

Policy Watch

Developments in Antitrust Economics

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This feature contains short articles on topics that are currently on the agendas of policymakers, thus illustrating the role of economic analysis in illuminating current debates. Suggestions for future columns and comments on past ones should be sent to C. Eugene Steuerle, c/o *Journal of Economic Perspectives*, The Urban Institute, 2100 M Street NW, Washington, D.C. 20037.

Introduction

During the late 1970s and 1980s, the federal courts transformed antitrust rules and the federal enforcement agencies altered their case selection criteria in response to theories developed by industrial organization economists. These developments in economic thinking, often associated with the Chicago school, led current antitrust law and practice toward a greater skepticism about the relationship between market concentration and market power and a greater recognition of the possible efficiency-enhancing role of vertical agreements (contracts between firms and their customers or suppliers) than was present in the 1950s and 1960s.¹ This survey will begin where those developments leave off by highlighting more recent developments in antitrust economics that have influenced the way the federal antitrust enforcement agencies analyze five issues: efficiencies from mergers, entry conditions, practices facilitating coordination, exclusionary practices, and the unilateral competitive effects of mergers.

¹ For an introduction to the economic ideas behind antitrust's Chicago school revolution, see Bork (1978), Posner (1976) and the debates in Goldschmid, Mann and Weston (1974).

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Many of these developments are reflected in the Department of Justice (DOJ) and Federal Trade Commission (FTC) Horizontal Merger Guidelines (U.S. Department of Justice and Federal Trade Commission, 1997). These guidelines describe federal agency enforcement policy and have been influential in the courts, although judges are not required to follow them. They have been revised four times since originally promulgated in 1968 by Justice, and have grown in economic orientation and sophistication with each revision.

New Developments in Analyzing the Efficiencies from Mergers

How should antitrust enforcers take into account the potential for mergers to generate cost savings and other efficiencies when evaluating an acquisition's likely competitive effects? The old legal precedents were skeptical of an efficiency defense to mergers. But in the 1997 revision of the efficiencies section of the 1992 merger guidelines, the federal enforcement agencies adopted an approach consistent with Williamson's (1968) framework for the welfare analysis of mergers.

The revised guidelines recognize that mergers can create conflicting incentives: they can lead to higher prices if they facilitate the exercise of market power, or they can lead to lower prices if they generate cost savings that encourage the merged firm to compete more aggressively. (In a dynamic context, the merger guidelines are also concerned with the possibility that firms could exercise market power by slowing innovation, or the possibility that the efficiencies from merger could generate product improvements.) An acquisition's net effect on price in any market depends on which effect dominates. It is quite possible to have both a gain in productive efficiency (cheaper production) along with a loss in allocative efficiency resulting from greater market power. The merger guidelines focus on price, and thus emphasize identifying the net effect of the merger on consumer's surplus within the markets where anticompetitive harm appears possible. Under some circumstances, there is flexibility for the enforcement agencies to take into account production efficiencies that are generated in other markets or that do not appear likely to be passed on to consumers.

The need to assess the relative magnitude of the price-increasing and price-reducing incentives of mergers calls attention to the pass-through rate; that is, the rate at which the merged firm would pass on cost changes into prices. The lower the pass-through rate, the greater must be any marginal cost reductions to overcome an anticompetitive incentive to raise price and generate a price reduction on net.² Because the federal enforcement agencies consider only those efficiencies that are merger-specific—that is, efficiencies from the proposed merger unlikely to be

² The emphasis is on marginal cost reductions, not fixed cost savings. While fixed cost savings may benefit the economy by allowing resources to flow to other industries, they do not create an incentive to lower price in the markets where the competitive harm appears likely.

