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The 2023 Merger Guidelines and The Role of Economics

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Abstract
Relying heavily on legal analysis, the 2023 Merger Guidelines argue for a fundamental shift in antitrust enforcement that places more emphasis on protecting competitors and less on protecting the beneficiaries of competition. It is up to courts, not economists, to ascertain whether this interpretation of antitrust law is correct. But economists can and should analyze the likely economic effects. Evidence that antitrust enforcement has permitted some markets to be overly concentrated justifies the tightening of horizontal merger enforcement that is signaled by these guidelines. Evaluating the elimination of double marginalization from vertical mergers as a part of an efficiency defense rather than as a primary economic effect reflects a fundamental misunderstanding of the economics of vertical mergers. At a minimum, these guidelines will further damage the reputation of the DOJ and FTC among competition policy enforcers in other countries. A potentially more serious cost will be if foreign competition authorities use these guidelines to justify enforcing their own laws to protect inefficient domestic firms against foreign competition.

Keywords Antitrust · Merger Guidelines · Horizontal Mergers · Vertical Mergers

JEL Classifications L0 · L4

1 Introduction

The Department of Justice (DOJ) and the Federal Trade Commission (FTC) (collectively, the “Agencies”) are law enforcement agencies. Their mission is to enforce the laws, not maximize economic welfare, consumer surplus, or any other economic aggregate that might be the focus in university seminar rooms. If Congress passes and

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the President signs a law to protect small firms even if doing so harms consumers as a group, the Agencies are not wrong to enforce them.

2 The Role of Economists

The Agencies look to their economists for analytical economic analysis in support of their mission of enforcing the law. Academic economists might opine on what the laws should be, but they should strive to distinguish scientific analysis from political philosophy and avoid practicing law without a license.

The technical analysis that economists provide the Agencies is essential for the Agencies to enforce the antitrust laws. The point applies not only to work on individual cases, but also, at least traditionally, to merger guidelines. Arguably, the most successful guidelines to come from the Agencies were the DOJ 1982 Merger Guidelines (U.S. Department of Justice, (1982). They replaced the DOJ 1968 Merger Guidelines (U.S. Department of Justice, 1968, "1968 Merger Guidelines"], which laid out levels of market concentration and changes in market concentration that would likely lead the DOJ to conclude that a merger violated the Clayton Act.[1] But the earlier guidelines were silent on the principles of market definition. The lawyers at the Agencies would not have devised the hypothetical monopolist/SSNIP test on their own. The success of that test is not measured in Google search hits (although they do well by that measure). Rather, the true measure of their success is acceptance by, first, U.S. judges and, then, competition agencies throughout the world.

To be sure, economists at the Agencies have contributed to policy decisions in ways that transcend solving technical problems. For many years, the FTC did not prioritize enforcing the price discrimination provisions of the Robinson-Patman Act. The input from economists about the possibly beneficial and, indeed, pro-competitive uses of price discrimination likely played a key role in the FTC's exercise of prosecutorial discretion. But the opinion of many economists that the Robinson-Patman Act was unsound economic policy did not repeal or otherwise invalidate the Robinson-Patman Act, nor would it prevent the FTC from deciding to try to start enforcing it more vigorously if a majority of the Commissioners decided to do so.

In passing laws, including competition statutes, Congress might have objectives other than maximizing economic welfare as economists would measure it. For example, out of a concern about undue political influence by very large firms, it might enact statutes to limit the growth of very large firms even if they offer consumers better products and/or lower prices. It might pass laws to protect the private interests of generous contributors to influential legislators. In either case, economists should measure the costs to society of such laws. But the role of that analysis is to inform decision makers and the public. Economists have no inherent power other than their power to persuade.[2]

[1] The Hart-Scott-Rodino Antitrust Improvement Act was not enacted until 1976. The 1950 Celler-Kefauver Act strengthened the anti-merger provisions of the Clayton Act.

[2] Economists have a vested interest in the enforcement philosophy that has guided the Agencies and U.S. courts for nearly a half century. If the standard for whether a horizontal merger merits blocking under

3 The 2023 Merger Guidelines Differ Fundamentally from Previous Merger Guidelines

These points about the mission of the Agencies and the role for economists are crucial for assessing the 2023 Merger Guidelines [U.S. Department of Justice & the Federal Trade Commission (2023a), "MGs"] and the fundamental differences of those MGs from previous merger guidelines.[3] They propose a radical change in the enforcement philosophy of the Agencies and the reasoning that underlies that philosophy. To the extent that the Agencies plan to bring enforcement actions based on this changed philosophy, it is appropriate (and, indeed, incumbent upon them) to explain this change to companies, their counsel, and the public at large.[4]

But agency guidelines are just that – guidelines that the Agencies issue to explain how they decide what cases to bring. They are neither laws nor regulations. Courts sometimes look to the Agencies for input on competition issues that arise in privately initiated cases, and the Agencies can and do offer such advice by filing *Amicus* briefs on competition cases. Ultimately, however, it is the courts that decide; the power of the Agencies ultimately lies primarily[5] in their ability to persuade courts that the Agencies' enforcement actions conform to the law.

