CPI's North America Column Presents:

Why the Consumer Welfare Standard Remains the Best Guide for Promoting Competition

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Introduction

The central goal of antitrust policy should be to maintain competitive markets so that companies feel continued pressure to improve quality, lower prices, and boost productivity through constant innovation. Observers have always debated the best way to accomplish this goal in specific cases. But for roughly 40 years the field has enjoyed a broad consensus on the main criteria that should guide policymakers: the consumer welfare standard (CWS). CWS is used to evaluate mergers and competitive practices by whether they harm economic welfare. If they do, then regulators step in to either prevent them or to negotiate agreements to remove the harm. In the absence of harmful conduct regulators generally let market forces determine the best outcome.

The adherence to the CWS implies two important tenets. The first is that when evaluating mergers or alleged anticompetitive behavior policymakers should base their decisions on a detailed empirical study of the markets in question. While this can be difficult, current law does not allow regulators to act without developing a strong case that business actions would result in probable harm. Second, regulators and judges do not base their decisions on an idealized version of what the economy should look like. They neither attack nor favor pricing practices, market integration or divestiture, or supply chain policy unless there is clear evidence of harm to other market participants.

Recently, some groups have argued for a more aggressive standard than the CWS. Nicknamed "Neo-Brandeisians" for their adherence to Justice Louis Brandeis' belief that even moderate levels of market concentration are bad per se, they rightly view the consumer welfare standard as the major intellectual barrier to a more aggressive antitrust enforcement that would atomize markets and punish large firms. They offer two main arguments. The first is that the CWS is too narrow to protect harms to other market participants. The second is that market consolidation poses clear dangers to both the economy and society that outweigh any reductions in prices or increases in innovation. Both of these arguments are false.[2] While it is possible to argue for a more robust antitrust policy, the CWS should continue to guide public policy.

How the CWS Protects Against Non-Consumer Harms

A main strength of the CWS is its flexibility. Over the years it has adapted to handle new developments such as the Internet, reduced trade barriers, foreign investment, and global supply chains. In its present form, it addresses many of the objections raised by neo-Brandeisians.

Protecting the Long-Term

Neo-Brandeisians claim that regulators concentrate too much on short-term price reductions, ignoring the longer-term threat that market concentration poses. For example, Lina Khan of the Open Market Society argues that the current approach to Amazon unfairly privileges lower prices and greater selection, and that Amazon will ultimately drive out competitors and raise prices, at which point it will be too late for regulators to intervene.[3]

But nothing in the CWS restricts regulators to concentrating on the short-term. It is always possible that regulators will be too lax. But it is also possible that potential long-term threats will never come to fruition. In either case, regulators are free to forego short-term benefits to prevent long-term threats. They just need to make a compelling case about the existence of the latter. In many cases regulators have conditioned approval of a merger on divestitures and other agreements that increase longer-term competition.

Preventing Monopsony Power

Neo-Brandeisians also claim that the CWS ignores buyer power. Companies can use market power to harm sellers as well as buyers. A recent paper by the Roosevelt Institute argues that companies such as Wal-Mart and Amazon use market power to squeeze small suppliers.[4] Others have claimed, largely inaccurately, that large companies exert monopsony power in labor markets to hold down wages.[5]

But, despite its name, the CWS incorporates harms to all market participants, not just consumers. In 2010 the government filed a civil complaint against six high-tech companies that had agreed not to cold call each other's employees.[6] A class action suit resulted in a recovery of $415 million.[7] More recently, several fast-food chains dropped the practice of using noncompete agreements after being challenged by a group of state attorneys general.[8] A joint statement by the Department of Justice and the Federal Trade Commission clearly states that "The DOJ will criminally investigate allegations that employers have agreed among themselves on employee compensation or not to solicit or hire each other's employees."[9] However, even with this, the consumer welfare standard does put a needed check on antitrust authorities acting on behalf of competitors seeking protection. After all, when large companies press suppliers to lower prices, the beneficiaries are consumers.

