

# Resetting merger policy in the new Administration

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## I. Introduction

1. We are in an extraordinary wave of mega-mergers involving leading firms in major industries. The resulting increases in concentration resonate with broad concerns, including at the White House, that the U.S. economy may be becoming less competitive. Meanwhile recent economic research increasingly challenges the conventional view that most mergers are competitively beneficial or at least benign, and that current merger control policy adequately identifies and addresses the few—but important—exceptions. Instead, a growing body of evidence casts doubt on the traditional claim that the great majority of mergers overall deliver benefits, and suggests that mergers at or near the enforcement margin have often been harmful to consumers.

2. All this presents the new Administration with a challenge, an opportunity, and—we believe—a need to reset merger control policy. Our recommendation has two parts. First, the evidence already indicates that merger control should become tighter than it has recently been, that the often disparaged “structural presumption” deserves more respect, and that merger remedies on average need to be stronger in order to do their advertised job of fully preserving competition. Second, in a longer focus, consumers and the economy would greatly benefit from much more investment in making merger control better-targeted (“smarter”), and we point to some obvious, if mildly costly, investment opportunities that should be eagerly embraced.

3. There are, of course, many components to sound merger policy—resources, staff, leadership, legal authority, economic tools, IT support, and much else. Given the high stakes, it would not be hard to recommend worthwhile improvements in all of these. Our approach here is both inevitably narrower and, we hope, better targeted. With the decline in useable presumptions

in merger analysis, each significant merger demands an investigation uniquely focused on that specific merger. Market definition, concentration or diversion assessments, competitive concerns, offsetting factors, are all examined on a case-specific basis with the objective of arriving at a detailed and uniquely applicable conclusion.

4. This one-at-a-time retail approach is costly and time-consuming; more importantly, we believe, it fails to fully exploit (and build) useable experience, or the knowledge and institutional infrastructure that can assist in making merger review and control substantively more effective and procedurally more efficient.

5. We begin with a brief summary of the factual basis for concern over mergers and merger policy, in light of significant new economic research. We then offer specific recommendations for how the new Administration can strengthen and improve merger enforcement.

## II. Facts and forces

6. In the past few years, airlines, telecom, hospitals, groceries, pharmacy benefits managers, banking, pharmaceuticals, meat packing, beer, and seed companies, among many others, have consolidated via mergers and acquisitions. Newly proposed mergers in insurance markets, semiconductors, telecom, drug stores, chemicals, and oil field businesses dominate the news. October has just witnessed the largest monthly total value of announced mergers ever—a quarter of a trillion dollars in a year that will also set a record.<sup>1</sup> The proportion of mergers valued in excess of \$1 billion and reported to the two U.S. antitrust agencies—the Antitrust Division of the Justice Department (DOJ) and the Federal Trade

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<sup>1</sup> Merger Deals Set a Record, Even as Election Looms, *Wall Street Journal*, Oct. 28, 2016. The worldwide total for the month is twice that, nearly a half trillion dollars in deals.

Commission (FTC)—has nearly tripled in the past fifteen years. While not all of these mergers will be approved, many are of a scale and significance that would have made them unthinkable and therefore not even proposed in the not-too-distant past.

7. Not entirely coincidentally, concern has arisen that the U.S. economy may be less competitive than it used to be, or than it ought to be. Numerous articles and commentary in the popular and business press carry such headlines as “Why Corporate America Could Use More Competition,”<sup>2</sup> “How Mergers Damage the Economy,”<sup>3</sup> and “Too Much of a Good Thing,”<sup>4</sup> referencing corporate profits. More significantly, a recent Issue Brief by the Council of Economic Advisors, entitled “Benefits of Competition and Indicators of Market Power,” suggests that “*competition may be decreasing in many economic sectors*” and provides indicators of this concern.<sup>5</sup> The first such indicator is rising industry concentration, for which it cites an array of supporting data, followed by increasing rents to a few firms and decreased rates of firm entry and labor mobility.

8. While the CEA Issue Brief discusses the role of antitrust policy in restraining concentration, it offers no opinion about agency actions, mostly emphasizing the importance of competition concerns in other policy areas. But other evidence has now documented the relationship between antitrust policy and rising concentration. FTC data show that its merger enforcement actions have over time steadily narrowed its focus to just the highest concentration industries.<sup>6</sup> Among mergers resulting in four or fewer significant competitors, the percent of formal investigations that led to some type of FTC action held steady or even rose a bit between 1996 and 2011. For mergers that left more than four remaining rivals, however, the corresponding percent of investigations that prompted enforcement dropped from 38% to zero by 2008–2011. This tolerance toward mergers in all but the highest concentration cases has contributed directly to rising concentration.