In the early 2000s, the Agencies lost several high-profile merger challenges. The FTC lost *Arch Coal*;[6] the DOJ lost *Oracle-PeopleSoft*.[7] And both agencies had failed in their attempts to block several hospital mergers (Greaney, 2002). To be effective, Agency enforcement had to conform with what the courts would accept. Thus, for those who would criticize U.S. antitrust enforcement as being too lax – and, in some respects, I include myself among them – one cannot attribute previous enforcement solely or even primarily to the Agencies. The courts have been the main drivers.

the Clayton Act is whether prices to consumers will go up or down, the Agencies, companies, and courts generally rely on economic analysis to apply that standard. Economists should not be surprised if non-economists view economists' higher-level advice to base policy on economic analysis as self-serving.

[3] Many others have pointed out this difference. See, for example, Baker et al. (2023).

[4] As an alternative to revising the merger guidelines, the Agencies might have relied on speeches by senior Agency officials to signal their change in enforcement philosophy. This alternative approach would have had both advantages and disadvantages. On the one hand, most of the guidelines that the Agencies have issued reflected a bipartisan consensus that made it likely that they would survive changes in administration; and, as I discuss in more detail in Section V, a lack of consensus within the US harms the standing of the US Agencies with competition authorities in other countries. But, there are also problems when the prevailing guidelines do not reflect current enforcement. In 2006, the Agencies issued Commentary on the Horizontal Merger Guidelines (U.S. Department of Justice & Federal Trade Commission, 2006). At that time, the Agencies believed that the 1997 Horizontal Merger Guidelines (U.S. Department of Justice & Federal Trade Commission, 1997) did not accurately reflect how they were conducting merger review. The Commentary was an attempt to give a more accurate account without actually revising the Guidelines. Ultimately, however, the Agencies decided in 2010 that they had to incorporate those changes into actual guidelines (U.S. Department of Justice & Federal Trade Commission, 2010).

[5] Because it is expensive for companies to fight challenges from the Agencies and even to endure the cost and delays that are associated with a second request, the Agencies do have the power to prevent some mergers that they could not successfully convince a court to block.

[6] *Federal Trade Commission v. Arch Coal*, 329 F. Supp 2d 109 (D.D.C. 2004).

[7] *United States v. Oracle*, 331 F. Supp. 2d 1098 (N.D. Cal 2004).

A striking feature of the MGs is their frequent reference to Supreme Court cases. Previous versions of the merger guidelines did not refer to cases at all. The 2006 Commentary on the Horizontal Merger Guidelines [U.S Department of Justice & Federal Trade Commission (2006)] did cite cases, but they were recent cases that illustrated recent enforcement rather than Supreme Court precedent.

The case that the MGs cite most frequently is *Brown Shoe v. U.S.*,[8] a case that Bork (1978, p. 210) famously characterized as having considerable claim to being the worst antitrust essay ever written. But the criticism of *Brown Shoe* is not limited to Bork and his adherents. Most modern antitrust practitioners view it as being a deeply flawed decision and, more importantly, one that does not reflect modern enforcement by the courts.[9] But the Supreme Court has never overturned *Brown Shoe*; and, in citing *Brown Shoe* frequently, the Agencies seem to be suggesting that the problem with US antitrust enforcement is not problematic Supreme Court antitrust decisions that could be used to enforce economically harmful policy but, rather, an emerging case law that has deviated from Congress' original intent in passing the core antitrust statutes.

Time will tell whether these arguments persuade the courts.[10]

4 A Few Observations about the Economics

While the primary issue with the MGs is whether the courts will accept enforcement based on them, I comment briefly on what these guidelines say about how the Agencies interpret economic evidence.

4.1 Tightening Horizontal Merger Enforcement

I applaud some aspects of the MGs. The clear statement of principles at the beginning makes them far more accessible to the public than did previous guidelines. Moreover, some (but not all) of the eleven principles reflect changes that have a defensible economic foundation.

In particular, US antitrust enforcement has allowed some markets to become too concentrated, and some tightening of horizontal merger enforcement is therefore

[8] *Brown Shoe v. United States*, 370 U.S. 294 (1962).