achieved (or to be achieved as rapidly) absent the merger—and because merger-specific efficiencies typically lead to firm-specific cost savings (that do not diffuse to the rest of the industry), the relevant pass-through rate for evaluating mergers is usually firm-specific. A firm-specific pass-through rate relates a change in the price a firm charges for a product to a change in the marginal cost of that product, holding constant the marginal cost of rivals' products. The firm-specific pass-through rate is likely to be lower than the rate at which industry-wide cost changes are passed through to prices. Indeed, in the special case where a competitor is a price-taker, the firm will not alter price at all in response to firm-specific costs change though it will do so when industry-wide costs are affected.³

The distinction between firm-specific and industry-wide pass-through rates became important in the Federal Trade Commission's recent court challenge to the proposed merger of Staples and Office Depot (Ashenfelter, Ashmore, Baker and McKernan, 1998). The empirical results presented by one FTC expert witness, Orley Ashenfelter, showed that Staples' firm-specific pass-through rate was only 15 percent; much lower than the industry-wide rate. If so, the merger would lead to higher prices unless merger-specific efficiencies generated marginal cost reductions at least six or seven times the magnitude of the price increase that would otherwise occur.

New Developments in Analyzing Entry Conditions

One of the earliest and most far-reaching Chicago school successes came in convincing the courts to recognize that new competition—supply substitution or entry—could counteract or deter the exercise of market power. Recent developments in economic theory have helped clarify the significance of sunk expenditures in determining when this would occur. If the fixed costs of entry are not sunk, and entrants have variable costs comparable to incumbents, the market is “contestable” and performs competitively regardless of market concentration among incumbent sellers (Baumol, Panzar and Willig, 1982). But if entry requires sunk expenditures, and incumbents would be expected to react quickly to cut price in response to entry, entry may be deterred even if the pre-entry price exceeds competitive levels. This may occur because the prospective entrant, recognizing the prospect of post-entry competition, will not expect to earn a contribution margin adequate to cover its sunk costs (Schwartz and Reynolds, 1983).

In theory, even small sunk expenditures may be sufficient to protect incumbents' exercise of market power (Stiglitz, 1987). But the courts (and the merger guidelines) have acted as if relatively small sunk costs create a relatively small entry deterrent. For example, in 1984 an appellate court held that Waste Man-

³ A low firm-specific pass-through rate does not necessarily imply competitive behavior, however, because in general the rate depends on the ratio of the slope of the demand function to the slope of the marginal revenue function, and thus importantly on the curvature (second derivative) of demand (Bulow and Pfleiderer, 1983).

agement could acquire another trash hauler despite a high combined market share in Dallas after concluding that low fixed (and sunk) costs made entry into trash collection easy.

The merger guidelines were revised in 1992 to describe how the federal enforcement agencies determine whether significant sunk expenditures would deter entry in response to an anticompetitive merger. The guidelines now ask whether a new competitor operating at “minimum viable scale” could secure pre-merger prices and thus be profitable (Salop, 1986; Willig, 1991; Ordover and Baker, 1992; Baker, 1997d). This question recognizes that if the entrant must operate at an output level too large for the market to absorb without depressing prices further, or if incumbents would keep the new producer from achieving the necessary output level by expanding sales in response to entry, then new competition sufficient to solve the competitive problem from merger would not be forthcoming. The guidelines test the entrant’s profitability at pre-merger prices, notwithstanding the price increase expected as a result of an anticompetitive merger, because entry will solve the competitive problem only if it returns the market price to pre-merger levels. Hence, the potential entrants relevant for merger analysis—namely, those whose entry would solve the feared competitive problem—will evaluate the profitability of entry based on a forecast that price will be at the pre-merger level.

New Developments in Analyzing Practices Facilitating Coordination

Before George Stigler (1964) wrote about oligopoly, most antitrust commentators took the view that in an industry characterized by a handful of firms, some form of tacit collusion was almost certain to arise and, in consequence, price would be elevated substantially above the competitive level. Stigler questioned the inevitability of noncompetitive oligopoly behavior by highlighting the need for oligopolists to identify a consensus and to deter deviation from it, thus raising the sort of informational and dynamic issues that have become central to contemporary oligopoly theory. For example, he observed that when firms make inferences about the strategies of rivals from changes in their own market share, an industry participant’s ability to cut price without detection by rivals, and thus its incentive to do so, increases as the market grows less concentrated.

