US Draft Merger Guidelines

A Dynamic Competition Perspective

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Process

Good to reassess antitrust doctrine in light of progress in economic theory

- The Court "*has felt free to revise [its] legal analysis as economic understanding evolves and to reverse antitrust precedents that misperceived a practice's competitive consequences*", Kimble v Marvel Entertainment, LLC [2015] 576 US _.

Legitimate role of agencies in development of antitrust doctrine

- Guidelines "*may also assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws*", VMG, 2020

Evolution

DMG

- Presumption and precaution philosophy
  - *"Agencies do not seek to predict"*, but *"assess the risk"*
  - *"Preventative"*
- Conjectures
  - *"Agencies do not seek to specify the precise actions the merged firms would take to weaken rivals"*
- Heavy focus on concentration, size, and structure
- Simplifications
  - Internal growth and contract > external growth
  - Liability triggered by any increase in concentration w/ HHI > 1800; MS > 30% triggers a SLC
- Normative preference against oligopoly (and monopoly)

HMG 2010 and VMG 2020

- "*Prediction and control"* philosophy (Langlois)
  - *"Agencies usually rely to predict"*
- Theories of harm
  - Possibility theorems requiring empirical or formal evidence in a particular case
- Heavy focus on market power, anticompetitive (*"net"*) effects, and harm to customers
- Simplifications
  - Price as proxies for quality, innovation, …
  - Liability triggered by a *significant* increase in concentration in highly concentrated markets; HHI < 2500 means "moderately concentrated"
- Normative focus on short-term anticompetitive effects (fn 15)

Dynamism: more or less?

A step towards dynamism in HMG 2010 & VMG 2020

- Change to future competition & innovation, not present competition
- Benchmark is innovation that would prospectively prevail "*in the absence*" of the merger
- Focus not just on past competition, but also "*anticipated future prices*"
- Explicit recognition that mergers "*enable innovation*"

A step backward in DMG 2023

- Keeping the competitive status quo
  - *The Agencies therefore begin their merger analysis with the question: "How does competition present itself in this market and might this merger risk lessening <u>that</u> competition substantially now or in the future?"*
- Little to no recognition of innovation benefits from mergers

Challenges in the DMG treatment of dynamism

Guideline 4 ➡ "*Potential entrant*" elimination

- States a "*presumption that new entry yields procompetitive effects*"
- But heavy focus on
  - Acquired potential entrant. Limited interest in market investigation of competitive pressure from other potential entrants
  - Lost "*deconcentration*" opportunity *per se* problematic. No focus on the possibility of higher growth opportunities by internalization (Facebook/Instagram?)
- Double standards => "*Secondary source*" of competition when invoked as a defense, but lost potential entry in itself sufficient to establish SLC in concentrated market as a merger offense

Guideline 7 ➡ "*Dominant position*" entrenchment by merger

- "*The agencies take particular care to preserve opportunities for deconcentration during technological shifts*"
- Technological shifts create competition not by deconcentration, but by reconfiguration of channels of competition (Petit, 2021)

Empirical facts

Economy wide

- Rising concentration, correlating w/ technological intensity, fixed costs, and output growth (Kwon, Ma & Zimmerman, 2023)
- Large firms get less innovation per R&D or employment USD (Bound & al, 1982; Akcigit & Kerr, 2018)
- Large firms do more incremental research (Argente et al, 2020)
- Low survival rate of small and new firms owing to higher capital constraints (Aghion et al, 2007)

Digital

- Increasing returns on supply and demand side (Arthur, 1981; Bresnahan, 2023)
- Leading to natural oligopoly equilibrium (Shaked & Sutton, 1983); Autor & al, 2020)
- New firm creation and entry orders of magnitude higher relative to every other industry sector (Georgousis, Heiden & Petit, 2023)
- Mostly relies on non patented innovation (Bessen, 2023)

Predicable error?

Question

- Given the above empirical facts, what can a M&A policy adverse to size and external growth ever achieve?

Answer

- Innovation needs a dynamic market for corporate control
- A dynamic market for corporate control requires to keep open opportunities for exit by M&A
- A policy that reduces exit by M&A will limit funding of small innovative firms
- Systemic risk of innovation destruction
- Even worse in digital economy where startups sunk costs are higher (less startup patents to sell upon exit)

DCI ongoing work

- Screening for Innovation (*FTC v HJ Heinz C, et al* [2001] DC Cir No 00- 5362)
- Operationalizing Capability Audits (Murmann and Vogt, 2022; Petit & Teece, 2021; 2023)

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