

Paper Trail: Working Papers and Recent Scholarship

This department tracks current working papers or recently published articles on issues of interest to antitrust practitioners and enforcers. In this issue, we offer for your consideration three recent papers and one not-so-recent article. The paper by Paul Pautler dovetails nicely with the David Scheffman interview published in this issue. Pautler is one of Scheffman's deputies at the FTC, and the paper may be at least suggestive of what the Bureau of Economics thinks of recent empirical research in Industrial Organization. Patrick Greenlee and Alexander Raskovich have a surprising answer to those who think that a financial interest by a downstream firm in an input supplier can reduce the degree of double marginalization. Patrick Bolton, Joseph Brodley, and Michael Riordan—all distinguished antitrust scholars—evaluate predatory pricing case law in light of modern research. And in a not-so-recent article, Gregory Werden and Luke Froeb reach some unsettling conclusions about the practical role of entry in antitrust analysis. While not covered here, the editors also encourage readers to review the article by Roy Epstein and Daniel Rubinfeld in the forthcoming issue of the Antitrust Law Journal, Vol. 69, Issue 3 (2002).

We welcome readers' suggestions of papers you have found to be particularly useful or insightful. Contact Editors Bill Page, page@law.ufl.edu, or John Woodbury, jrw@crai.com.

—JRW

Papers and Summaries

Paul A. Pautler, "Evidence on Mergers and Acquisitions," FTC Working Paper No. 243 (Sept. 25, 2001).

This paper is a very useful compendium of merger studies conducted from the mid-1980s to the present. Pautler—who is one of David Scheffman's deputies in the FTC's Bureau of Economics—describes the primary empirical methodologies used to gauge the effects of mergers and then, with an admittedly broad brush, characterizes the results from each approach. For example, with respect to "event" methodologies using stock market returns, Pautler concludes that there are small net gains to shareholders, but the bulk of the returns are captured by rival firms. Whether this is due to an anticompetitive effect of the merger, an expectation that rivals are now also "in play" for a merger, or to an efficiencies "demonstration effect" is unresolved. It is unfortunate that

Pautler does not offer an overall conclusion about what this vast empirical literature implies for the severity of merger policy.

Patrick Greenlee and Alexander Raskovich, "Vertical Ownership Without Control," Economic Analysis Group Discussion Paper (EAG 01-6) (July 20, 2001) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=278088.

One piece of conventional wisdom is that if a firm acquires a purely passive (silent) financial interest in an upstream (input) supplier, and if the upstream market is something less than perfectly competitive, then that acquisition is pro-consumer. This is because effective price to the downstream firm—the nominal price of the input charged by the upstream supplier less the share of upstream profits due the downstream firm as a result of its passive financial interest—will be closer to the marginal cost of producing the input. The downstream firm will then increase its output above its pre-acquisition level. It is also conventional wisdom that this

statement isn't exactly true. As a result of the lower effective price for the input, the downstream firm will demand more of the input, and so the upstream firm will respond by raising the price "somewhat." Greenlee and Raskovich show that for a large class of market environments, the upstream price increase exactly offsets what the effective reduction in price would have been due to the downstream firm's financial interest. As a result, the downstream firm does not increase its output and, in these equilibria, there is no consumer benefit from the acquisition of the interest. In these cases, some control over the upstream firm might be required to realize the efficiencies from the elimination of double-marginalization. A competition policy that limits any control accompanying a financial interest (out of, e.g., vertical foreclosure concerns) may have the effect of limiting the efficiency gains from the acquisition.

Patrick Bolton, Joseph F. Brodley, and Michael H. Riordan, "Predatory Pricing: Strategic Theory and Legal Policy," 88 *Georgetown L.J.* 2239 (2000).

For some time—particularly since the *Brooke Group* decision—plaintiffs' success in bringing federal predatory pricing claims has been trivial at best. The authors of this article argue that the predatory pricing pendulum has swung too far in the reluctance of the courts to pursue these matters. As a result, too many "true" predatory pricing events are unpunished. Among the sources of this disconnect is the failure of the courts to realize that further review of some of the key empirical literature on which the courts have relied did not establish that price predation is in fact a rarity. Another major disconnect is the theoretical approach taken by the courts, using an outdated theory of price predation that is static and non-strategic. Using the modern theory of predation that is both dynamic and strategic, the authors provide a framework for assessing predation claims that they believe is consistent with *Brooke*.

Gregory J. Werden and Luke M. Froeb, "The Entry-Inducing Effects of Horizontal Mergers: An Exploratory Analysis," *J. Indus. Econ.* 525 (Dec. 1998).

While this article might not be "recent" by many definitions of the word, an editorial board member recently (as conventionally defined) stumbled across it. Entry considerations play a critical role in evaluating the likely competitive effects of a merger. Yet, this paper suggests that reliance on entry may be misplaced. In particular, the paper uses simulations of Bertrand competition to evaluate the efficacy of entry in constraining post-merger price increases. However, the typical Bertrand models—the type that antitrust practitioners usually roll out to evaluate unilateral effects in a differentiated product industry—evaluate the sufficiency of entry after the model is "run." Here, the authors incorporate entry explicitly into the model and find that typically, the entry opportunity created by a post-merger price increase—even with very large mergers—is in fact not sufficiently large to induce entry. These results suggest, then, that our usual reliance on entry to resolve apparent competitive problems could be misplaced. ●