This line of thought led toward attempts to classify industry structures as more or less likely to facilitate coordination. (The term “coordination” is now frequently used in this context in preference to traditional terms “collusion” and “cooperation,” since those terms may carry with them the legal idea of an agreement. Coordination refers to any equilibria in which firms adopt, with or without discussion or communication with their rivals, strategies that recognize that they have interacted in the past and will continue to do so in the future.) The resulting focus on the presence or absence of factors facilitating coordinated outcomes became particularly influential in merger analysis at the federal enforcement agencies following the promulgation of the 1982 Department of Justice Merger Guidelines.

The key post-Stiglerian development in the economic theory of coordinated behavior is the recognition that repeated interactions can facilitate supracompetitive pricing. Stigler had highlighted the difficulties of sustaining coordination with a focus on a one-shot prisoner's dilemma game, pointing out the difficulties firms face in achieving consensus and deterring deviation from it. But as has become well-known, in an infinitely repeated game—even the prisoner's dilemma—coordinated outcomes (often including the repeated play of the cooperative outcome of the one-shot prisoner's dilemma) can readily be sustained. This result is broadly known as the “folk theorem,” and it suggests that deterring defection may not be as difficult as it appeared to Stigler. For example, Green and Porter (1984) showed that while uncertainty about whether rivals are cheating on the cartel consensus may lead to occasional price wars, it does not necessarily undermine the possibility of substantial periods of coordination. Moreover, the other Stiglerian cartel problem, of identifying an oligopolistic consensus, appears less daunting when firms have the opportunity to engage in “cheap talk”—in the sense that term is used in Farrell and Rabin (1996)—as by announcing (indeed, negotiating) proposed price increases in the business press, without commitment, before they are implemented.

In light of these developments in economic theory, it is not surprising that business strategists teach managers how to facilitate coordination, albeit in ways calculated to avoid reaching what antitrust law would term an agreement, through practices that help firms achieve consensus or deter deviation such as price leadership, unilateral signaling announcements, selective advertising to discipline recalcitrant rivals, and standardization to simplify industry decision variables and facilitate the identification of a consensus (Porter, 1980).⁴ Yet Stigler's insight that coordination is not inevitable has not been undermined. Even when the number of firms is small, coordination among sellers may be unsustainable if buyers adopt large, widely spaced and randomly timed procurements, for example. Accordingly, a task force reviewing antitrust aspects of defense industry consolidation recommended that the Defense Department schedule its purchases in such a way as to reduce the risks of coordinated interaction by sellers (Defense Science Board Task Force, 1994).

The implication of these recent developments in economic theory in calling renewed attention to the possibility of coordination is consistent with the empirical re-

⁴ Some of these practices may call to mind another set of post-Stiglerian oligopoly models: models that suggest ways that firms can achieve supracompetitive prices in one-shot play, through commitments to take strategic action that will discourage vigorous competition by horizontal rivals. For example, firms may achieve higher prices by committing to less aggressive conduct—reducing advertising or production capacity, perhaps—when rivals would predictably respond by acting less aggressively as well (that is, when the decision variables of rivals are “strategic complements”) (Cooper, 1986; Fershtman and Judd, 1987; Bonanno and Vickers, 1988; Besanko and Perry, 1994; Rey and Stiglitz, 1995). Antitrust enforcers and courts have as yet made little use of these models, though they occasionally arise in merger enforcement. They raise litigation challenges of proving that a firm's acts are adopted with the goal and reasonable expectation of dampening competition, and, outside the merger setting, issues about the reach of the antitrust laws to the extent the commitments are unilateral.

search surveyed by Bresnahan (1989), which suggests that some concentrated industries possess a great deal of market power and that anticompetitive conduct is a significant cause of high price-cost margins. Moreover, the active criminal enforcement program of the Justice Department's Antitrust Division demonstrates that firms do indeed fix prices, notwithstanding that such agreements are not enforceable contracts.