9. Meanwhile, new economic research has cast doubt on key assumptions that underlie modern merger policy. One of us has conducted a meta-analysis of all retrospective studies in the economics literature covering horizontal mergers in the U.S. over the past twenty-five years.<sup>7</sup> These studies evaluate the outcomes of actual mergers, taking into account as far as possible other plausible influences for any price changes. That study reports that more than 80% of these studied mergers have resulted in price

increases, and those increases average about 10%. Most of these mergers are “at the enforcement margin”—that is, close calls looked at carefully by the antitrust agencies. The implication is that for mergers at the enforcement margin, policy has been systematically too permissive,<sup>8</sup> allowing anticompetitive mergers, higher concentration, and harm to consumers.<sup>9</sup>

10. Related to this is the fact that of mergers that have been subject to enforcement actions, ever fewer are challenged. Rather, most problematic mergers are now resolved through some type of remedy—either divestitures or conduct remedies. The evidence from these same merger retrospectives suggests, however, that these remedies have not generally been fully effective in maintaining or restoring pre-merger competition. Both types of remedies are associated with significant price increases, with conduct remedies much the worse. It would seem that remedies are not doing their job, may in fact be overused as an alternative to outright challenges, and by permitting mergers to proceed, may also have contributed to rising industry concentration.

11. Additional insight into these issues comes from other research into mergers.<sup>10</sup> Another new study examines the effect of mergers on price-cost markups and on productive efficiency from all manufacturing plants that have undergone recent mergers. It finds no evidence of gains in productive efficiency subsequent to mergers involving these plants, but significant increases in price-cost margins. These results call into question the conventional wisdom that most mergers (even if not those at the enforcement margin) are efficiency-enhancing, or at worst competitively neutral. This evidence implies that the vast majority of mergers do not in fact deliver their promised benefits, but rather raise profit margins.

12. Another strand of recent empirical economic research investigates the competitive effects of common, third-party ownership of companies in the same industry. While this arrangement is well short of merger, the study finds significant weakening of competition. This is

8 Strictly, the inference is that mergers of the type that has been likely to be studied in this way (and the results then published) are on average anticompetitive. One might be concerned that this selection over-weights mergers on the enforcement margin that researchers believe may have been wrongly decided by the agencies or courts. But for purposes of evaluating agency decision-making, those on the enforcement margin represent the correct set of experiences, and if the selection process favors those believed to be wrongly decided, that selection in turn makes our point. One could also worry about publication bias, but in view of the general findings in the literature, a study that finds a horizontal merger to be pro-consumer is probably at least as publishable as one that finds the reverse.

9 Other compilations of studies due to Weinberg, Ashenfelter, and others have come to similar conclusions, albeit with fewer studies and less selective criteria. M. Weinberg, The Price Effects of Horizontal Mergers: A Survey, *Journal of Competition Law and Economics*, (2007) O. Ashenfelter, D. Hosken, and M. Weinberg, October 2008. O. Ashenfelter, D. Hoskens, and M. Weinberg, Did Robert Bork Understate the Competitive Impact of Mergers? *Journal of Law and Economics*, 2014. See also A Review of Merger Decisions in the EU: What Can We Learn from Ex Post Evaluations, Report to the European Commission, 2015, for a similar compilation of European mergers. Concern over the permissiveness of merger policy was articulated earlier by Baker and Shapiro, among others, although without the benefit of systematic data. J. Baker and C. Shapiro, Reinvigorating Horizontal Merger Enforcement, in *How the Chicago School Overshot the Mark*, R. Pitofsky (ed.), Oxford, 2008.

10 B. Blonigen and J. Pierce, Evidence for the Effects of Mergers on Market Power and Efficiency, *NBER Working Paper No. 22750*, October 2016.

2 *Wall Street Journal*, July 8, 2015.

3 *New York Times*, October 31, 2015.

4 *The Economist*, March 26, 2016.

5 Council of Economic Advisors Washington, DC, April 2016.

6 J. Kwoka, The Structural Presumption and Safe Harbor in Merger Review: False Positives, or Unwarranted Concerns? *Antitrust Law Journal*, forthcoming.