[9] Hovenkamp (2023) argues that the critics include the Supreme Court which "very largely cleaned up its own *Brown Shoe* mess."

[10] After the Agencies lost a series of challenges to hospital mergers, the FTC launched a Merger Litigation Task Force (Federal Trade Commission, 2002) and the Bureau of Economics undertook a series of retrospectives on consummated hospital mergers (Haas-Wilson & Garmon, 2011; Tenn, 2011; Thompson, 2011). The Haas-Wilson & Garmon study formed the basis for Haas-Wilson's testimony in the FTC's successful challenge to Evanston Northwestern Healthcare's acquisition of the Highland Park Hospital (Federal Trade Commission, 2007); and the empirical methods the Bureau of Economics developed (in conjunction with noted academic health care economists) were essential to the subsequent success of the Agencies in challenging hospital mergers. These examples support the proposition that the Agencies are far more effective in persuading courts with economic evidence rather than legal arguments that imply that they know better than the courts how to interpret Congressional intent and Supreme Court precedent. The Agencies have economists. The courts do not.

appropriate (Ashenfelter & Hosken, 2010; Ashenfelter et al., 2014; Baker & Shapiro, 2007; Weinberg et al., 2011). The 2010 Merger Guidelines [U.S. Department of Justice and the Federal Trade Commission (2010)] had changed the threshold post-merger HHI that they consider to be highly concentrated from 1,800 to 2,500, which is the HHI that would arise in a market with just four firms of equal size. The 2023 MGs set the threshold back to 1,800.

Since the sizes of firms in real markets are never exactly equal, the HHI for any market with only four firms exceeds 2,500 (the HHI for a market with only four firms that are of equal size). Thus, the 2,500 threshold might initially seem to imply that Agencies will tolerate "6 to 5" horizontal mergers but not "5 to 4" horizontal mergers.

Such an interpretation misses an essential point. The threshold that the Agencies consider tolerable varies by market, and merging parties can (and do) use guideline thresholds against the Agencies when it suits their interest. In practice, therefore, guideline thresholds create a quasi-safe harbor. As a result, the Agencies have good reason to set thresholds that might seem overly restrictive. A threshold of 2,500 means that the Agencies are unlikely to challenge any merger that leaves a post-merger HHI under 2,500. It does not mean that they are likely to challenge any merger with a post-merger HHI over 2,500. Whether 1,800 is the right number, it is appropriate to establish a threshold under which a "5-to-4" merger is not the outer limit of what structural conditions might elicit a challenge but, instead, is well within the range that might elicit a challenge.[11]

An economically valid rationale for lowering the threshold HHI to create a structural presumption against clearing a merger is to prevent the risk of coordinated effects. The 1982 and 1984 DOJ Merger Guidelines [U.S. Department of Justice (1982, 1984)] preserved the concern with coordinated effects that underpinned the DOJ 1968 Merger Guidelines [U.S. Department of Justice (1968)].

Over time, however, the Agencies placed heavier emphasis on unilateral effects, and the guidelines changed to reflect that emphasis. As in virtually all areas of antitrust, the legal standard embodies decision-theoretic judgments. The simple economics of oligopoly is that firms in such markets have a mutual incentive to cooperate and a private incentive to cheat. Most industrial economists likely find the logic underlying Stigler (1964) to be compelling. The title of that article is "A Theory of Oligopoly," but it would be just as accurate to call it "A Theory of Coordinated Effects." At the technically more sophisticated level of the "folk theorem," (Fudenberg & Maskin, 1986; Fudenberg & Tirole, 1991), a wide range of outcomes is possible.

At one time, the Agencies used a checklist of "plus factors" based roughly on Stigler (1964). But industrial economists have never been able to demonstrate empirically what factors increase the likelihood of collusive outcomes. As a result, the primary plus factor that has survived is a history of collusion in the industry. But, while economists have not identified conditions when they can reliably conclude that a merger is more likely than not to result in coordinated effects, it is naïve to ignore the

[11] The Agencies have traditionally treated efficiency claims with great skepticism. The amount of skepticism that is appropriate should arguably depend on the extent of post-merger concentration. If the Agencies are going to consider challenging "5-to-4" mergers that they might have cleared in the past, the risk of crediting efficiency claims is lower than it is in, say, a "3-to-2" merger.

risk that increased concentration facilitates coordinated behavior. The large number of instances of price fixing that the DOJ detects and prosecutes is strong evidence that collusion is not a rare event; and, as both a matter of economic theory and common sense, reducing the number of independent suppliers increases the risk of coordinated behavior.