The contemporary perspective on coordination has helped shape a Department of Justice investigation of collusion among the major airlines, which was settled in 1993 and 1994 by consent decrees in federal court. DOJ alleged that the leading U.S. air carriers employed a computer system run by an airline joint venture to fix prices. The computer system collected each airline's actual *and proposed* price changes and sent them to computerized reservation systems used by travel agents. The computer also processed the price information and gave the airlines detailed reports that were unavailable to users of computerized reservations systems. According to Justice, the airlines used those detailed reports effectively to conduct negotiations, creating a language using fare relationships and footnote designators. They allegedly reached complex bargains across markets, such as trades where one carrier offered to increase fares on a route into a rival's hub in exchange for the rival's assenting to increase fares on a route into the first carrier's hub. The consent order prevents the airlines from using footnote designators and other methods to engage in costless quasi-public negotiations about price levels. These issues extend beyond airlines: the Federal Communications Commission recently altered its rules governing spectrum auctions to require bidding in round numbers, as a means of preventing bidders from costlessly communicating (and potentially coordinating) using the "trailing digits" in their bids.

New Developments in Analyzing Exclusionary Practices

Antitrust law has long been concerned with the anticompetitive potential of exclusionary practices. Early 20th century antitrust litigation involving Alcoa, for example, arose in part out of that firm's efforts to deny potential rivals in aluminum production access to low cost electric power. Enforcement interest in exclusionary conduct waned as courts recognized that conduct that excludes rivals can also promote competition—as when a deal for exclusive distribution discourages dealer free-riding on manufacturer promotional efforts. However, recent economic research, often relying on game-theoretic modeling techniques, has clarified the logic by which exclusionary practices can harm competition, and thus brought a resurgence of interest in the ways firms can achieve market power by raising rivals' costs or through other non-price exclusionary conduct (Salop and Scheffman, 1987; Ordoover, Saloner and Salop, 1990; Rasmusen, Ramseyer and Wiley, 1991; Bernheim and Whinston, 1998).

One insight suggested by this literature is that exclusionary practices can harm competition by leading rivals to participate in, or accede to, what might be termed an "involuntary" cartel. Suppose, for example, firms *A* and *B* would like to collude with rival *C*, their only actual or potential competitor in a market protected from

entry, but they cannot do so because *C* would increase output (or enter) were *A* and *B* to raise price. If *A* could somehow raise *C*'s marginal costs or otherwise make it more difficult for *C* to sell more, then *C* would be led to do what it would not have done previously: reduce its output. *A* might be able to accomplish this end by foreclosing *C* from access to low cost sources of supply or distribution, perhaps through exclusive contracts, or by making it more difficult for *C* to attract customers, perhaps by tying sales of its products together. Then, *A* and *B* could take advantage of the less aggressive competition from *C* to exercise market power.

It is by no means a foregone conclusion that such a strategy would work for firm *A*. Firm *C* may have alternative means of obtaining supply or distribution. Firm *B* may not go along with *A* in reducing output once *C* is taken out of the picture. The strategy may be unprofitable for *A* given that it must bear the full costs of excluding *C* while sharing with firm *B* the benefit of any higher prices that result. Moreover, *A*'s strategy may both disadvantage *C* and increase aggregate economic welfare. For example, a manufacturer may foreclose rivals from effective distribution by requiring the dealer not to handle the products of rival manufacturers, but the same practice may also lead the manufacturer to increase its promotional effort, reduce dealer free-riding, and result in better service to customers. Notwithstanding these caveats, it should be clear that it is possible for exclusionary deals with suppliers, distributors, or customers to impair horizontal rivalry and reduce aggregate surplus.