7 J. Kwoka, *Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy*, MIT Press, 2015. There are about sixty such studies covering fifty mergers individually and more than 2000 others in grouped-merger studies.

a concern by itself, of course, but also, a lesson that strongly suggests a fortiori that full mergers among the same sets of firms would harm competition.<sup>11</sup>

13. No single study, data source, or set of conclusions is definitive, of course. Each is subject to possible limitations in its number of observations, time period, selection bias, statistical significance, and method of analysis. Yet the breadth and consistency of the evidence, as well as the plausible causal linkage between the narrowing of enforcement, rising concentration, and harmful outcomes of mergers, make a convincing case for revisions of merger enforcement policy and practices. It is to those revisions that we now turn.

### III. Implications for resetting policy

14. Among the most important advances in merger control has been the promulgation of the Merger Guidelines by the Federal Trade Commission and the Department of Justice. The 2010 guidelines (issued while one of us was chief economist at the FTC) in particular have gone far toward explaining the analytical tools and processes that the agencies use in evaluating the competitive effects of a specific merger. Our recommendations here center on strengthening the agencies' ability to make better and more explicit use of experience with the outcomes of past mergers. The 2010 Guidelines newly mentioned this as a source of information (section 2.1.2), but they are about how to evaluate one specific merger already before the agencies. We take a broader view here, and have three recommendations. One of these involves greater reliance on some findings of economics, notably based on reviewing past experience; another urges more ongoing evaluations to build the knowledge base, and a third focuses on the judiciary that reviews agency actions. We take these up in turn.

#### 1. Toughening enforcement

15. In part based on the evidence briefly described above, we recommend a general toughening of merger control, in two somewhat distinct directions. The first would be more enforcement actions "at the margin," or against "close call" mergers.

16. While in the end the agencies or courts have to arrive at a nearly one-dimensional view on the strength of the case against a proposed merger, the analysis typically evaluates a merger on multiple dimensions: closeness of competition between the parties, availability of other substitutes, market concentration, ease of entry, efficiencies, etc. Thus if we are recommending more enforcement against "close-call mergers," which close call mergers?

Close in which dimension? Equivalently, which (inevitably imperfect) indicators of concern should get more weight, notwithstanding their imperfections? Which kinds of exculpatory evidence should be evaluated with more skepticism?

17. In the long run, as discussed below, the right answer must be: those that are found, through all the evidence including ongoing review of the ever-growing dataset of mergers, to be most predictive of harm. But we should not be paralyzed pending long-run research. What to do now?

18. We favor expanding the weight put on less traditional indicators that reflect sound economic logic (as indeed at least one of us has argued elsewhere<sup>12</sup>) and/or experience, but we would also encourage continued<sup>13</sup> use in appropriate circumstances of the most traditional indicator of competitive problems: concentration. Merger control is in need of stiffening, as discussed above, in part because (in a very relevant range of concentration) agencies' and courts' confidence in the use of concentration as an indicator of competitive problems has ebbed faster than their confidence in the use of other economic indicators has grown. This loss of confidence is in part due to overstated doubts about its empirical foundation, in part due to a policy or decision-theoretic concern that it would prohibit too many beneficial mergers, and in part due to the problems of market definition.

19. While often described as sharply down-weighting the role of concentration, the current 2010 Horizontal Merger Guidelines in fact devote a great deal of discussion to market definition, which is largely a preparation for measuring shares and concentration. The Guidelines then echo the Supreme Court's statement that significant horizontal mergers in concentrated industries can be presumed likely to have anticompetitive results without the need for detailed economic evidence in each specific case.<sup>14</sup> Specifically, the Guidelines state that "*Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power,*" although they go on to state (again echoing the Supreme Court) that "*this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.*" We think this gets it about right. But in practice much hinges on the term "persuasive," since claims such as ease of entry or offsetting efficiencies appear often to persuade some but not others. We would hold fast to the notion that the evidence needs to be truly and fully persuasive.<sup>15</sup>

11 J. Azar, M. Schmalz, and I. Tecu, Anticompetitive Effects of Common Ownership, *Ross School of Business Paper No. 1235*, 2015.

12 J. Farrell and C. Shapiro, An Economic Alternative to Market Definition, *B.E. Journal of Theoretical Economics*, 2010.

