

## Paper Trail: Working Papers and Recent Scholarship

*The lead-off paper in this issue is a recently published article by Jonathan Baker. In previous issues of The Antitrust Source (see “archives,” <http://www.antitrustsource.com>), the chief agency economists (Mike Katz and Dave Scheffman) have told antitrust practitioners that we should expect a greater agency emphasis on coordinated effects analysis in merger reviews. Certainly, some if not many economists may have been dismayed because coordinated effects approach has at least the appearance of being both unstructured and subjective, focusing as it does on the “plus” factors and concentration. Baker’s paper is an important first and very big step in proposing a much more structured framework for coordinated effects analysis. It is well worth the read.*

*Another paper described here is one authored by a number of FTC economists, including Dave Scheffman, reviewing the problems that arise in the course of using scanner data in estimating substitution patterns among suppliers of scanable products. The paper also discusses the difficulties in using those patterns in the standard models used to simulate the unilateral price effects of mergers. This is the paper that Scheffman promised us at the ABA Antitrust Section’s “brown bag” last September (a transcript of which appeared in our January edition). The authors made a clear effort to make the paper accessible to a non-economist audience, although there are times when the discussion, perhaps unavoidably, does become a bit technical.*

*Finally, the events of 9/11 will always and appropriately overshadow any event in antitrust. However, on that day, the FTC hosted a roundtable of some of the leading players in the economics of Industrial Organization, a transcript of which recently became available. While the discussion breaks no new ground, it is a useful overview of the state of empirical IO. The discussion does occasionally ramble (as it would with any transcript of spoken remarks) and even more occasionally becomes technical (we’re sure that lawyers will find the global concavity discussion quite interesting). However, it is by and large very readable and accessible.*

—JRW

### Papers and Summaries

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#### **Jonathan Baker, Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws, 77 *N.Y.U. L. Rev.* 135 (2002).**

As noted above, this article provides a framework for a more structured analysis of coordinated effects claims by focusing on the role and identification of “mavericks.” The concept of mavericks is not new to antitrust, and it is well known that the identification of a maverick can neutralize the agencies’ concern with what might otherwise be an anticompetitive merger (or raise substantial concerns if the maverick is one of the merging parties). In conventional antitrust wisdom, the maverick label is usually applied to a firm that is a disruptive price cutter or innovator. Baker instead argues that an appropriate redefinition of a maverick would be one that is at or near indifference about participating in the tacitly collusive agreement. In this view, the maverick may not be one that actually cuts prices, but instead is the one that constrains the amount of any tacitly collusive price increase. Consequently, there is always a maverick.

Baker deals with easiest cases conceptually in an appropriately perfunctory way. If the deal does not involve the maverick *and* the behavior of the maverick does not change as a result of the deal, a merger between non-mavericks will not have a price effect. If the merger does involve the maverick *and* there is no other firm that can assume that title, then the merger will raise prices (ignoring entry possibilities and other merger-induced destabilizing events).

But Baker's article goes far beyond these simple cases and provides insights into the process of identifying a maverick, predicting whether the behavior of a maverick not party to the deal will change following the deal, considering how a merger might create a maverick, and how a merger might neutralize a maverick. Baker illustrates these insights using numerous real-world examples drawn from existing case law. And along the way, the article provides a lucid discussion of the rise and fall of the "structural presumption," that concentration is the critical variable of interest in merger analysis.

This article is certainly the most carefully constructed and analytically interesting evaluation of coordinated effects analyses available during the (perhaps now bygone) era of unilateral effects. It certainly doesn't provide all of the answers for (e.g.) identifying mavericks and determining when a merger might affect the behavior of a maverick. Nor will it replace the "plus" factors or Posner's checklist, but it is a very solid start along the road of developing a more structured approach to structural analysis.

**Daniel Hosken, Daniel O'Brien, David Scheffman, Michael Vita, Demand System Estimation and its Application to Horizontal Merger Analysis, FTC Bureau of Economics Working Paper (April 2002)**

<http://www.ftc.gov/be/workpapers/wp246.pdf>.

