Hearing #1 on Competition and Consumer Protection in the 21st Century

Georgetown University Law Center

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Welcome

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Introductory Remarks

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The Current Landscape of Competition and Consumer Protection Law and Policy

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The Current Landscape of Competition and Consumer Protection Law and Policy

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The Current Landscape of Competition and Consumer Protection Law and Policy

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The Current Landscape of Competition and Consumer Protection Law and Policy

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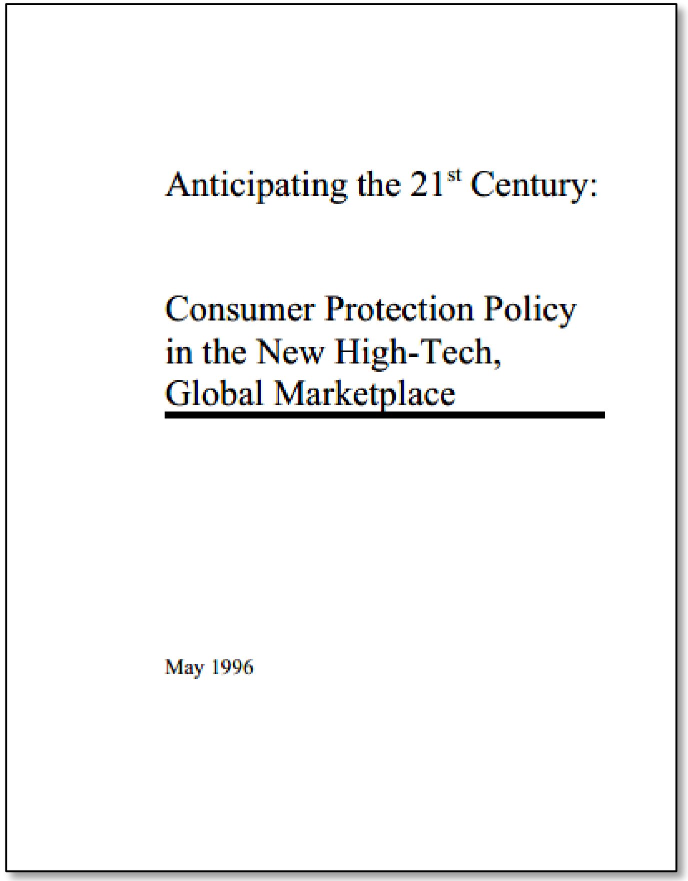
Consumer Protection and Privacy

21st Century Challenges

Overview

- Reflecting on the 1995 Hearings
- Consumer Protection Policy To Date
- Policy Considerations for the Future


Anticipating the 21st Century:

Consumer Protection Policy in the New High-Tech, Global Marketplace

May 1996

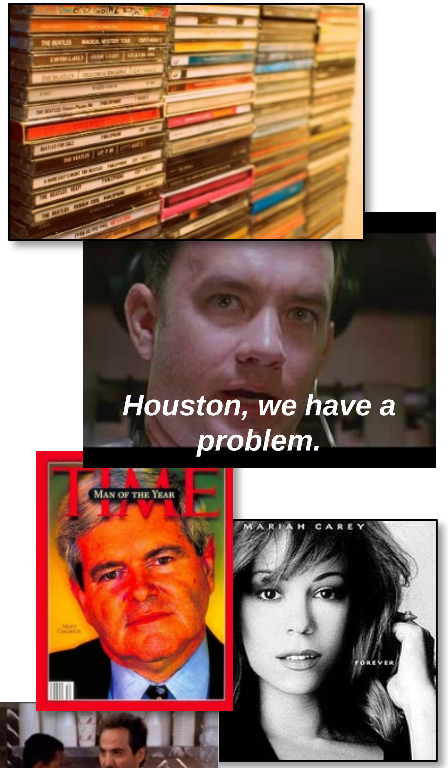
1995 Hearings

Hearing panels: “*The Newest Medium for Marketing: Cyberspace,*” “*Privacy in Cyberspace,*” “*The Changing Role of the Telephone in Marketing*”