In several recent cases, enforcement agencies have claimed that an attempt was made to raise the costs of rivals. The FTC recently found that Toys R Us convinced toymakers not to provide certain merchandise to warehouse club stores, thereby reducing retailing competition from an alternative distribution channel. (The toy retailer's defense is in part that it was acting to prevent free-riding by rival dealers on its investments in promoting toys and the firm is likely to appeal.) The FTC's 1997 consent settlement with Time Warner resolving a complaint arising from its acquisition of Turner Broadcasting sought to address (among other things) concerns that Time Warner might have been able to reduce the competition facing its company-owned cable television systems by raising the price of CNN and other programming to satellite providers of broadcast video. Similarly, in several recent enforcement actions involving health care providers, the Department of Justice has challenged health insurance plans with high market shares that adopted "most-favored-customer" provisions, which require affiliated dentists or other providers not to accept lower reimbursement rates from any other insurance plans they also join. Justice was concerned that such provisions would discourage entry by lower-cost rival insurance plans, by making it difficult for those rivals to convince providers to join their networks.⁵

The Justice Department's 1995 consent decree with Microsoft also addressed practices that allegedly harm competition by raising rivals' costs. A key provision

⁵ The close scrutiny that most-favored-customer provisions receive from the federal enforcement agencies also derives from a concern that they may facilitate coordination by discouraging targeted price-cutting (Salop, 1986; or see the survey in Baker, 1996).

prevents Microsoft from receiving royalties from computer manufacturers on a per-processor basis, regardless of whether Microsoft's Windows operating system was installed on those machines. Under this provision, a firm effectively pays twice for the operating system if it installs an operating system owned by a Microsoft rival—once to the rival and once to Microsoft—but it pays only once for a computer with Microsoft's operating system installed. Gilbert and Shapiro (1997) characterize this provision as a "penalty clause." It raises the costs for firms with rival operating systems seeking to induce computer manufacturers to adopt a competing operating system for some product lines, and could thus protect Microsoft's alleged monopoly power in operating systems.

In the 1995 Microsoft case, the Justice Department was seeking to protect competition in innovation as much as price competition. Protecting incentives for innovation is a common recent theme at the antitrust enforcement agencies. Another example occurred when two pharmaceutical producers, Ciba-Geigy and Sandoz, sought to merge in 1996. The FTC obtained a consent settlement requiring the merged firm (Novartis) to sell off one of the competing research and development efforts in genetic engineering to a third firm to protect competition in innovation. Moreover, in a new round of Microsoft litigation, the Justice Department is currently asking a court to determine whether Microsoft's integration of Internet browser software into Windows harms innovation and tends to create or maintain monopoly by excluding rivals selling browsers such as Netscape (DOJ's view), or promotes innovation and competition by improving software design (Microsoft's position).⁶

The widely discussed possibility of network externalities—the benefit that users obtain when other customers use the same product, as with much computer software—raises the stakes for antitrust enforcers in discriminating between harmful and beneficial exclusionary practices.⁷ The possibility of network effects increases the efficiency benefits of having a single standard in the marketplace, but it may also entrench a firm and so allow it to exercise market power in a more damaging way. In consequence, antitrust enforcement decisions may be ineffective unless they are made early in an industry's development, before a standard becomes so secure as to make an antitrust remedy impractical. Yet it may be hard to make reliable judgments before uncertainties about the consequences of the challenged conduct have been fully resolved in the marketplace.

New Developments in Analyzing Unilateral Anticompetitive Effects of Mergers

Unilateral theories of the anticompetitive effect of mergers have become common in the internal analyses of antitrust enforcement agencies during the last de-

⁶ For a range of views on competitive issues raised by the Microsoft case, see the conference volume edited by Eisenach and Lenard (forthcoming); see also Carlton and Waldman (1998).

