Journal of Economic Perspectives—Volume 18, Number 3—Summer 2004—Pages 223–226

Comments

To be considered for publication in the Comments section, letters should be relatively short—generally fewer than 1,000 words—and should be sent to the journal offices at the address appearing inside the front cover. The editors will choose which letters will be published. All published letters will be subject to editing for style and length.

Activist Antitrust?

Robert W. Crandall and Clifford Winston (Fall 2003, pp. 3–26) and Jonathan B. Baker (Fall 2003, pp. 27–50) discuss the costs and merits of antitrust enforcement. Both sides are to be commended on their excellent reviews of the relevant literature and the assessments of existing evidence. However, one is left with an uneasy feeling that the developing debate over whether the U.S. antitrust policy is worth the resources it consumes is not moving toward its resolution.

The discussions over the merits of tougher antitrust enforcement have taken place in economics journals as well as in legal publications for decades. For recent assessments of merger policy, for example, see the debate in the Fall 1997 issue of the *Review of Industrial Organization* and the exchange in the 2001 *George Washington University Law Review* symposium. The difficulty with such debates is not that a consensus is not reached—this we can live with—but that there simply is very little concrete evidence to argue one side or another. Some attempts at broad assessments of the effectiveness and impacts on welfare of antitrust policy have been made. For studies of merger policy, for example, see Elzinga (1969), Pfunder, Plaine and Whittemore (1972) and Rogowsky (1982, 1986). But although the scarcity of such evidence is often explicitly recognized, as Crandall and Winston do, the arguments remain little more than normative speculation.

In any event, the case against active antitrust enforcement must be made very strong to be considered seriously. Crandall and Winston speculate that "the influx of foreign competition, deregulation, the entry of new firms and the emergence of new technologies" have created an environment competitive enough so that antitrust enforcement is all but unnecessary. They also argue that only a handful of U.S. industries are concentrated by the accepted measures of market power, such as the four-firm concentration ratio. However, instances of cross-border collusion and anticompetitive practices in deregulated industries exist and are well known. The development of new communication technologies (like the Internet) probably provides many new opportunities for firms to coordinate their pricing, for example, by making cheating easier to detect and punish. The market concentration figures based on nationally defined industries are less than informative: in many industries firms operate and compete locally, where market concentration is higher.

One aspect that both sides seem to recognize as significant is the deterrent effect of antitrust presence. I will limit my comments here to merger policy, with which I am most familiar. Unfortunately, Crandall and Winston conclude that there is no evidence pointing to the size of this deterrent effect, and Baker, in his defense of antitrust deterrence, overlooks an important contribution made by Audretsch (1983). Although somewhat dated, Audretsch's study attempts to quantify explicitly the benefits and costs of Section 7 enforcement. The benefits are assumed to consist of a distributive effect in addition to the efficiency effect, where the former addresses to surplus shifted away from consumers by the (proposed) merger, while the latter deals with the deadweight loss. To estimate costs, Audretsch uses data on lawyer-hours devoted to merger investigations, data collection, litigation and other variables. The results are quite interesting: an average merger case brought by the Justice Department or the FTC

deters between 11 and 16 other mergers. As to the welfare impact of merger policy—some 25 percent of merger cases are welfare-enhancing. In other words, the deterrent effect is present, is quantitatively significant and on balance contributes to welfare (considering that, as Crandall and Winston note, nearly 75 percent of mergers fail).

The implicit costs of antitrust enforcement are often overstated. It is frequently argued that, for example, merger policy disrupts the day-to-day operations of firms too much by forcing managers to comply with "second requests," prepare filings and gather data. But, and Baker alluded to this briefly, of thousands of mergers taking place each year, fewer than 4 percent are subject to detailed review by the agencies. The vast majority of mergers go unscrutinized and ultimately fail, which if anything makes a case for broadening the scope of review. The agencies have been working toward reducing the burden of second requests (Baer, 1996).