Report excerpts

“*Consumers now can sample and purchase compact discs on the telephone . . . .*”

“*Advances in computer know-how already have enabled the collection, storage, and retrieval of enormous amounts of data on individual consumers . . . **it is likely that data collection will expand.***”

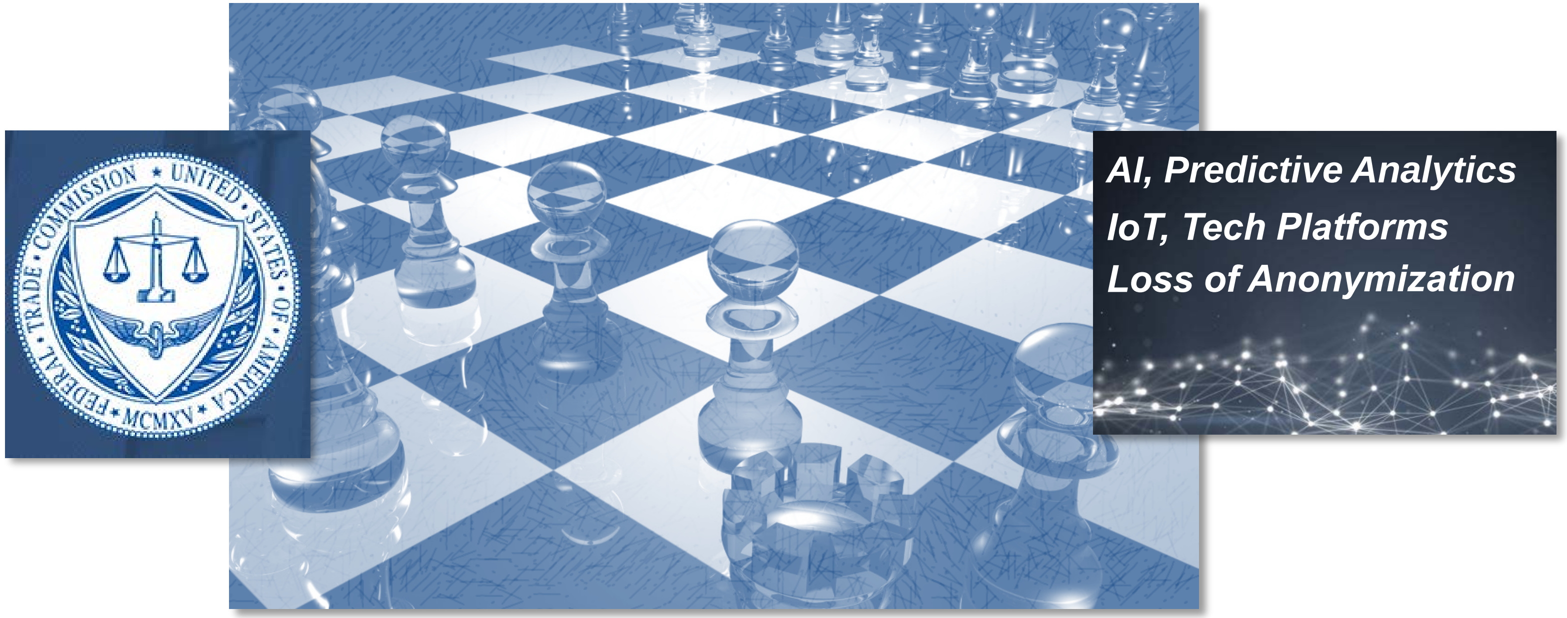


Risk-Based Approach

- Consumer sovereignty with notice, choice
- Fight fraud, deception, and unfair business practices that cause injury
- Support industry self-regulation

- Business guidance
- Consumer education

Does the Technology Marketplace Require a Change in FTC Approach?