13 One of us would say "greater."

14 This presumption was first articulated by the Supreme Court in the *Philadelphia National Bank* case of 1962.

15 One of us might even substitute the term "conclusive."

**20.** This is not the place to fully discuss the light cast by economic research (including recent research) on the structural presumption, but the perception that it has been overturned by modern economics is not correct. Salop has demonstrated the rational basis for a decision rule like the structural presumption in the face of some information about outcomes but also uncertainty with respect to particular cases.<sup>16</sup> One of us has provided empirical evidence that use of the rule would not result in large type I errors.<sup>17</sup> We take these findings as an indication of the value of appropriate reliance on concentration. As our qualifier “appropriate” acknowledges, concentration is more informative, and the structural presumption makes more sense, in some circumstances than in others. For instance, it is better targeted toward assessing concern with coordinated effects than unilateral effects. To give another example from the Guidelines, market shares and concentration have different significance when they are “*stable over time, especially in the face of historical changes in relative prices or costs*” (Guidelines, 5.3). Moreover, its application rests on market definition, which can be controversial and uncertain, potentially—but not always—a significant caveat to the usefulness of the structural presumption. However, all of this calls for intelligent and selective use, not for blanket disuse.

**21.** Improved learning ought to enhance our ability to use experience with past mergers to help predict the effects of newly proposed ones. Loss of confidence in the structural presumption, below the very highest levels of concentration, unaccompanied by the development of new presumptions, inevitably either undermines enforcement or requires a kind of *de novo* development of industry-specific oligopoly science for every merger separately, or both. A presumption is in a sense the vehicle by which the evaluation of a proposed merger can import experience from previous mergers and the study of oligopoly more broadly.

**22.** A second change focuses on merger remedies—structural remedies that involve divestiture of overlapping assets, and conduct remedies that seek to constrain the merged firm’s behavior in specific dimensions. Most of the agencies’ enforcement actions, as reported for instance in the annual HSR Reports, consist of such remedies rather than actually blocking mergers. In principle, remedies have the appealing property that they can preserve a merger’s efficiencies while undoing any anti-competitive effect.

**23.** But the currently available evidence is that, in recent mergers that have been studied, remedies—conduct remedies in particular—are on average by no means fully effective. Consequently, we recommend that agencies and courts should examine ways in which remedies can be made more effective, where this can be done. If that proves impossible, then logically the agencies should

shift enforcement actions away from reliance on remedies and toward outright “full-stop” challenges, recognizing that the wisdom of this hinges in part on courts’ receptivity to such challenges. At a minimum, use of a remedy should be evaluated with the recognition, based on experience, that remedies do not always have the intended or expected effects. The agencies, of course, already use remedies that they believe will be effective, but the available quantitative evidence suggests that in the recent past they have been on average too optimistic.

## 2. More attention to learning from experience: More systematic retrospectives

**24.** Our second recommendation is that merger enforcers should more fully and more consciously exploit past experience in order to learn and improve future policy. Improvements in merger policy have mostly derived from advances in economic theory and use of case-specific evidence. The opportunity to explicitly learn from detailed experience of outcomes of past mergers, as distinct from the agencies’ rich experience with making intelligent predictions, has only recently begun to be exploited on any significant scale, and the opportunity to do far more is tremendously valuable. We recommend that retrospectives be routinely conducted on a wider range of industries, with more attention to non-price effects, and with closer attention to the quantitative effects of various types of remedies. In addition, as Dennis Carlton has argued, retrospectives should compare post-merger outcomes to pre-merger predictions of those outcomes, as well as to pre-merger market performance.

**25.** While the merger retrospectives referenced above are largely either academic or the output of the “research mission” for economists at the agencies, the agencies have also sometimes publicly examined their own experiences in a more directly policy-focused way. In 1999, for example, the FTC released a review of its divestitures over the preceding six years. The results led to revisions in agency practices with respect to divestitures, and the study was replicated in several other countries. The FTC is currently completing another such study, this examining all types of remedies in recent years. While neither of these involve quantitative retrospectives—with measurement of performance outcomes and proper controls for other factors—they have been path-breaking.

**26.** The FTC has also used quantitative merger retrospectives quite directly in policy. After a series of courts rejected the FTC’s (as well as DOJ’s) efforts to block what it believed were anticompetitive hospital mergers, in 2000 the FTC launched a systematic review of the effects of the mergers it had sought, but failed, to block. Those retrospective studies found that as the FTC had predicted, adjusted for other factors, prices generally did rise. Armed with these results and some other revisions to its approach, the agency returned to court to challenge new mergers—this time, more successfully.