Protecting Innovation

Because they falsely believe that the CWS only looks at short-term price changes for consumers, neo-Brandeisians also argue that it fails to register other harms such as reduced product quality or slower innovation. The Roosevelt Institute claims that: "Rather than investing in research and development to generate innovative products, corporations have relied on lax merger regulation to buy out competitors, or they have employed a litany of anti-competitive practices to prevent them from entering the market in the first place."[10]

But the CWS allows regulators to consider non-price factors such as poor quality or reduced innovation. The federal government's guidelines explain that potential effects are expressed as price changes "[f]or simplicity of exposition" and that nonprice terms also matter, including "reduced product quality, reduced product variety, reduced service, or diminished innovation."[11] According to Joshua Wright of George Mason University, between 2004 and 2014 the Federal Trade Commission challenged 164 mergers, alleging harm to innovation in 54 of them.[12] More recently the DOJ prevented two mergers based on the likely effect on research and innovation.[13] The government guidelines explicitly address whether a merger is "likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger."[14]

Moreover, there is considerable evidence that larger firms can be more productive, more innovative, and spend more on research and development. Data from the National Science Foundation shows that large firms invest more in research and development and enjoy higher returns from it.[15] The relationship between firm size and innovation is especially complex. Highly regulated monopolies can often face little pressure to improve. In some cases, regulators may even prevent it. But in many cases market power and higher profits create both the incentive and the ability to bring innovations to scale. Economist Carl Shapiro points out that intense competition can prevent companies from earning enough profits to invest in research for the long-run.[16]

Problems CWS Cannot Fix

The CWS offers regulators both simplicity and flexibility. They are free to look at all the benefits and harms a merger or business practice might lead to. They can then weigh these effects against each other to determine whether intervention would improve social welfare. They face only two constraints. First, any regulatory action must be guided by the desire to increase economic welfare broadly or consumer welfare more narrowly. Second, any action must be supported by an empirical study of the markets involved. Regulators cannot act for political, ideological, or sentimental reasons.

The sole job of the CWS is to give often fierce debates about antitrust policy a common standard. The fact that it has done this very well for the last 40 years explains why virtually all antitrust experts support keeping it, even as they disagree about the best way to implement it. Yet its critics would jeopardize this success by using antitrust to address an array of social problems such as data privacy, the political power of large firms, and economic inequality. These problems exist, although they are not always as clear cut or significant as many advocates claim. But antitrust policy is poorly equipped to deal with them. Other policies, including consumer protection laws, campaign finance reform, labor laws, and job training, are better suited to address the root causes of specific problems.

Not All Alleged Harms Deserve a Response

Finally, explicit in the neo-Brandeisian critique is an aversion to large companies and a sympathy for those harmed by competition. Its proponents long to return to an economy dominated by the small proprietor. They forget that local businesses were often characterized by high prices, limited choices, and high credit costs. They were also far less efficient than their larger successors. In *The Great A&P and the Struggle for Small Business in American,* Marc Levinson describes the great inefficiency of national food markets in the late 19th Century and how large chains, including A&P, replaced local grocers by restructuring the supply chain to offer consumers more choice, better quality, and cheaper prices despite fierce opposition from incumbents.[17] Other markets underwent similar transformations.

Conclusion

Living standards are closely linked to productivity. The purpose of antitrust policy should be to maintain adequate market competition on the theory that competition forces companies to innovate. But innovation often results in eliminating costs and laying off workers or even driving lagging companies out of business. It can also require companies to operate at greater scale. Those who lose from that process invariably complain. Yet government attempts to protect companies from competition or workers from redundancy have invariably helped narrow interests at the expense of the broader good. Policies to repurpose assets, train workers, and maintain open markets will do a better job of extending the benefits of higher productivity to everyone. The CWS offers a flexible yet disciplined framework for evaluating market structure. We should keep it.

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[4] Marshall Steinbaum, Eric Harris Bernstein, and John Sturm, "Powerless: How Lax Antitrust and Concentrated Market Power Rig the Economy Against American Workers, Consumers, and Communities," (Roosevelt Institute, February 2018), 42, http://rooseveltinstitute.org/wp-content/uploads/2018/03/Powerless.pdf.

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[10] Steinbaum, et al., "Powerless: How Lax Antitrust and Concentrated Market Power Rig the Economy Against American Workers, Consumers, and Communities," 7-8.

[11] U.S Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, 2.

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[17] (Hill and Wang 2011).