Then & Now

1996 Pitofsky Report – "*The New Marketplace*"

- Consumer access to the Internet
- Rapid convergence of phone, TV, and online
- New avenues for fraud
- Tracking challenges for law enforcement

2018

"*Rapid changes in technology and cyber threats provide a significant challenge to the Agency's ability to fulfill its consumer protection mission . . . .*"

- Chairman Simons, Senate Testimony

Global Patchwork of Consumer Protection/Privacy Laws

Then & Now

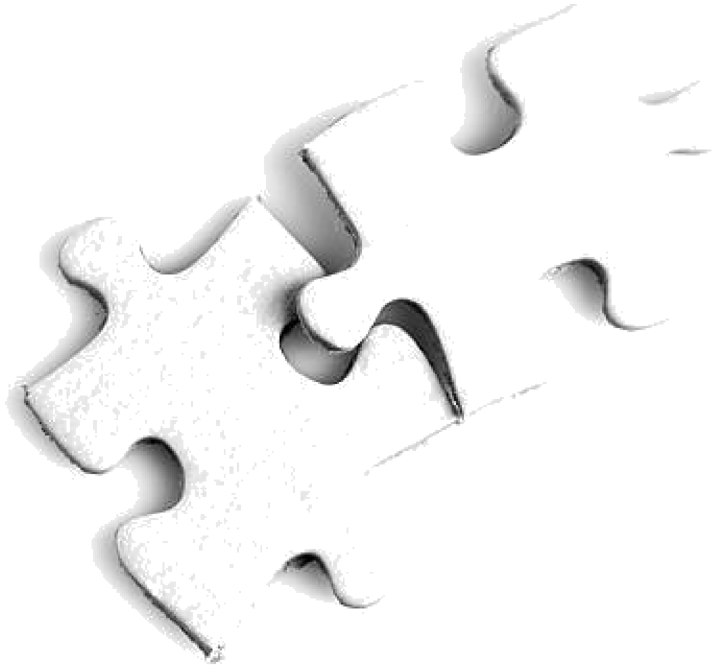
1996 Pitofsky Report

"[the global market] is still a market that is legally fragmented by national laws and jurisdictional boundaries. This patchwork of law creates an array of problems . . . It also creates obstacles for legitimate businesses engaged in global trade that must incur the costs of complying with a variety of legal standards . . . ."

2018

- Global patchwork of consumer protection laws
  - EU's GDPR
  - California
- FTC leadership role in the privacy law debate
- Benefits vs. Costs

Where to Focus the Enforcement Efforts



"[I]t is critical . . . that the FTC protect consumers [but] without unduly burdening them or interfering with the ability of firms, especially small firms and new entrants, to use data to enhance competition."

- Chairman Simons, Senate Testimony

Self-Regulation and Industry Standards

- Proven track record
- Adaptable
- Incentivize with safe harbors
- Regulatory oversight
- Business guidance

Closing Thoughts

<u>The more things change, the more they stay the same</u>

- Support Innovation While Protecting Consumers
- Most Companies Want to Do the Right Thing
  - Clear laws, regulatory guidance, and self-regulation support these efforts
- Prioritize Enforcement for the Fraudsters and Companies Causing Consumer Harm

The Current Landscape of Competition and Consumer Protection Law and Policy

Panel Discussion

Jason Furman, Alysa Hutnik, Jan McDavid,
Tim Muris, James Rill, David Vladeck

The Current Landscape of Competition and Consumer Protection Law and Policy

Audience Q&A

Has the US Economy Become More Concentrated and Less Competitive: A Review of the Data

Gregory Werden

U.S. Department of Justice

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Has the US Economy Become More Concentrated and Less Competitive: A Review of the Data

Jonathan B. Baker

American University Washington College of Law

Market Power in the US Today

Overview

- Nine reasons to think market power is substantial and has been growing
- None is individually decisive, but they have different weaknesses so are collectively persuasive
- Interpreting the economic evidence: market power vs. scale economies

Insufficient Deterrence of Anticompetitive Coordinated Conduct

- Insufficient deterrence of express cartels (criminal)
  - Steady rate at which DOJ uncovers them
  - Penalties and damages are on average too low
  - No evidence of systematic chill to procompetitive conduct or excessive compliance expenses
- Insufficient deterrence of tacit collusion leading to higher prices
  - Probably harder to deter than express cartels
  - *E.g.*, Miller & Weinberg 2017