16 S. Salop, *The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach*, *Antitrust Law Journal*.

17 Kwoka, *op. cit.*, forthcoming.

27. These and other such initiatives<sup>18</sup> illustrate that retrospectives are valuable investments in strengthening future policy. Surprisingly, the agencies themselves, while very aware of this lesson from their own studies, have not pursued it as vigorously as we would hope. Why do the agencies not do more retrospectives? A big part of the answer surely is limited resources, as we know from experience and discussion. But we would argue that this is a false economy and that retrospectives are a very valuable investment, as witnessed by the FTC's program of hospital merger retrospectives that made subsequent investigations and challenges less resource-intensive and more accurately targeted. Even if the resulting learning only modestly cuts down on "errors" (whether errors allowing anticompetitive mergers or blocking beneficial ones, or both), the sheer scale of merger activity means that putting a few million dollars into getting smarter about merger review would have a very handsome payback for competition, consumers, and business.<sup>19</sup> We therefore urge the agencies to take up this cause, including by requests for funding such new research investments.

### 3. Judicial education

28. Our antitrust agencies between them have over a hundred Ph.D. economists working on merger control, and hundreds of lawyers who are experienced in merger control and at least generally familiar with the economics. Yet when the agencies challenge a merger, the decision is (with caveats in the case of the FTC) in the hands of a generalist court, often one unfamiliar with the economic tools that comprise the analytical and empirical foundations of policy. The more technical aspects of market definition, competitive effects, entry, and efficiencies are not self-evident, nor are the most recent empirical findings with respect to concentration, diversion, and competitive effects. As a result, the agencies may rightly perceive that they need to make a different—and often a less precise—case in court than that which they develop internally. Worse yet is the possibility of judicial review that results in an erroneous decision accompanied by an opinion that establishes a troublesome precedent. And that risk in turn creates the derivative risk that the agencies may bring only the clearest cases, rather than all those that should be brought.<sup>20</sup>

18 For some time the UK Office of Fair Trading and the Competition Commission conducted regular evaluations of their competition policy actions. The 2014 framework establishing the Competition and Markets Authority as their successor explicitly provided that it "will report annually on (...) independent evaluations of the impact of at least two cases (including at least one market study or investigation)."

19 Such an initiative may be more straightforward for the FTC than for the Antitrust Division of DOJ. The FTC has authority to collect data for research purposes, and has used that authority in its reviews of remedies. While DOJ has no comparable authority, it might require data production from merging parties as part of any settlement of a merger, since it has legitimate interest in the effects and effectiveness of its policies. This would still represent a considerable increase in the numbers of retrospectives.

20 Evidence of this latter possibility would be a too high won-loss record in merger challenges, although we do not mean to dismiss the sunnier alternative interpretation of such a favorable record. Indeed, DOJ has not recently lost any merger cases whatsoever. Concerns over the outcomes of court proceedings almost surely play a role in excessive reliance on remedies as opposed to challenges to mergers.

29. We do not suggest a move to specialist courts, but we would urge a concerted effort by the agencies to explain more fully their economic criteria for identifying problematic mergers and their methods for analyzing effects. To avoid being treated merely as part of the litigation process on the part of an "interested party," that explanation probably needs to be either detached from, or well after, any particular case. The 2010 Merger Guidelines, perhaps even more than their predecessors, aimed to explain best current practices in this sense, but they could usefully be supplemented or updated through agency Commentaries or White Papers explaining best current understanding to the courts, the business community, the press, and other interested observers. These documents would not have the same force as the Merger Guidelines, but they would constitute a readily accessible overview and explanation of the agencies' perspective on key matters.<sup>21</sup> Subject to appropriate confidentiality, they could also disclose lessons from the ongoing program of learning from retrospective experiences.

30. In addition, the agencies might devise fuller educational curricula for those judges who may be interested in antitrust and others about to be confronted by an antitrust case for the first time. These curricula could be offered periodically in real time at the agencies, but also made available online through posted materials, perhaps streamed videos of lectures, and similar strategies for disseminating information and materials on key issues.

## IV. In conclusion

31. We recommend adjusting or resetting merger policy based on experience with carefully studied past mergers, which will involve a stiffening of merger control at least at the margin. We also recommend greatly expanding the rate at which such experience is gathered, recorded, and studied. Practice makes perfect, but only with accurate feedback.

32. Our recommendations are directed at making the process less of an isolated, one-at-a-time analytical exercise for each merger, and more one that is systematically informed by experience such as retrospectives, supported by presumptions where appropriate (the presumptions themselves presumably informed by experience), and reviewed by an informed judiciary. This would help make our merger control more effective, more predictable, and more efficient. We urge the new Administration to seize a moment in which such changes seem possible and to reset merger control in a fashion that will better serve the interests of competition and consumers. ■

21 In order not to appear to carry too much of an endorsement, the agencies could extract examples from the record in litigated matters, as the 2006 Commentary on the Merger Guidelines did.