4.2 Vertical Mergers

In recent years, the Agencies have dramatically altered their approach to reviewing vertical mergers. The 2020 Vertical Merger Guidelines [U.S. Department of Justice & Federal Trade Commission (2020)] signaled tighter enforcement. The FTC rescinded those guidelines as not being tough enough [U.S. Federal Trade Commission (2021)]. And the MGs promise even tougher enforcement.

Prior to issuing the 2023 MGs, the Agencies issued draft MGs (U.S. Department of Justice & Federal Trade Commission, 2023b). If one compares the draft and final versions, the draft did not include the following footnote, which does appear in the final version:

A common rebuttal argument is that the merger would lead to vertical integration of complementary products and as a result, "eliminate double marginalization," since in specific circumstances such a merger can confer on the merged firm an incentive to decrease prices to purchasers. The Agencies examine whether elimination of double marginalization satisfies the approach to evaluating procompetitive efficiencies in Sect. 3.3, including examining: (a) whether the merged firm will be more vertically integrated as a result of the merger, for example because it increases the extent to which it uses internal production of an input when producing output for the relevant market; (b) whether contracts short of a merger have eliminated or could eliminate double marginalization such that it would not be merger-specific, and (c) whether the merged firm has the incentive to reduce price in the relevant market given that such a reduction would reduce sales by the merged firm's rivals in the relevant market, which would in turn lead to reduced revenue and margin on sales of the related product to the dependent rivals. (U.S. Department of Justice & Federal Trade Commission, 2023a, pg. 16.)

So, according to the US Agencies, the elimination of double marginalization as a result of a vertical merger is (1) a mere footnote, (2) a "rebuttal point," and (3) merits the same degree of skepticism with which the Agencies generally treat efficiency claims. Item (a) in the footnote seems to imply that even when they consider a possible efficiency from the elimination of double marginalization, the Agencies will view an increase in the degree of vertical integration as problematic. Item (b) is typical of Agency assertions about less restrictive approaches to accomplishing merger objectives. They invariably ignore the practical barriers to such solutions. If the parties were unable to overcome double marginalization prior to a merger, the Agencies and courts should question how confident they can be of any assertion that contractual alternatives are available. Item (c) reflects an effect that has a rigorous

economic foundation.[12] As De Stefano and Salinger (2024) show, the "Chen effect" is a direct offset to EDM. What the footnote ignores is that it also limits the incentive to raise rivals' costs.[13]

Why should EDM (as mitigated by the Chen effect) be considered in the efficiency analysis as a possible rebuttal to a finding of a harm to competition rather than as a primary competitive effect? Such a treatment is inconsistent with how the Agencies evaluate horizontal mergers. As merger analysis is inherently forward-looking, the Agencies predict the competitive effects of horizontal mergers by analyzing the effect on incentives generally and pricing incentives in particular.

The core of such analysis is to identify and try to measure the pre-merger pecuniary "externalities"[14] between the merging firms: The presumption is that the merged entity will internalize those externalities. When Toyota considers reducing the price that it charges for cars, the externality with respect to Honda is the reduction in Honda's profits that would result from diverting Honda's sales to Toyota. If Toyota and Honda were to merge, the merged firm would suffer those lost profits and would have an incentive to take them into account.

Apply that logic to vertical mergers: Consider a market in which an upstream monopolist sells an essential input to two competing downstream firms. Prior to any merger, the upstream firm sets prices to maximize its profits without regard to how its prices affect the profitability of downstream firms. The external effect it ignores is that a price increase that increases its profits will reduce the profits of downstream firms. Similarly, when a downstream firm considers a price increase that increases its profits despite reducing the quantity it sells, it ignores the reduction in the upstream firm's profits that are due to the upstream firm's reduced sales of the input that it supplies to the downstream firm. The downstream firm also ignores the effect of its decision on the upstream firm's sales of the input (and concomitant profits) to the competing downstream firm.

A merger between the upstream firm and one of the downstream firms internalizes those effects. The elimination of double marginalization net of the "Chen effect" is the internalization of those externalities and corresponds exactly to the pricing pressure analysis that lies at the core of how the Agencies predict the price effects of horizontal mergers. Making the elimination of double marginalization a mere footnote to be treated with the same sort of skepticism that is typical of how the Agencies view efficiency claims ignores the basic economics of vertical mergers.

It is interesting to compare the section on vertical mergers in the MGs with the section on vertical mergers in the European Commission's non-horizontal merger guidelines (European Commission, 2008). That section begins by explaining the fun-

[12] The effect is sometimes called the "Chen effect," as Chen (2001) was the first published article to point it out.

