Opening Statement of Professor Carl Shapiro

Senate Judiciary Committee
Subcommittee on Antitrust, Consumer Protection and Consumer Rights

"The Consumer Welfare Standard in Antitrust: Outdated, or a Harbor in a Sea of Doubt?"

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Chairman Lee, Ranking Member Klobuchar, and Members of the Subcommittee, thank you for giving me the opportunity to testify in front of you today.

My Background

I am an economist who has been studying competition policy, and more generally the relationship between government and business, for nearly 40 years. I am a Professor of Business and Economics at the Haas School of Business at the University of California at Berkeley. I served as the Deputy Assistant Attorney General for Economics in the Antitrust Division of the Department of Justice during 2009-2011 and previously during 1995-1996. I led the working group at the Antitrust Division that, together with the Federal Trade Commission, revised the DOJ/FTC Horizontal Merger Guidelines in 2010. I also served as a Senate-confirmed Member of the President's Council of Economic Advisers under President Obama during 2011 and 2012.

I am an advocate of vigorous, principled antitrust enforcement, especially regarding horizontal mergers. In addition to my academic research, I have served on numerous occasions as a consultant and expert witness for the Antitrust Division and for the Federal Trade Commission. Since leaving government service in 2012, I have provided testimony in Federal court as an economic expert in support of the DOJ's successful challenge of the merger between Bazaarvoice and PowerReviews in 2013, and in support of the FTC's successful challenge of the merger between Staples and Office Depot in 2015. I also have consulted and testified for a number of private clients in antitrust cases, and I testified on behalf of the U.K. Competition and Markets Authority in London, England in March 2017.

My recent paper, "Antitrust in a Time of Populism," is directly relevant to the questions that the Subcommittee is exploring at this hearing.[1] That paper assesses and interprets the evidence on concentration in U.S. markets, corporate profits, and price/cost margins. Based on that evidence I call for more vigorous horizontal merger enforcement in the United States.

My recent paper with Herbert Hovenkamp, "Horizontal Mergers, Market Structure, and Burdens of Proof," also is relevant to this hearing.[2] Based on economic evidence, that paper strongly supports the "structural presumption" in merger law, which states that mergers between rivals that significantly increase market concentration and lead to highly concentrated markets are likely to harm competition.

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[1] This paper is available on my web site at http://faculty.haas.berkeley.edu/shapiro/antitrustpopulism.pdf and is appended to this opening statement.

[2] This paper is available on my web site at http://faculty.haas.berkeley.edu/shapiro/structuralpresumption.pdf and is appended to this opening statement.

The Goal of Antitrust: Promoting Competition

Much of my career has been devoted to the goal of making sure that Americans enjoy the benefits of competitive markets. Consumers benefit from competition due to lower prices and improved products and services. *In my view, the proper goal of antitrust is straightforward: to promote competition.* We need rules of the road in three general areas to protect the competitive process from sabotage: (1) **Cartels**: rules against cartels and other forms of collusion; (2) **Mergers**: rules stopping firms from merging rather than competing, and (3) **Exclusionary Conduct by Dominant Firms**: rules stopping dominant firms from engaging in exclusionary conduct to weaken or eliminate their rivals.

The central paradox of antitrust is that to have a "free market" economy, we need these rules – we need our antitrust laws. Put starkly: to have free, competitive markets we need government oversight. We have known this for at least 125 years, since the passage of the Sherman Act, and we have taught this to many other countries. This is an American idea, not a Democratic idea or a Republican idea.

The Consumer Welfare Standard

The goal of antitrust is to promote competition. But how do we make that goal operational when it comes to antitrust enforcement? In practice, the antitrust enforcement agencies and antitrust courts apply the "consumer welfare" standard. As I use the term, applying the "consumer welfare" standard means that *a business practice is judged to be anti-competitive if it disrupts the competitive process and harms trading parties on the other side of the market*. To illustrate how this works, let us consider the three general areas identified above: cartels, mergers, and exclusionary conduct by dominant firms.