On a final note, agencies' poor track record in selecting the right cases to bring and devising proper remedies seems to be the basis of most anti-antitrust arguments. The system is far from perfect, but let's not confuse "works poorly and needs improvement" with "harmful and should be done away with," as Crandall and Winston seem to suggest. Antitrust policy as a concept has evolved over decades and is here to stay; it is not clear how *lack* of any evidence of its harm can lead one to conclude that it is wasteful. Moreover, the deterrent effect, which even critics agree is probably quite large, even if difficult to measure, will be lost if the role of antitrust enforcement is minimized. The activist approach to enforcement is precisely what allows agencies' actions to have this deterrent effect.

Mikhail S. Kouliavtsev
Philadelphia University
Philadelphia, PA

References

Audretsch, David A. 1983. *The Effectiveness of Antitrust Policy towards Horizontal Mergers.* Ann Arbor, Mich.: UMI Research Press.

Baer, William J. 1996. "Reflections on 20 Years of Merger Enforcement Under the Hart-Scott-Rodino Act." Speech before the Conference Board of the FTC, October 29; Available at ⟨http://www.ftc.gov/speeches/other/hsrspeec.htm⟩.

Elzinga, Kenneth G. 1969. "The Antimerger Law: Pyrrhic Victories?" *Journal of Law and Economics.* 12:1, pp. 43–78.

Pfunder, Malcolm, Daniel Plaine and Anne Marie Whittemore. 1972. "Compliance with Divestiture Orders Under Section 7 of the Clayton Act: An Analysis of the Relief Obtained." *Antitrust Bulletin.* 17:1, pp. 19–180.

Rogowsky, Robert A. 1982. "An Economic Study of Antimerger Remedies." Ph.D. dissertation, University of Virginia.

Rogowsky, Robert A. 1986. "The Economic Effectiveness of Section 7 Relief." *Antitrust Bulletin.* 31:3, pp. 187–233.

* * *

Robert W. Crandall and Clifford Winston's article "Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence" ignores much evidence (surveyed by Werden, 2003) supporting the core elements of antitrust policy—prosecuting cartels and challenging anticompetitive horizontal mergers. On mergers alone, the article offers original empirical evidence, interpreted to suggest that merger enforcement has not "increase[d] consumer welfare in any systematic way, and in some instances the intervention may even have reduced consumer welfare." However, no such conclusion is warranted by the evidence mustered.

For the years 1984–1996, the authors relate Census price-cost margins for the 20 two-digit SIC "major groups" within the manufacturing sector, to merger consent decrees, contested merger challenges successful in court contested challenges unsuccessful in court and agency requests for additional information. Their most relevant finding is that the merger challenges that were unsuccessful in court had a significant negative effect on price-cost margins. The authors argue that this implies that "the antitrust authorities overreach and attempt to block productive mergers." But with productive mergers allowed to proceed—a mere handful delayed slightly—the logical implication is that the system worked as intended and effectively served the interests of consumers.

Another finding is that the merger challenges that were successful in court had insignificant negative effects on price-cost margins. The authors hint that the effects of such mergers would have been significant if merger enforcement promoted consumer welfare. However, most contested merger cases involve unconsummated transactions, and the successful challenge to an unconsummated transaction merely preserves the status quo ante. No matter what the welfare effect of a merger might have been, or how accurately the enforcement agencies predicted it, no change in price-cost margins should have followed the challenge of an unconsummated merger.

A third finding is that consent decrees had a significant positive effect on price-cost margins, and no plausible explanation of this finding is consistent with the authors' suggestion that excessive merger enforcement stifled efficient asset consolidations. The few consent decrees that merely prevented challenged asset consolidations could not possibly have had any effect on price-cost margins, but most of the consent decrees allowed the proposed mergers to proceed with limited curative divestitures. If price-cost margins increased after such consent decrees because prices increased, the likely reason is that the divestitures were inadequate, so enforcement should have been be more rigorous. If price-cost margins increased after such consent decrees because costs decreased, the likely reason is that the divestitures cured the competitive problems posed by the mergers while permitting the mergers to achieve cost-reducing efficiencies.