Insufficient Deterrence of Anticompetitive Mergers

- Retrospective analyses of “close calls” allowed to proceed
  - Ashenfelter & Hosken 2010; Kwoka 2015, 2017; but see Vita & Osinski 2016

- Manufacturing mergers systematically raised margins without lowering costs
  - Blonigen & Pierce 2016; *e.g.*, Kulick 2017

Insufficient Deterrence of Anticompetitive Exclusion

- Antitrust rules governing exclusion were relaxed the most beginning in the late 1970s
  - Vertical ≠ exclusion but correlated

- More than one-quarter of international cartels used vertical restraints to support collusion, as by deterring cheating or entry
  - Levenstein & Suslow 2014

- Vertical restraints and vertical integration can harm competition
  - *E.g.*, Dafny, Ho & Lee 2018 (merger of demand complements); MacKay & Smith 2014 (RPM); Houde 2012 (vertical merger); Hastings & Gilbert 2005 (vertical merger); Grimm, Winston & Evans 1992 (vertical merger)

Insufficient Deterrence of Anticompetitive Exclusion, cont'd

- Studies of vertical conduct are poorly designed to identify their anticompetitive potential and the potential benefits of antirust enforcement:
  - if they do not account for the possibility that the antitrust laws deterred anticompetitive conduct
  - or if they are studying markets with competitive structures

- Many studies that identify procompetitive benefits of vertical practices do not provide good guides for antitrust enforcement policy
  - *E.g.*, studies reviewed by Lafontaine & Slade 2008; but see MacKay & Smith 2014

Market Power is Durable

- The average cartel cut short by antitrust enforcement lasted 8 years, and many lasted 40+ years
  - Levenstein & Suslow 2011; see Harrington & Wei 2017
- Many near-monopolies persisted for decades before eroding
- Erroneous judicial precedents do not systematically outlive market power
  - Baker 2015

Increased Equity Ownership of Rival Firms by Diversified Financial Investors

- Investor ownership of rivals has become common
  - Large institutional investors collectively own 2/3+ of private equity, up from 1/3 in 1980

- When rivals have common financial owners, they compete less aggressively and prices rise
  - Azar, Schmalz & Tecu 2018; Azar, Raina & Schmalz 2016; Schmalz 2018; see Newham, Seldeslachts & Banal-Estañol 2018; but see Gramlich & Grundl 2017; O’Brien & Waehrer 2017; Patel 2018; but cf. Hemphill & Kahan 2018.

Increased Governmental Restraints on Competition

- Patent scope
  - *E.g.,* Masur 2011
- Occupational licensing
  - *E.g.,* Edlin & Haw 2014; Kleiner & Kreuger 2013
- Lobbying to limit rivalry (*e.g.*, citizens petitions at FDA)
  - *E.g.,* Feldman, Frondorf, Cordova & Wang 2017; Carrier & Minniti 2016

The Rise of Dominant Information Technology Platforms

- Some reasons for success likely insulate them from competition in some major markets
  - *E.g.*, network effects, intellectual property protection, endogenous sunk costs, & the absence of divided technical leadership
- Average price-cost margins in the US increased after 1990
  - De Loecker & Eeckhout 2017; Eggertsson, Robbins & Wold 2018; Hall 2018; but see Traina 2018
- Higher margins probably reflect in part market power by firms that have made substantial fixed investments in information technology
  - including large IT and Internet platforms but also in other industries
  - Kurz 2018

Oligopolies are Common and Concentration is Increasing in Many Industries

- Many sectors have become substantially more concentrated over recent decades, and firms in them often exercise market power
  - Airlines — Borenstein & Rose 2014; Ciliberto & Williams 2014; Evans & Kessides 1994
  - Brewing — Miller & Weinberg 2017
  - Hospitals — Cutler & Scott Morton 2013; Gaynor & Town 2012; Dafny, Ho & Lee 2016
- While economy-wide evidence shows modest increases in manufacturing concentration, and many industries with rising concentration remain unconcentrated …
  - Peltzman 2014; Ganapati 2017; Autor, Dorn, Katz, Patterson & Van Reenen 2017
- … the economy-wide evidence is less reliable than industry studies
  - Werden & Froeb 2018