Cartels: Consider a cartel among retail gasoline stations that elevates the retail price of gasoline. This cartel replaces competition with collusion, so it obviously disrupts the competitive process. This cartel also clearly harms consumers by elevating the price of gasoline at the pump. In general, cartels disrupt the competitive process and harm the customers that buy from members of the cartel. In my example, those customers are final consumers, so the "trading parties on the other side of the market" are consumers. Hence, the term "consumer welfare standard" is very fitting.

Next, consider a cartel that raises the price of jet fuel. This cartel replaces competition with collusion, so it obviously disrupts the competitive process. This cartel directly harms the airlines that purchase jet fuel, not airline passengers, who are the final consumers. For the jet fuel cartel, the "trading parties on the other side of the market" are airlines. This cartel is anti-competitive under the "consumer welfare" standard because it disrupts the competitive process and harms these trading parties, namely the airlines. Under the "consumer welfare" standard, properly interpreted, we need not trace through the effect of the cartel on airline passengers to conclude that the jet fuel cartel is anti-competitive.

Mergers: Mergers between rivals also replace competition with coordination, as the two merging firms come under common ownership. As with cartels, the typical danger is that the loss of competition will lead to higher prices, reduced product quality, or other harms to the customers purchasing from the merging firms, who are the "trading parties on the other side of the market." A horizontal merger is judged to be anti-competitive if it significantly reduces competition and harms the trading parties on the other side of the market. In an airline merger, those trading parties are consumers, namely airline passengers. Hence, the term "consumer welfare standard" is very fitting.

Next, consider a proposed merger between two railroads that carry corn from farms in Iowa to customers in Chicago. This merger may substantially reduce competition in the transportation of corn from Iowa to Chicago. This merger may well harm farmers in Iowa by enhancing the merged railroad's *buyer power*, even if the merger does not harm the customers who purchase corn in Chicago, perhaps because they can purchase corn coming from many other locations, not just from Iowa. This merger is judged anti-competitive if it significantly reduces competition and harms the trading parties on the other side of the market. In the railroad merger, those trading parties are the farmers seeking to ship their corn from Iowa to Chicago. We still use the term "consumer welfare standard," but when antitrust analysis involves possible buyer power, the term "supplier welfare standard" would be more precise.

Exclusionary Conduct by Dominant Firms: The analysis becomes a bit trickier when we look at the behavior of large, dominant firms. Suppose that a large, dominant firm charges lower prices than its rivals, or offers a superior product, and thus drives smaller firms, which cannot match its offerings, from the market. Even if this firm gains a dominant market position, that must be seen as the *result* of competition, not as a failure of the competitive process. To find otherwise would tie antitrust in knots by encouraging firms to compete and then turning on them when they succeed. In this situation, the goal of "promoting competition" again lines up nicely with a "consumer welfare" objective. The firm in question has been competing, and the trading parties on the other side of the market are the beneficiaries of that competition. In contrast, if a dominant firm threatens to cut off any trading parties who deal with its smaller rivals, such exclusive dealing can exclude rivals and harm those trading parties, and thus can be judged anti-competitive under the "consumer welfare" standard. By evaluating conduct based on its impact on trading parties on the other side of the market, we can accurately distinguish between legitimate forms of competition (such low prices) and anti-competitive conduct (such as exclusive dealing). That is the essence of the "consumer welfare" standard as applied to dominant firms.

Over the past 100 years, many people have been tempted to cry foul when a single firm gains a dominant position, and have called upon antitrust to remedy the situation. This is the second major paradox of competition policy: sometimes, the competitive process leads to a single firm having a dominant market position. So long as that firm has played fair, competing on the merits, this outcome should not be seen as a failure of antitrust. However, since dominant firms have powerful incentives to protect their position and keep threats at bay, it is critical for antitrust to be vigilant to make sure that dominant firms do not engage in exclusionary conduct. This is certainly true in the tech sector today, as I discuss in my article, "Antitrust in a Time of Populism." While every case is different, as a good simple guide, a dominant firm crosses the line if it excludes rivals through conduct that does not benefit the parties with which it trades. Again, the "consumer welfare" standard serves as a valuable guide.

