

# Confronting Rising Market Power

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*Rising market power in the U.S. economy is not just a microeconomic problem, as the textbook analysis shows, creating allocative efficiency losses and transferring wealth away from victimized participants in the affected markets. Rising market power also undermines inclusive prosperity by contributing to inequality and slowed economic growth. Modern economic research points to multiple ways to attack market power and enhance competition, including ways of strengthening antitrust enforcement, improving antitrust rules and institutions, and deploying regulation to enhance competition.*

## Rise of Market Power

The rise of market power presents a 21st century challenge for inclusive prosperity. Some of the evidence for a serious and growing market power problem comes from macroeconomic data. Growing profits from the exercise of market power is a leading explanation for the declining labor share of GDP – a modern phenomenon that overturns the view of mid-twentieth century economists that factor shares were stable (Barkai 2016; Eggerston et. al 2018). Rising market power also likely contributes to declining business investment economy-wide (Gutiérrez & Philippon 2017; Fahri & Gourio 2018), a growing gap in profitability between the most and least profitable firms (Furman & Orszag 2015), and other aspects of declining business dynamism that include the slowed rate of which firms and plants expand when they become more productive (Decker et al. 2017) and a decline in the rate of startups (Decker et al. 2016).

This conclusion is not based on studies of concentration trends. The consensus among academic economists is that it is difficult to learn from studies that attempt to measure concentration in industries over time. This difficulty has two sources. First, evidence about

aggregate concentration or concentration in broad industries is largely uninformative because an industry and an antitrust market are often not the same thing. Concentration measured at the industry level with nationwide data may mislead when there are important differences in the extent of competition across sub-national geographic markets or smaller product markets within the industry.

Second, the industrial organization economics literature has long established that the relationship between concentration and market power runs in both directions. On the one hand, firms with large market shares can suppress competition. On the other hand, when markets are free from anticompetitive conduct, a talented competitor can accumulate a large market share. In some cases, econometric techniques can be used to isolate the first causal relationship. Academic studies in a number of important industries find that rising concentration due to mergers caused higher prices or lower quality, for example in hospitals (Gaynor and Town 2012; Dafny et al. 2016), dialysis clinics (Eliason 2018; Wollmann 2019a), and brewing (Miller and Weinberg 2017).

Other economic evidence of rising market power comes from large samples of firms and industries. One widely-discussed study of all publicly traded firms finds that markups (price-cost margins) have risen sharply since 1990 among firms in the top half of the markup distribution (De Loecker & Eeckhout 2017). In addition, the huge growth in overlapping equity ownership of rival firms by diversified financial investors over the past four decades has plausibly led to less aggressive competition and higher prices in many industries (Schmalz 2018, Backus et al. 2019).

Still more evidence of market power comes from labor markets – in this case monopsony power (exercised by buyers). Recent studies find that employers have monopsony power over college professors (Goolsbee & Syverson 2019) and nurses (Prager and Schmidt 2019). Wages for nurses may fall after hospital mergers for this reason. The extensive use of non-compete agreements in employment contracts involving low-wage fast-food workers and the no-poach agreements between a number of high-technology firms over software engineers and between rail equipment suppliers over their workers, provide additional examples.<sup>1</sup>

Moreover, there is evidence that antitrust law, the governmental policy charged with discouraging the exercise of market power, is falling short. Many express cartels go undiscovered (Harrington & Wei 2017; Levenstein & Suslow 2011), and tacit collusion is probably even more prevalent because it is harder for antitrust enforcers to prosecute and deter. Anticompetitive horizontal mergers (between rivals) appear to be underdeterred (Wollmann 2019b; Blonigen & Pierce 2016; Ashenfelter et al (2014)). While the studies of the competitive effects of vertical agreements and mergers (between firm and their suppliers and distributors, or sellers of complementary products) are mixed, a study that accounts for changes in the strictness of antitrust enforcement (hence is capable of identifying the effects of antitrust) finds that relaxed enforcement leads firms to engage in harmful conduct (MacKay & Smith 2014).