Oligopolies are Common and Concentration is Increasing in Many Industries, cont'd

- Evidence involving broad national aggregates is consistent with rising overall concentration or with increased multi-market contact
  - White & Yang 2017; Francis & Knutson 2015; Grullon, Larkin & Michaely 2017

- Concentration is high and possibly growing in many labor markets
  - Azar, Marinescu & Steinbaum 2017; Benmelech, Bergman & Kim 2018; Azar, Marinescu, Steinbaum & Taska 2018; Council of Economic Advisors 2016; Dube, Jacobs, Naidu & Suri 2018

Decline in economic dynamism

- Market power is a leading explanation or a plausible contributing explanation for a number of long term trends:
  - Secular slowdown in business investment
    - Guitiérez & Philippon, 2017
  - Rising profit share of GDP
    - Barkai 2016; Eggertsson, Robbins & Wold 2018; but see Karabarbounis & Neiman 2018
  - Slowed rate at which firms and plants expand when they become more productive
    - Decker, Haltiwanger, Jarmin & Miranda 2017

Decline in economic dynamism, cont’d

- Market power is a leading explanation or a plausible contributing explanation for a number of long term trends:
  - Declining rate of startups
    - Decker, Haltiwanger, Jarmin & Miranda 2016; Hathaway & Litan 2014
  - Growth and productivity gains increasingly coming more from incumbents than entrants
    - Garcia-Macia, Hsieh & Klenow 2016
  - Growing gap in accounting profitability between the most and least profitable firms
    - Furman & Orszag 2015

Market Power vs. Scale Economies

- Most plausible benign explanation
  - Increased scale economies and temporary returns to the first firms to adopt new information technologies in competitive markets
    - Perhaps creating "superstar" firms
- In many industries, efficient firms have grown in scale
  - high fixed costs of investments in information technology (IT)
  - network effects (demand-side scale economies)
  - increased scope of geographic markets
  - reductions in barriers to international trade
- Concentration and price-cost margins could both rise even if markets are competitive, and the first firms to invest in IT may earn substantial rents
  - With dynamic competition, as rivals invest too, rents would dissipate

Market Power vs. Scale Economies, cont'd

- Six reasons for concern about market power cannot be reconciled with the benign alternative
  - Anticompetitive coordination is insufficiently deterred
  - Anticompetitive mergers exclusion are insufficiently deterred
  - Anticompetitive exclusion is insufficiently deterred
  - Market power is durable
  - Increased common equity ownership of rivals softens competition
  - Government restraints on competition are on the rise

Market Power vs. Scale Economies, cont'd

- The benign alternative at best a partial explanation but not the full story for the other three

- Dominant IT platforms
  - benefitted from scale economies in supply and demand (network effects), and first mover advantages
  - but can also protect their positions by excluding rivals

- Rising industry concentration in various sectors
  - often accompanied by market power (based on evidence independent of concentration)
  - higher fixed expenditures can deter entry and soften competition

Market Power vs. Scale Economies, cont'd

- The benign alternative is not the full story, cont'd
- Reduced economic dynamism
  - The benign explanation supposes profits are rising because dynamism is *increasing*, but the evidence instead shows *reduced* dynamism
  - If economic dynamism were increasing, corporate profit streams would be riskier, but the financial markets appear to view corporate profit streams as less risky than in the past

What’s Wrong With Market Power

- Harms within the affected markets
    - Wealth transfer
    - Allocative efficiency loss
    - Wasteful rent-seeking
    - Slowed innovation and productivity improvements

- Economy-wide harms
    - Slowed economic growth
    - Increased inequality

Summary

- Market power has been growing in the US economy for decades
- The US needs to strengthen antitrust rules, institutions and enforcement
  - The error cost balance has shifted since the 1995 FTC hearings and since the rules changed during the 1980s
  - Concerns about insufficient deterrence have grown relative to concerns about chilling beneficial conduct
- For references and further discussion
  - Jonathan B. Baker, The Antitrust Paradigm: Restoring a Competitive Economy (Harvard University Press, 2019)

Has the US Economy Become More Concentrated and Less Competitive: A Review of the Data

Panel Discussion

Jonathan Baker, Steven Berry,
Fiona Scott Morton, Joshua Wright

Has the US Economy Become More Concentrated and Less Competitive: A Review of the Data

Steven Berry

Yale

How do we learn about the effects of changes in competition?