⁷ For more discussion of network externalities, see Carlton and Klammer (1983); the Symposium on Network Externalities in the Spring 1994 issue of this journal; and Shapiro and Varian (1999).

cade. Instead of focusing on how a merger could make coordination more likely or more effective, the unilateral theories describe how a merger would make it profitable for the merged firm to raise price without assuming repeated play, as by taking rivals' reactions as given.⁸

Two developments in economics spurred the recent interest in unilateral theories. The first was a theoretical literature that investigated the conditions under which oligopolists would find merger profitable even if the industry members were not coordinating their actions, but were instead taking each other's output or price as given, consistent with Cournot-Nash or Bertrand-Nash solution concepts (Salant, Switzer and Reynolds, 1983; Deneckere and Davidson, 1985; Perry and Porter, 1985; Farrell and Shapiro, 1990). The second was an empirical literature encouraged by the simultaneous development of new econometric tools and computerized point-of-sale scanner data (Baker and Bresnahan, 1985; Berry and Pakes, 1993; Hausman, Leonard and Zona, 1994; Werden and Froeb, 1994; Baker, 1997a). These tools and data can make it possible to identify the extent to which buyers consider individual products to be close substitutes; the extent to which, in consequence, individual products constrain the pricing of rivals; and the extent to which mergers encourage higher prices by removing those constraints. The 1992 revisions to the DOJ and FTC Horizontal Merger Guidelines recognize these economic developments by describing several ways in which a merger can lessen competition through unilateral effects; see also Willig (1991).

The most common unilateral theory can be illustrated by a hypothetical example in which many buyers of one firm's Crunchy cereal brand view a rival's Fruity brand as their second choice at current prices. A merger between the firms would provide an incentive to increase the price of the Crunchy brand. Before the merger, a higher Crunchy price would lead to some loss of sales to the Fruity firm. But if the Crunchy firm acquires the Fruity firm, then it will recapture some of the contribution to profit on the lost Crunchy sales through an increase in Fruity sales. Accordingly, the merger removes Fruity as a competitive constraint on Crunchy pricing. This problem is the most serious if the Fruity and Crunchy brands are the closest substitutes for each other, but that is not necessary for competitive harm to occur. The merged firm has some unilateral incentive to raise the Crunchy price even if most of the lost sales go to brands other than Fruity—as long as some of the lost sales go to Fruity. Moreover, the merger could lead to higher prices even if the merging firms account for small shares of the breakfast cereals category.

The application of this unilateral theory of anticompetitive effect is controversial; not because the economic theory is questioned, but because the results can be demonstrated through methods (such as the estimation of demand cross-elasticities between only a few products) that do not necessarily require an over-

⁸ A merger that operates as a commitment to less aggressive conduct, leading to higher prices when rivals would predictably respond by acting less aggressively as well, would also harm competition unilaterally, though some might instead view this outcome as coordinated.

all definition of a market (Baker, 1997c). Under such circumstances, the traditional practice of not challenging mergers among firms with low market shares (memorialized in “safe harbors” based on market concentration in the Merger Guidelines) may be undermined. Some critics make this point by arguing that this approach is tantamount to reviving the concept of “submarkets”—or very narrow definitions of markets—which Chicago school antitrust commentators had attempted to discredit.

Although the merger in the hypothetical example leads to a higher price so long as Crunchy and Fruity have a non-zero demand cross-elasticity, this theory does not in fact imply that all mergers among sellers of differentiated products will harm competition. Other forces, recognized in the merger guidelines though ignored in the above example, may undermine or counteract the merged firm’s incentive to raise price. These include: product repositioning, in which a third firm, Oaties, responds to the Crunchy price rise by adding Crunchy Oaties to its product line; efficiencies, in which the merger may lower marginal cost, leading the post-merger price to fall notwithstanding the loss of direct competition between the brands; and entry by other firms.