Each of these studies can be critiqued. But many studies suggest that market power has been on the rise for decades – notwithstanding their use of very different methods and their different potential vulnerabilities. They add up to a compelling case, where the whole is greater than the sum of the parts. Some of the evidence may have benign explanations in part, such as growing scale economies in supply or demand, perhaps leading

to the creation of “superstar” firms with high profits and productivity and low labor shares, or rents to first movers with new information technology and network effects (Baker, 2018). But the overall picture is clear: market power has been growing in the U.S. for decades.

Firms with market power need not compete aggressively to sell their products, so they tend to raise prices, reduce quality, and/or innovate less. Market power can also contribute to slowed economic growth. One channel involves harms to productivity (Holmes and Schmitz Jr. 2010; Bloom and Van Reenen 2010). The literature studying the opening of markets to trade similarly shows that a reduction in entry barriers, hence an increase in competition, increases productivity (Pavcnik 2002). Another harm from insufficient competition is lessened innovation. Some market power is inherent in many pro-competitive innovations, as the reward that provides an incentive for creating a valuable differentiated good or service. However, innovation is harmed when firms create market power through mergers or exclusionary conduct. Theoretical and empirical economic studies overwhelmingly demonstrate that innovation is harmed by anticompetitive conduct (Federico et al. 2019).

## Economic Approaches to Attacking Market Power

It is important at the outset to emphasize that public policies to strengthen competition largely avoid the typical policy tradeoffs that economists love to weigh. With minor qualifications,<sup>2</sup> policies that enhance competition are unambiguously beneficial for inclusive prosperity. To take the extreme case, turning a monopoly market into a competitive one almost always means greater output, reduced allocative efficiency losses (lower deadweight loss), greater productivity and innovation, lower prices, and less inequality. Other policies for addressing inequality in particular, such as labor market and tax policies, may create disincentives or allocative efficiency losses that must be weighed against their distributional benefits. Policies to enhance competition, by contrast, offer what is close to a free lunch.<sup>3</sup>

Market power contributes to growing inequality because the shareholders and senior executives who earn rents from its exercise are disproportionately wealthier than

the buyers, including ultimate consumers, and suppliers, including workers, who may be harmed (Ennis et al. 2017; Gans et al. 2018). In a recent year, the wealthiest one percent of the population held half of the stock and mutual fund assets, and the top ten percent held more than 90 percent of those assets (80 percent after accounting for indirect ownership through retirement plans and similar financial accounts) (Wolff 2014). Consumption, by contrast, is not nearly so concentrated. Gans reports that the consumption of the top 20% of the wealth distribution is approximately equal to that of the bottom 60%, but their equity holdings are 13 times larger. Thus, if a dollar of monopoly profit is transferred to lower prices, most of that dollar moves from benefitting the top 10% through the value of their stock or dividends to instead benefitting the bottom 90% through lower costs of purchases. Therefore, antitrust enforcement redistributes wealth without incurring the traditional shadow costs arising from taxation and, indeed, is an actively beneficial form of redistribution for the economy.<sup>4</sup>

Strengthening antitrust enforcement is the most obvious way to enhance competition, particularly given the history of antitrust enforcement in the United States. The interpretation of the antitrust laws changed dramatically in the late 1970s to weaken what economists and lawyers originally associated with the University of Chicago described as excessive enforcement. In a series of changes to antitrust policy and jurisprudence championed by “Chicago school” commentators and often supported by large firms that stood to benefit from relaxed enforcement, some conduct that had been illegal was permitted (Baker 2002) and judicial acceptance of a number of assumptions underlying Chicago views had the effect of making it more difficult for plaintiffs to prevail and easier for defendants to establish efficiency justifications.