What evidence should we trust?

Zombie IO mistakes involve forgetting that

- **concentration is an outcome, not a cause**.
- **in a market equilibrium, we will typically make bad mistakes if we fail to distinguish supply (cost) from demand**

Living Alternatives

- Direct observation of the **effect of exogenous policy variation** (allowed/disallowed mergers?)
- **Pure Description and Measurement**, including econometric measurement of markups from accounting data
- **“Within important industry” study** of: demand, cost, markups, & the number and nature of operating firms.

The Chicago Critique

Do not regress outcomes (e.g. markup) on concentration (e.g. H)

It is still true that:

- Accounting data is suspect, markups don't distinguish price from mc
- **There is no economic model in which H is the "cause" of anything, concentration is the joint outcome of many factors, which have diverse effects on many outcomes. This is not (just) a matter of "endogeneity," but of an incoherent causal framework.**
- **We should not trust** any causal interpretation of a regression of "outcome on Herfindahl concentration"

The Bresnahan Critique

A regression of p on "controls" & concentration (H), even with an "instrument" for H, is very difficult to motivate / interpret

It is still true that

- Price is a function of the observed and unobserved marginal cost and demand factors of the whole list of operating firms.
- **What is a "reduced-form price IV regression"? S or D?** What is possibly **properly excluded** that might serve as an instrument (IV) to learn the effect of concentration on price?
- Better to run a "real reduced form," where **every RHS variable is exogenous,** including **exogenous policy variation**.
- To make further causal statements, have to use the **use exclusion restrictions of S and D and Entry** to learn about marginal cost, demand, markups, etc., **(this is "modern empirical IO")**

Descriptive Cross-Industry Measurement

A good example: De Loecker and Eeckhout (2017/18) on markups

- Econometrically adjusted accounting markup data, hoping for **p/mc**
- Finds within-industry **trends to higher markups** / profits
- Although: **sensitive** to the inclusion of various (perhaps) **fixed / intangible costs**

Questions:

- Why?
- How much is **price up** vs how much is **mc down**? (*Chicago calling ….*)
- What's up with fixed / intangible costs?

Empirical IO on Important Industries

Good example: Ganapati (2017) on Wholesale

Data: concentration up, quantities up, # of locations up, IT spending up, dual foreign-domestic sourcing up.

Put through the lens of a series of very standard, simple empirical IO "Oligopoly Cost & D & Entry" models:

- **Increased quality** (nearby locations, dual-sourcing, maybe logistics) is driving up demand and p
- **MC is falling** (maybe logistics?)
-
- **Markups are rising** because of **p up and mc down, p up because of product quality & less competition**
- **FC is rising** (IT? rents on early sunk investment?)

A Substantive Hypothesis

Consistent with both examples, is there is an endogenous trend to substitute fixed (sunk) costs for marginal cost?

- This may **drive markups up** through [i] increased product quality, [ii] endogenously decreased competition and/or [iii] lowered costs.
- Welfare consequences are complex, but **sophisticated context-sensitive anti-trust policy is clearly important**.
- **Distributional consequences could be first-order.** Does a decreased mc imply a lower share of payments to variable inputs (wages?) and an increased share to FC (a good or bad rent?)
- **But:** evidence is **far from conclusive** in either the aggregate or within industry (aggregate productivity flat vs. little sign of widespread price increases, lack of sufficient within industry studies to even partially aggregate.)

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The Regulation of Consumer Data

James Cooper
Federal Trade Commission
Bureau of Consumer Protection

The Regulation of Consumer Data

Panel Discussion

Howard Beales, Maureen K. Ohlhausen,
Dan Solove, David Vladeck

Closing Remarks

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