The foregoing ignores the critical fact that the data employed on price-cost margins was highly aggregated. The authors argue the aggregation in their data only caused the effects of merger enforcement to be "somewhat diluted." A numerical example, however, illustrates that merger effects easily could be undetectable in such highly aggregated data.

Suppose a merger increased average prices in the relevant market by 5 percent, but the relevant market affected by the merger accounted for just 1 percent of the revenue in the two-digit major group for which price-cost margins are observed. If the premerger price-cost margin for that major group was 0.25 (which was the average figure reported by Collins and Preston, 1968), the postmerger price-cost margins for the major group would be 0.2504. Surely, the 5 percent price increase would be lost in the noise of unexplained variation in price-cost margins (the reported R^2 is 0.45). Thus, it is essential to ask how the scope of markets affected by the mergers compared with the scope of the SIC two-digit major groups for which price-cost margins were observed.

For the Department of Justice's merger cases brought during the seven years following the release of the 1982 Merger Guidelines (a period substantially overlapping that studied in the article), Pittman and Werden (1990) calculated "Commerce Quotients"—the ratios of the annual "dollar volumes of commerce" (that is, revenues) in the alleged relevant markets to the values of shipments for the corresponding four-digit SIC industries. They found that the Commerce Quotients were less than 0.25 for 77.8 percent of the alleged relevant markets and less than 0.01 for 32.5 percent of the markets. Roughly translating to two-digit major groups is straightforward, because the 20 SIC major groups in the manufacturing sector encompass about 400 four-digit SIC industries. The two-digit Commerce Quotients, thus, would be less than about 0.01 for roughly 3/4 of the markets and less than about 0.0005 for roughly a 1/3 of the markets. Therefore, it is quite clear that the data used in the article were too aggregated to permit the measurement of any effects of merger enforcement.

Additional empirical evidence on the effects and effectiveness of antitrust enforcement would be useful, but there is already far more empirical evidence on the price effects mergers and cartels than the authors acknowledge (Werden, 2003), and they provide nothing new of value. By no means have they demonstrated that overly stringent merger enforcement has lessened consumer welfare.

Gregory J. Werden
Antitrust Division, U.S. Department of Justice
Washington, D.C.

The views expressed herein are not purported to reflect those of the U.S. Department of Justice.

References

Collins, Norman R. and Lee E. Preston. 1968. *Concentration and Price-Cost Margins in Manufacturing Industries.* Berkeley: University of California Press.

Pittman, Russell W. and Gregory J. Werden. 1990. "The Divergence of SIC Industries from Antitrust Markets: Indications from Justice Department Merger Cases." *Economics Letters.* July, 33, pp. 283–86.

Werden, Gregory J. 2003. "The Effect of Antitrust Policy on Consumer Welfare: What Crandall and Winston Overlook." U.S. Department of Justice, Antitrust Division, Economic Analysis Group Discussion Paper 03-02, January.

Response from Robert W. Crandall and Clifford Winston

The only constructive value that we can attach to the letters from Mikhail S. Kouliavtsev and Gregory J. Werden is that they give us another opportunity to stress to researchers the importance of contributing more empirical evidence on the effect of antitrust policy on consumer welfare. Our paper pointed out that the existing body of evidence suggests that there has been little benefit to consumers from U.S. antitrust policy. Indeed, the accompanying paper by Jonathan B. Baker did not challenge our posi-

tion by offering hard evidence of consumer benefits. Instead, Baker simply asserted that the benefits of antitrust policy from deterring presumably harmful activity are likely to exceed the costs of enforcement.