Many economic assumptions that drove the Chicago school thinkers to believe their rules would be an improvement have since been shown to be unsupported by theory or evidence (Baker 2015), so it is not surprising they were a poor guide to changing enforcement policy. Relaxed competition enforcement is a leading suspect in explaining the rise of market power over the ensuing decades, though other forces – particularly changes in market structure associated with the growth of information technology – likely also contributed importantly. The evidence of increasing market power, the evidence of insufficient antitrust enforcement,

and the affirmative benefits of competition, put improvements to antitrust rules and enforcement at the top of the competition-promotion agenda. We also favor complementing stronger rules and enforcement with regulatory changes to promote competition.

Our program for confronting rising market power has four themes: strengthening antitrust enforcement under current rules, reforming the rules to enhance deterrence of anticompetitive conduct, adopting institutional changes to make antitrust enforcement more effective, and employing regulatory tools to foster competition. In every case, we call on courts, Congress, government enforcers, private litigants, and regulators to look to modern economic thinking and economic tools for guidance.

## **Strengthening antitrust enforcement under existing rules**

The first step is to enforce the antitrust laws as they are now interpreted. Industrial organization economics has advanced greatly since the late 1970s. The game theoretic revolution in microeconomics and the development of new empirical techniques provide new ways to identify harmful practices that can be attacked under the current antitrust rules (e.g., Collection 2018). The enforcement agencies already use econometric methods, sophisticated simulations, bargaining theory, and other tools to identify harmful conduct and prove cases. While the agencies may be discouraged by occasional decisions that reject modern economic ideas, such as the district court’s decision in *AT&T-Time Warner*,<sup>5</sup> they should not give up on economics in litigation. If an appropriate economic tool shows that business conduct would harm competition, the agencies should rely on it regardless of the risk that a court will not understand. The history of pharmaceutical pay-for-delay litigation – a long string of FTC losses in court followed by eventual success<sup>6</sup> – shows that the agencies are capable of convincing courts to change their views when they rely on sound economics and persevere.

One of today’s significant challenges is convincing courts to do more to protect potential competition.<sup>7</sup> When markets become more concentrated because of network effects or economies of scale, the primary locus of competition shifts from competition *in* the market to competition *for* the market. In that

setting, consumers rely on nascent competitors and potential competition to put pressure on oligopolists or dominant firm, making potential competition a critical source of consumer welfare. This dynamic is particularly important in markets where innovation can overthrow a dominant incumbent, including many high technology and pharmaceutical markets. Without adequate antitrust enforcement, dominant firms in such markets may prevent competition for the market through exclusionary conduct. For example, researchers have found that some incumbent firms protect their market power through so-called “killer acquisitions” (Cunningham et al. 2018): they purchase smaller rivals with nascent projects that threaten their existing profitable products, and shut down the research.

The research on killer acquisitions supports a more general point: antitrust enforcers and courts should pay more attention to preventing exclusionary conduct by dominant firms in high-technology markets that benefit from strong network effects. In these markets, entrants are necessarily small until some shock makes them explosively popular, after which the market can tip very quickly. A small rival or prospective entrant could grow into an important competitive constraint, and that possibility is often the main source of competition in such markets. While antitrust enforcers have had some success in attacking conduct by a monopolist that excluded nascent competition, as in high-profile litigation involving Microsoft two decades ago, doing so is particularly challenging when the excluded product poses a future competitive threat but has not yet had substantial marketplace success.<sup>8</sup>

## Reforming antitrust rules

Antitrust can also be strengthened by reforming the rules that the courts apply, for example by recognizing the important role for potential competition in today’s economy. Economic analysis is essential for explaining to courts and Congress why current rules strike a bad balance in decision-theoretic terms between deterring anticompetitive conduct and deterring valid efficiencies not available through less harmful means, and should be revised. Even judges and representatives who currently accept the erroneous economic assumptions that support current rules may be persuaded by modern economics and strong evidence to change their views.

