arguments in the context of adjudicating that same proceeding? There is no doubt the commission (and probably the courts) will have a chance to answer that question fairly soon.

Finally, the agencies appear to differ over the extent to which economic tests can replace discretion as the basis for enforcement decisions. The commission's statement, while recognizing economics as the chief basis for antitrust policy and identifying economic factors for the decision maker to weigh, leaves the weighing process to human judgment. The department, in contrast, would replace subjective judgment with economic tests to the extent possible. In defining the relevant product market, for example, the guidelines call on the department initially to define a provisional product market based on the output of the merging firms and then to probe the boundaries of the market based on an elasticity measurement:

> the Department will hypothesize a price increase of five percent and ask how many buyers would be likely to shift to the other products within one year. The Department will continue expanding the provisional market until it satisfies the general profitability standard. . . .

That standard defines a market as "a group of products such that a hypothetical firm that was the only present and future seller of those products could raise price profitably."

The same approach appears repeatedly throughout the guidelines. In defining the relevant geographic market, the department must identify a provisional market area on the basis of the merger parties' shipment patterns and then determine whether the area is sufficiently insulated from outside competitive pressures that a 5 percent increase in the price of the relevant product could be sustained after one year. Similarly, the guidelines measure "production substitution" in terms of the number of firms that would convert existing facilities to production of the relevant product within six months of a 5 percent price increase, a shorter period than is used for market definition. And the guidelines measure the height of entry barriers in terms of the number of new entrants within two years of a 5 percent price increase, a period that some economists have criticized as overly generous.

THE JUSTICE DEPARTMENT'S NEW POLICY and to a lesser extent the FTC's imply a scientific approach that will surely not be possible in the great majority of situations. Even the department seems to recognize as much, for its guidelines identify numerous subjective factors to which it "will give particular weight" and on which it "often will have to rely [for] inferences." Nonetheless, the guidelines not only suggest that the department believes its policy is now crowned with the halo of science but are abundantly clear on which science has been chosen. These documents are an important step toward a more predictable pattern of public antitrust enforcement. If they survive the test of time, the next target will be private damage actions—currently the one totally uncontrollable element of antitrust enforcement. ■