Kouliavtsev approves of antitrust policy on similar grounds. First, he claims that the implicit costs of antitrust enforcement are often overstated. He doesn't provide any figures on the matter, but Baker estimated that the total "direct" costs of U.S. antitrust policy are only about $1 billion per year—an estimate that strikes us as far too low. Currently, there are about 9,000 members of the American Bar Association's Antitrust Section. The average revenues generated by each lawyer at the country's largest 100 law firms was $600,000 in 2002. Even if the average ABA Antitrust Section member derives only half of his or her revenues from antitrust, these lawyers' annual revenues from antitrust would be about $2.7 billion per year. If we include the earnings of lawyers who are not members of the Antitrust Section as well as the substantial economic consulting revenues and other private costs of antitrust enforcement, then private-sector direct costs would surely approach $4 billion per year. But even this estimate understates the enforcement costs of antitrust policy because we have not included—nor do we have any way to estimate—the costs that may be created because firms are deterred from engaging in activities that would enhance social welfare for fear of antitrust action.

Kouliavtsev cites only a 1983 book by Audretsch as empirical support for his view that antitrust policy deters mergers that would harm consumers. Audretsch assumes that any increase in concentration in any alleged product market increases the price-cost margin. Despite this rather heroic assumption, Audretsch's analysis of 59 horizontal merger cases brought between 1952 and 1972 uniformly concludes that the gains in allocative efficiency were less than the enforcement costs created by the action. Even when Audretsch uses a questionable approach to assume that the average merger case brought by the antitrust authorities deters between 11 and 14 other prospective mergers, the allocative efficiency gains are still less than enforcement costs in two-thirds of the cases. These findings hardly constitute favorable evidence on the efficacy of antitrust merger policy.

Werden does not even attempt to report any empirical evidence that indicates that his employer has created benefits for consumers. Instead, he reinterprets the coefficients of our model of merger court outcomes and price-cost margins in an unsuccessful effort to cast merger policy in a better light. First, he simply repeats our optimistic interpretation of the finding that unsuccessful challenges had a negative effect on price-cost margins—that is, the courts do not allow the regulators to block mergers that could potentially improve welfare. That conclusion is not complimentary to the regulators. Second, he claims that a successful antitrust challenge should not affect price-cost margins; thus, our finding of an insignificant effect should have been expected. Werden fails to understand how our model is identified. Given an imperfect merger enforcement policy and a variation in such policy and court-based outcomes across industries, one should see successful challenges lowering price-cost margins if antitrust merger policy were benefiting consumers. Finally, he asserts that our result that consent decrees are associated with higher price-cost margins is implausible. Nevertheless, he suggests that if prices did rise that antitrust authorities should have insisted on more restrictive decrees. But if antitrust authorities typically get it wrong when negotiating decrees, why should they be asked to negotiate even more aggressively?

Werden ignores that we qualified our analysis because we were restricted by the Department of Justice and Federal Trade Commission to use data at the highly aggregated two-digit level. Instead, he constructs an example that deals with the diluted effects of a hypothetical merger on two-digit industry price-cost margins, but does not discuss the relevance of this example for estimating the effect of merger *policy* on these margins. Similarly, he reports "Commerce Quotients," but it is not clear how they are relevant to any assessment of merger policy. He seems to imply that aggregation would prevent us from detecting the effects of merger policy; but we must stress that we were able to find an effect—Werden simply doesn't like the effect we uncovered.

It would have been far more useful, and scholarly, for Werden to have estimated his own model based on disaggregated data at the four-digit level that his employer can provide him—but will not provide to academic researchers. Hopefully, our paper will help break down these barriers so that independent researchers can provide additional evidence that is needed to determine whether antitrust policy is providing benefits that exceed its palpable costs.

This article has been cited by:

1. LARS SØRGARD. 2009. OPTIMAL MERGER POLICY: ENFORCEMENT VS. DETERRENCE *. *The Journal of Industrial Economics* **57**:3, 438-456. [Crossref]