Without getting into specific antitrust rules – though one of us has suggested a number of possibilities for improvement along with the economic research supporting them (Baker 2019) – we suggest that Congress consider strengthening the antitrust laws to address harms to future competition by requiring that plaintiffs be asked to show merely an appreciable risk to competition rather than prove likely competitive harm, and that it consider shifting the burden of proof to defendants in cases in which the plaintiff can demonstrate that harm is likely. Some in Congress have proposed new laws to take steps in a similar direction, as with a merger bill that has three Democratic presidential candidates as co-sponsors.<sup>9</sup>

## Institutional reforms

We have three suggestions for institutional reforms to strengthen antitrust enforcement. First, we would encourage Congress to lower the threshold for pre-merger notification, consistent with economic research suggesting that firms are manipulating the size of horizontal acquisitions to reduce the likelihood of antitrust scrutiny (Wollmann 2019b). Doing so would not necessarily give the enforcement agencies an impractical administrative burden, even during a transition period before firms learn not to risk making anticompetitive small acquisitions. For example, Congress could instruct the FTC to design a form “EZ-merge” for acquisitions of firms with sales or assets between \$2 million and the new HSR threshold. Businesses could choose their primary type (e.g. auto tire retailer, primary care physicians, funeral home) from a drop-down menu and enter the ZIP codes of most of their customers. An agency algorithm could flag for further review potential horizontal overlaps – for example between two physician groups in the same specialty and geographic area or two dialysis clinics in the same town.

Second, while many of the newly-reported acquisitions may be below the size level normally handled by the federal agencies and fall into a small geographic area, so would not be subject to federal review, the federal agencies may be able to support review by state enforcers, which often lack resources and economic expertise. We suggest that in lines of business where transactions are frequent, such as mergers involving physician groups or dialysis clinics, the federal agencies develop prototype

complaints to assist state enforcers. In addition, when such mergers are challenged, the federal agencies could consider joining the complaint and providing an economic expert. This approach could potentially generate scale economies that make enforcement cost effective over a far larger share of economic activity. Moreover, federal agency involvement could help the states develop effective relief, and discourage the states from adopting settlements unlikely to deter other anticompetitive mergers or restore competition, such as price caps, which are often ineffective.

Third, Congress should create a specialized trial court to hear cases brought under the federal antitrust laws. Doing so would allow antitrust cases to be heard by judges with expertise in evaluating complex economic evidence. Today, district court judges rarely bring antitrust experience to the bench and rarely hear antitrust cases. Judges on a specialized antitrust court would be more likely to hit the ground running. That will encourage litigants to rely on the best economic arguments and modern economic tools, improving the accuracy of judicial decisions and discouraging judicial acceptance of the erroneous economic assumptions that have supported relaxed antitrust enforcement.<sup>10</sup>

## Regulation to foster competition

Regulation is a different but complementary way to promote competition, as the Obama administration recognized by instructing all executive branch agencies to identify ways to do so in an Executive Order.<sup>11</sup> While the federal antitrust agencies already engage in some competition advocacy, Congress could explicitly authorize them to analyze and comment publicly on the effects on competition of significant proposed agency regulations, and provide them with funding to do so. Such analyses would help regulators and the public understand when, for example, a Medicare rule concerning drug formularies is likely to raise prices. The federal antitrust agencies are widely viewed to be less susceptible to capture than specialist regulatory agencies; to the extent this is true, their comments will be more pro-competitive.

In addition, regulators can create competition by facilitating entry. In addressing competition problems of dominant online platforms, for example, regulators could promote multi-homing among online platform

users, facilitate data transfer, or create open standards. The competitive problem of overlapping equity ownership of rival firms by diversified financial investors (often termed “common ownership”) may require a regulatory solution, though antitrust enforcement has also been suggested (Posner et al. 2017).

No single new case, rule change, or regulatory reform will transform the economy by restoring the competition that has been lost. But with modern economics showing the way, we can make progress in fostering inclusive prosperity by making the economy more competitive.

