EVALUATING THE COMPETITIVE EFFECTS OF CORPORATE ACQUISITIONS AND MERGERS

Public Comment to the Federal Trade Commission
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The commission's most active area of antitrust enforcement is merger control, and as such, that policy lever has been the focus of recent public debate about whether the economy suffers from excessive consolidation. This comment responds to the United States contribution (dated May 27, 2018) to the OECD's Hearing on Market Concentration held in June of this year (FTC/DOJ 2018).

That document makes one overarching point: that widely-circulated and discussed estimates of rising market concentration in the US economy do not analyze antitrust markets, but rather aggregated industrial sectors. As such, they do not provide any guidance for policy nor reflect on the laxity of previous antitrust enforcement. The agencies' response secondarily claims that studies of particular sectors, banking and airlines, indicate no time trend in concentration for properly-defined antitrust markets. Finally, it notes recent scholarship to the effect that increasing concentration in the economy may reflect structurally increasing returns to scale, a so-called "winner take most" economy that inherently creates "superfirms" (citing Demsetz 1973, among others). This contribution raises several concerns about this evident defensiveness on the part of the antitrust enforcement agencies to legitimate public pressure.

First of all, it is correct that no comprehensive analysis of concentration trends in antitrust markets exists for the economy as a whole. But that is something the commission has in its power to rectify. In fact, no institution is better-placed, with sector-specific expertise as well as access to relevant data, to publish such tabulations of market concentration sector-by-sector and market-by-market, as well as for the economy as a whole, on an ongoing basis. If the commission considers it appropriate to weigh in publicly discrediting independent analysis of this issue, it is incumbent on the commission to contribute positively to rectifying the public's ignorance on the policy question at hand.

Second, while no economy-wide estimate of concentration trends exists, concentration in antitrust markets is exceedingly high across sectors, often well in excess of the threshold for "highly concentrated" according to the 2010 Horizontal Merger Guidelines. The Roosevelt Institute recently undertook a meta-study of merger retrospectives and the related literature, concluding that the average concentration reported in antitrust markets was very high in almost all of the sectors and studies considered (Abdela 2018).

While knowing the concentration trend would be an important aide to interpreting other economic trends, the fact of a high *level* of concentration is eye-opening, particularly for policy-makers, independent of the trend. Given additional concerns about concentration at the shareholder level and in labor markets, there is grounds for claiming the economy not only has a market power problem given evidence on markups, profitability, declining labor and capital shares, and declining business dynamism (Steinbaum, Bernstein, and Sturm 2018), but that it is related to its concentration problem as well. It is incumbent on the commission to acknowledge and confront rather than deny this problem.

Third, the literature on "superfirms" has significant empirical shortcomings, so it is inappropriate for the commission to rely on it as a supposed explanation for why concentration might be increasing. For the purpose of this discussion, I take the frequently-cited paper "The Fall of the Labor Share and the Rise of Superstar Firms" (Autor et al. 2017) as a representative statement of what might be called the "superfirm hypothesis."

That paper proposes a model of firm-level heterogeneity in total factor productivity, where a fixed cost of entry must be paid in labor and thereafter, firms who find it profitable to produce do so according to either a decreasing or constant returns-to-scale production technology. It poses a one-off increase in the elasticity of demand in the market into which firms sell their output as the driving force that causes the market share of high-productivity "superfirms" to increase. The paper explores various implications relating firm size to labor share firm-by-firm and in the economy as a whole, claiming that the model generates predictions consistent with the relevant stylized facts.

Unfortunately it also generates other predictions which are not consistent with the empirical literature.

- **Declining markups**. An increasing elasticity of demand generating the concentration of production in more efficient firms relies at its heart on the idea that consumers become more price-sensitive, so a firm that is better able to sell low gains market share at the expense of rivals. A corollary to this is that markups decline, both in aggregate (because inefficient firms that only survived due to consumers' insensitivity now exit) and potentially at the firm level as well, depending on the shape of the demand curve and the distribution of firm-level productivity. Intuitively, if more cutthroat competition is why superfirms come out on top, it's unlikely they'd simultaneously be able to enjoy increased market power rents.

  The empirical literature, on the other hand, documents a trend of rising markups in the US economy (De Loecker and Eeckhout 2017), and particularly rising markups by stock market "leaders" most often pointed out as potential "superfirms" (Gutierrez and Philippon 2017; Hall 2018). A chart published by Gutierrez and Philippon making this point and relating it to rising concentration is replicated below. As the commission noted, this measure of concentration is not specific to antitrust markets, but the Autor et al paper predicts the opposite relationship.