I have seen no evidence whatsoever that the "consumer welfare" standard is somehow outdated, so long as one accepts that the goal of antitrust is to promote competition. One of the wonderful things about our antitrust laws is that they express very broad concepts and principles – promoting competition and protecting consumers – and have proven extremely flexible over more than 100 years to address new situations, as our entire economy has evolved, with economic activity shifting over a long period of time from agriculture toward manufacturing and then toward services.

Furthermore, those who say that the "consumer welfare" standard is narrowly focused on price to the exclusion of other factors are simply incorrect: properly applied, the "consumer welfare" standard includes a range of factors that benefit consumers, not just low prices but improved product variety and product quality and of course more rapid innovation. Likewise, those who say that the "consumer welfare" standard is overly focused on short-term outcomes are mistaken.

As I embrace the "consumer welfare" standard, I would like to be very clear: *adopting the "consumer welfare" standard absolutely does not mean that one is assuming that market power is rare or transitory*. Those who claim or insinuate that anyone adopting the "consumer welfare" standard is necessarily in favor of a laissez-faire antitrust policy are simply incorrect. I put my own career forward as Exhibit A on that point. In my view, durable market power is quite common in the U.S. economy, which is why I favor vigorous antitrust enforcement. And I am hardly alone. During the 40 years that I have been studying and practicing antitrust, there has been a broad consensus among antitrust scholars and practitioners in favor of the "consumer welfare" standard. No evidence whatsoever has been put forward calling this consensus into question. Indeed, I know of no serious antitrust experts who favor abandoning the "consumer welfare" standard, and no workable alternative has been proposed.

Horizontal Mergers and the Structural Presumption

A wide range of evidence supports vigorous horizontal merger enforcement in the United States. My two papers cited above detail this evidence, which includes evidence from merger retrospectives, evidence of growing corporate profits, evidence that economies of scale have become more important in many industries, evidence of substantial differences in productivity across firms in the same industry, and highly detailed evidence from a great many merger investigations.

More specifically, I favor moderately more aggressive horizontal merger enforcement than we have seen in recent years. While legislation could well help in this regard, I believe the necessary level of merger enforcement can be achieved through suitable enforcement decisions taken by the DOJ and the FTC, so long as the DOJ and FTC are skillful and effective at conducting investigations and presenting their cases in court, and so long as they are provided with the resources necessary to do so.

Nor would a more assertive approach to horizontal merger enforcement require any major shift in the case law. The courts need only (1) define relevant markets or submarkets using the widely accepted "hypothetical monopolist test," as detailed in the DOJ/FTC Horizontal Merger Guidelines, and then (2) apply the structural presumption, which has been deeply established in the case law for over 50 years, which shifts the burden of proof onto the merging parties if their proposed merger substantially increases concentration in a properly-defined relevant market or submarket.

The structural presumption is a critical element of effective merger enforcement, so retaining and strengthening the structural presumption is essential. Eliminating or weakening the structural presumption would substantially undermine merger enforcement, the precise opposite of what the evidence indicates that we now need.

The Limits of Antitrust

Many of those who criticize the "consumer welfare" standard seem motivated by concerns about the political power of large corporations, or about the extreme levels of inequality in income and wealth found in the United States today. I very much share these concerns. We very much need campaign finance reform, and greater transparency regarding money in politics, to control the excessive political power of large corporations. We very much need a more progressive tax system, and better health care and educational opportunities for all Americans, especially children, to reduce levels of inequality.

But asking antitrust to solve these problems is very likely to be counterproductive. Antitrust enforcement agencies and courts are ill suited to handle these broader problems. Worse yet, *the core mission of antitrust, to promote competition, could easily be undermined if we ask antitrust to solve problems unrelated to competition*. For example, asking the DOJ to block mergers that enhance political power, as distinct from economic power, would necessarily politicize antitrust enforcement, which strikes me as extremely dangerous and unwise.

Finally, it is important to recognize that antitrust is just one arrow in the quiver of available policies to promote competition and protect consumers. The Federal Communications Commission has the authority to promulgate rules that protect media diversity, the Federal Energy Regulatory Commission has the authority to establish rules to promote competition in wholesale electricity markets, and the Department of Transportation has the authority to promote international airline competition, to give just a few examples. Antitrust rules necessarily apply across the entire economy. They cannot and should not substitute for tailored rules needed in specific sectors.