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## Endnotes

- 1 For more on these examples, see “AG Ferguson’s initiative to end no-poach clauses nationwide continues with seven additional chains,” Dec. 20, 2018, <https://www.atg.wa.gov/news/news-releases/ag-ferguson-s-initiative-end-no-poach-clauses-nationwide-continues-seven>; Complaint, U.S. v. Adobe Systems, Inc. (Sept. 24, 2010), <https://www.justice.gov/atr/case-document/complaint-o>; Complaint, U.S. v. Knorr-Bremse AG (April 3, 2018), <https://www.justice.gov/atr/case-document/file/1048866/download>.
- 2 One qualification is that it is possible for policies that encourage competition to lead to excessive entry, reducing aggregate economic welfare. Another is the possibility that overall industry innovation may be harmed on balance if dominant firms prevented from engaging in exclusionary conduct turn out to have markedly less strong incentives to invest in R&D. For that to happen, though, the other reasons a dominant firm would expect to appropriate sufficient returns, even with some imitation – such as intellectual property protections, rapid market growth, scale economies, network effects, the sale of complementary products, or customer-switching costs – must be weak, the dominant firm’s response if it treats rival R&D as a strategic complement must not counteract any effect of reduced appropriability, and new investment by formerly excluded rivals must not offset the dominant firm’s response. Still another qualification is that preventing the exercise of market power by worker-owned firms or non-wealthy shareholders against sellers of luxury products could increase inequality by reducing a transfer away from the wealthy.
- 3 The analogy works if one imagines that the current system burns up half the lunches and gives the remaining lunches to one person in the dining hall. From a public choice perspective, the distributional consequences of robust antitrust enforcement help explain why they have not been adopted.
- 4 The exercise of monopsony power in labor markets further contributes to increased inequality. Nor does greater market power in product markets benefit workers. With the decline of private-sector unionization, workers have limited ability to appropriate any increase in producer surplus.
- 5 We joined an amicus brief detailing various economic errors in the district court’s opinion. [https://www.researchgate.net/publication/327057400-Brief\\_for\\_27\\_Antitrust\\_Scholars\\_as\\_Amici\\_Curiae\\_in\\_Support\\_of\\_Neither\\_Party\\_United\\_States\\_of\\_America\\_Plaintiff-Appellant\\_v\\_ATT\\_Inc\\_Directv\\_Group\\_Holdings\\_LLC\\_And\\_Time\\_Warner\\_Inc\\_Defendants-Appellees\\_O](https://www.researchgate.net/publication/327057400-Brief_for_27_Antitrust_Scholars_as_Amici_Curiae_in_Support_of_Neither_Party_United_States_of_America_Plaintiff-Appellant_v_ATT_Inc_Directv_Group_Holdings_LLC_And_Time_Warner_Inc_Defendants-Appellees_O) The district court’s decision was upheld on appeal, but the appeals court did not make the same errors.
- 6 Federal Trade Commission v. Actavis, Inc., 570 U.S. 136 (2013).
- 7 Another significant challenge, labor market monopsony, is addressed in an EfIP policy brief by Marshall Steinbaum. We do not discuss it further here.
- 8 In the Microsoft litigation, the defendant maintained its operating system monopoly by excluding Netscape’s browser and the Java programming language. Those products, working together, could have reduced customer costs of using rival operating systems by allowing applications programming to access any operating system through the browser. Both Netscape’s browser and Java had previously been highly successful.
- 9 Consolidation Prevention and Competition Promotion Act of 2019. S. 307, 116th Cong. 2019.
- 10 We envision appeals going to the federal circuits, as now. We do not recommend converting the Federal Trade Commission into the specialized antitrust trial court for fear of losing its administrative adjudication of antitrust complaints, its competition rulemaking authority, the resources and expertise it devotes to antitrust enforcement, and its consumer protection authority and resources.
- 11 Exec. Order No. 13725, Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy, 81 Fed. Reg. 23417 (2016).

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