MARKUPS OF PRICE OVER COST

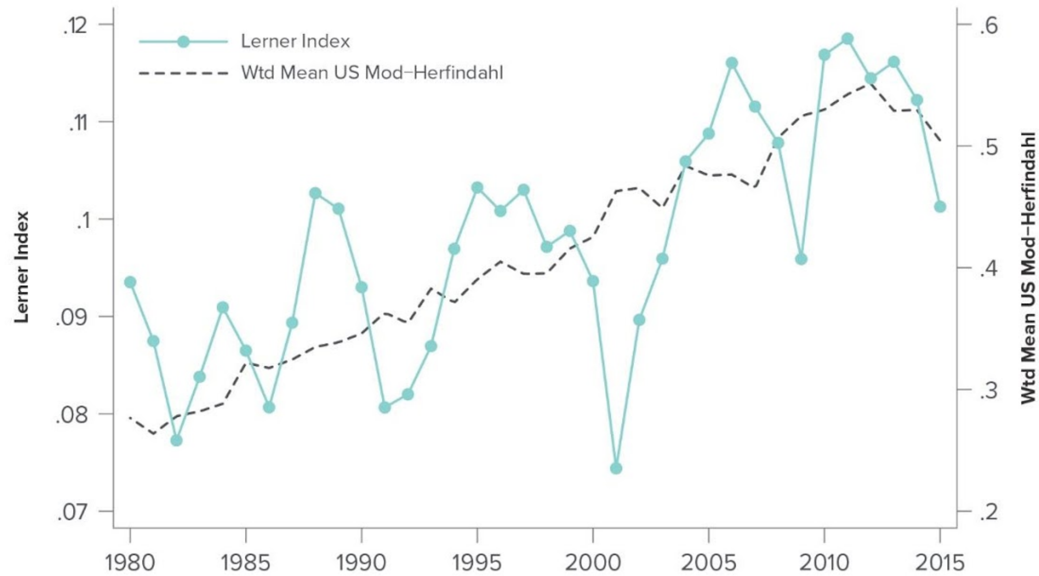

FIGURE 3A & 3B The Lerner index of a firm—computed by subtracting depreciation from operating income and dividing by sales—is a measure of its markups of prices over the cost of production. Figure 3a (above) shows that, on aggregate, Lerner indices have tracked increases in concentration and common ownership (measured by M-HHI). Figure 3b (below) shows that markups have increased for the largest one-third of firms (by stock market value) but not the smallest one-third. Source: Gutierrez and Philippon (2017).

- **Rising productivity growth**. The same mechanism that concentrates production in efficient firms also implies that aggregate productivity in the economy should be increasing. Unproductive firms exit, and among the remaining firms, the most productive ones account for a higher share of output.

  As is now well-known, one of the central puzzles of contemporary macroeconomics and industrial organization is the slowdown in aggregate productivity growth (Fernald 2015; Syverson 2016). Of course, the sources of aggregate productivity growth and explanations for its dynamics remain mysterious, so there is no particular reason to believe that they arise from aggregating up from individual firms. On the other hand, it is hard to imagine an economy in which the most productive firms were gaining market share thanks to their greater efficiency and consumers' greater price sensitivity, at the same time that aggregate productivity growth had fallen.

- **Competitive labor markets**. In the Autor et al paper, firms hire what labor they need (to pay both the fixed cost of entry and as an input to production at the margin) from a perfectly competitive labor market with an infinite supply of workers available at a constant wage. The paper claims that this setting, a mechanical production process hiring from a perfectly competitive labor market, explains the dynamics of the labor share of income both within firms and in the economy as a whole.

  This belies abundant evidence of monopsony power in the economy, but more specifically, it ignores the evidence about the dynamics of between- and within-firm wage inequality and wage segregation (Song et al. 2016). There's increasing evidence that the longstanding large-firm wage premium has disappeared for low- and middle-income workers, a dynamic that it isn't possible for the superfirm model to replicate (Bloom et al. 2018; Cobb and Lin 2017; Cosic 2017). In fact, which workers work at which firms is a crucial aspect determining what they are paid, and the fact that many workers no longer have access to the rents generated by profitable firms is an important component of the overall decline in the aggregate labor share. Even if it were true that the most profitable firms were profitable because of their superior efficiency and an increase in consumers' price elasticity of demand, one cannot draw conclusions about the labor market, the labor share of income, wage stagnation, or other labor-related outcomes by combining that mechanism with the assumption of perfect competition in labor markets.

Fourth, and finally, a point regarding the 'superfirm hypothesis,' which is quite relevant to the commission's question about the efficacy of vertical merger enforcement: *If* technology of distribution, network effects, and the like increasingly characterize markets as winner-take-all or winner-take-most, that does not excuse a lax merger enforcement or lax monopolization policy. On the contrary, it requires more vigilance regarding vertical transactions and vertical restraints. Any competitive pressure, such as it is, would arise up- or downstream from the monopolized segment, and an incumbent monopolist would be likely to use vertical integration to shut down those threats and potentially to extend its monopoly to adjacent segments of the supply chain. To the extent that the superfirm hypothesis is true, therefore, the existing prioritization in merger enforcement should be reversed: vertical mergers are more threatening to economic efficiency than horizontal.

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