In some cases it is possible to estimate demand cross-elasticities among the products of the merging firms; data limitations and the econometric problem of identification are the most common hurdles. Information on cross-elasticities can then be used—in combination with estimates of price and marginal cost for the relevant products—to make inferences about the strength of the merged firm’s incentive to raise price. One approach for making such inferences reports the extent to which the demand curve faced by the firm will grow steeper as a result of the transaction (Baker and Bresnahan, 1985). Another approach simulates the profit-maximizing post-merger prices, thereby incorporating information or assumptions about the non-local (and perhaps out-of-sample) behavior of demand and marginal cost (Shapiro, 1996; Werden, 1996, 1997; Hausman and Leonard, 1997).⁹ Even when quantitative estimates of the information needed to employ these techniques—such as demand cross-elasticities, marginal cost, the pass-through rate, or the oligopoly solution concept—are unavailable or imprecise, these methods can still inform the evaluation of qualitative information.

The unilateral theory based upon the loss of localized competition among sellers of differentiated products underlies a number of recent consent settlements reached between merging firms and the FTC or Department of Justice in

⁹ These are not the only ways econometric methods are now used to demonstrate unilateral anticompetitive effects of mergers. In litigating its successful challenge to the Staples/Office Depot merger, for example, the FTC introduced an econometric study to show that head-to-head competition among office superstore chains within metropolitan areas lowered the price of consumable office supplies (Baker, forthcoming). This study related variation in Staples’ prices to changes in the number and identity of rivals; it was not an effort to estimate demand cross-elasticities. Other econometric methods of measuring market power are surveyed in Bresnahan (1989) and Baker and Bresnahan (1992).

consumer product industries. For example, the FTC recently required two merging producers of distilled spirits, Grand Met and Guinness, to divest Dewars scotch and Bombay gin to resolve competitive problems arising from that transaction. Similarly, the Justice Department recently entered into a consent decree requiring Continental Baking Co., which markets Wonder Bread, to spin off a brand of white bread in each of several regions of the country before acquiring Interstate Bakeries Corp.

This model also applies outside of industries selling branded consumer products. For example, antitrust enforcers analyzing a proposed merger of accounting firms might ask whether the merger partners have greater expertise in auditing firms in certain industries, making them closer substitutes than rival firms for that business. A different unilateral theory, involving an auction model, was employed by the FTC staff to analyze the competitive effects of a merger involving two large drug store chains (Baker, 1997b).

Concluding Comment

Three decades ago, antitrust law relied heavily upon “per se” rules, which took the broad brush approach of deeming certain classes of business practices anticompetitive without regard to their effects in any particular case. Today, a case-by-case analysis is more common, often under the judicial rubric of applying the “rule of reason.” For example, in 1997, the Supreme Court ruled that maximum resale price maintenance (a practice by which a manufacturer capped dealer resale prices) would no longer be considered illegal per se. Similarly, at one time any attempt among sellers of substitutes to engage in price-fixing or market division was universally condemned; today, these practices could be allowed if they are necessary to create a valuable new product, as when separately owned teams create a sports league and set prices jointly or when separately owned moving companies in different cities adopt a common brand name. Moreover, antitrust enforcers and courts have shifted from relying primarily on market share evidence to predicting the competitive consequences of business practices; today, market definition and market shares are increasingly treated as merely one element in a detailed economic analysis of the consequences of the particular conduct at issue.

A benefit of this trend toward a more detailed economic analysis of individual practices is that it can reduce errors in determining the likely effects of business conduct. The FTC’s successful challenge to the Staples/Office Depot merger, for example, might have come out differently under the old approach. The government’s case was probably weakest in the market definition question (in showing that office superstores were a relevant product market excluding other channels for the distribution of office supplies) and strongest in offering direct evidence (documentary and econometric) that the merger would probably lead to higher prices for consumers. However, better analysis of individual cases may come at the

expense of reducing the clarity of legal rules and the certainty of their application, which affects both judges evaluating antitrust claims and firms wondering whether a proposed course of conduct would violate the antitrust laws. The increased reliance on case-specific economic analysis may also add to the cost and time involved in investigating and litigating cases. However this tradeoff is resolved—that is, regardless of whether economic models are used to design “per se” rules or to provide insights to guide the evaluation of case-specific evidence—economic analysis remains central to antitrust practice.

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