[13] The merged firm's incentive to raise its rivals' costs has the goal of restricting the sales of its competitors' brands so as to stimulate demand for its own brand. But the Chen effect is to restrict the merged firm's sales of its own brand so as to expand its sales of the input to its competitors. The two pricing pressures work at cross purposes.

[14] The term "externality" here is imprecise as the effect of one firm's pricing decision on another firm's profits is not the sort of economic externality (like pollution) that causes competitive market outcomes to be Pareto inefficient.

damental difference between horizontal and vertical mergers, with the benefits from the elimination of double marginalization playing a central role. After explaining that difference and acknowledging the potential benefits from vertical mergers, those guidelines go on to explain the potential concerns about market foreclosure. Even if one criticizes those guidelines for failing to acknowledge the difficulty in reliably determining that the foreclosure effects outweigh the potential benefits, the economics underlying them is far superior to the MGs or even the 2020 Vertical Merger Guidelines.

5 International Standing of the Agencies

In Section II, I argued that the role of the Agencies is to enforce the U.S. antitrust laws. It overstates matters to suggest that they should do so regardless of whether the laws are economically sound, as economics has traditionally played a role in the Agencies' exercise of prosecutorial discretion. But the Agencies are not necessarily wrong to enforce the laws that economists might judge to be economically harmful. Some aspects of U.S. trade policy protect U.S. competitors against foreign competition in ways that harm U.S. consumers and the efficiency of the U.S. economy. To cite just two examples: The relative success of U.S. car companies in selling light trucks is because of the 25% tariff that increase the prices that U.S. consumers and businesses pay for light trucks and that is likely a drag on the U.S. economy; and, the process by which the U.S. Department of Commerce imposes antidumping and countervailing duties protects special interests against foreign competition rather than promoting either consumer welfare or overall U.S. economic efficiency.

But, if the Agencies succeed in convincing the courts that the U.S. antitrust law should protect small competitors against competition from larger, more efficient rivals rather than protecting competition, such a shift will have repercussions in the role that the Agencies play in international antitrust enforcement. The Agencies participate in the International Competition Network (ICN) and the competition activities of the Organization for Economic Cooperation and Development (OECD). Depending on how they are enforced, competition laws in other countries and the European Union can be used to protect domestic firms from foreign competition. The Agencies have traditionally advocated forcefully in these international competition policy arenas for focusing competition law enforcement on promoting consumer welfare -- rather than protecting domestic businesses, including previously state-owned enterprises that often remain politically powerful even after privatization.

The Agencies may command far less respect among competition authorities in other countries than they once did. There have been several causes: The FTC's decision not to adopt the "Sect. 2 Report" (U.S. Department of Justice, 2008) that the staffs of the two Agencies had developed together did substantial damage to the proposition that U.S. antitrust enforcement reflected a bipartisan consensus that was based on sound economic principles.[15] The competition policy enforcers in other coun-

[15] See FTC (2008) for the statement by three FTC commissioners explaining why they voted against adopting the report. At the start of the Obama Administration, the DOJ withdrew the Sect. 2 Report. See

tries may well view the Vertical Merger Guidelines as being less sophisticated and therefore a less appropriate model than the European Commission's non-horizontal merger guidelines. So the blame for damaging the reputation of the U.S. Agencies as international leaders in competition policy enforcement does not lie entirely with the 2023 MGs. From the perspective of U.S. companies that compete in foreign markets, the companies should hope that the MGs merely further diminish the respect that the Agencies command rather than become a model for foreign competition authorities looking to protect domestic interests.

6 Conclusion

Georges Clemenceau said of Woodrow Wilson's Fourteen Points to guide the peace to conclude World War I, "The Good Lord only gave us Ten" (https://www.goodreads.com/quotes/1323876-fourteen-points-the-good-lord-only-gave-us-ten-and). The 2023 have fewer points than Wilson's fourteen, but more than the Decalogue.

While I applaud the Agencies' attempt to establish clear principles that demystify the merger guidelines, not all eleven and not even ten are economically sound. Moreover, underlying the Ten Commandments is one Golden Rule. To date, the one underlying principle of modern U.S. antitrust enforcement has been to protect competition (and, therefore, the beneficiaries of competition). If the courts endorse the U.S. Agencies' abandonment of that principle, then U.S. antitrust law will do the same sort of economic damage that the protectionist elements of U.S. trade policy do, and U.S. companies should not be surprised if foreign competition authorities follow suit.

Author Contributions I am the sole author of the paper.

Data Availability No datasets were generated or analysed during the current study.

Declarations

Competing Interests The authors declare no competing interests.

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