This paper describes an array of challenges faced by the economist using scanner data for estimating substitution patterns among the products of the parties to a proposed merger. In addition, the paper highlights the challenges arising when one uses those substitution patterns as an input into model to predict price changes.

The inventory of estimation problems discussed include, among others: the aggregation price and quantity data across stores (stores may charge different prices for the same commodity, but the scanner data provides on the "average" price, and consumers are assumed to respond to this average price by purchasing the quantity indicated) and channels (the elasticities may be different for mass merchandisers than for supermarkets); the choices made about the curvature of the demand curve and implications of that choice for simulated price predictions; and the "endogeneity" issue (when we observe a change in the price and quantity, is that a change driven by changes on costs while moving along the same demand curve or is it a result of a shift in demand?).

In terms of the simulation challenges, the paper notes three issues (although it claims only two), only one of which really has to do with scanner data-based estimation of substitution. First, the scanner data tracks consumer behavior among retailers, but typically the proposed mergers are among the upstream wholesalers and therefore the substitution pattern of interest is at the wholesale, not retail, level. In these models, the wholesale own-demand elasticity for a product (in absolute value terms) will always be less than the elasticity estimated at the retail level. Second, the paper correctly notes that even if one could infer wholesale elasticities from the retail elasticities, ignoring other dimensions of competition (particularly shelf-space competition) in the pricing simulation may generate misleading results. Third, if wholesalers pay slotting fees (e.g.) to retailers for being carried, then again the standard simulation models may not be accurate.

On the one hand, this is a useful read for antitrust practitioners who frequently find that their clients have access to scanner data. We all should be aware of the pitfalls in using these data. On the other hand, the paper rarely indicates the direction of the bias (have we underestimated or overestimated cross-price elasticities) or the size of the bias if the estimation is less than perfect. The paper would have been much more helpful if instead of an uninformative conclusion, it had described when one should attach more or less weight to a particular problem if considering the use of scanner data. Certainly, a set of Estimation Guidelines would be useful for lawyers and economists alike. Perhaps there will be an Episode II of this paper.

(On a somewhat related matter, there is virtually no discussion of how demand analysis might be used in newly-emphasized coordinated effects analyses. The discussion is instead focused on unilateral effects. And in note 3, there is a sizeable list of recent articles that are described as validating the predictions of the simulation models, notwithstanding the concerns by the agencies' chief economists about the inability of the unilateral effects models to predict prices.)

### **Federal Trade Commission, Empirical Industrial Organization Roundtable (Sept. 11, 2001)**

<http://www.ftc.gov/be/empiricalioroundtabletranscript.pdf>.

The roundtable was moderated by Dave Scheffman (Director of the FTC's Bureau of Economics), who asked that the speakers focus on where the agencies need additional research to hone merger enforcement policy. Inevitably the speakers did so against the backdrop of current antitrust wisdom. Some of the highlights.

Dennis Carlton began by noting that we really don't know what methodology we should use to predict the price effects of mergers. Should we be relying on price-market share/concentration studies within industries—the “reduced form” approach—or relying on estimates of own and cross price elasticities which are then plugged into simulation models?

While it's fair to say that there was a mix of views, it was surprising (at least to this editor) that there was a sense if not consensus among the participants that the Bertrands are overused. To paraphrase Janusz Ordover, some participants opined that Bertrands were used as an excuse for ignoring real-world market complexities. Many (but not all) of the participants agreed that appropriately done price-share/concentration studies might provide insight into coordinated effects implications of a merger. While Jerry Hausman explained why his approach to large-scale demand analysis was preferable to the alternative demand approaches, he did concede that perhaps industry-specific “true” reduced forms might be useful for merger evaluation.

Carlton also expressed the view that the economics profession knows so little about innovation that the evaluation of innovation market effects should play no role in antitrust analysis. Dick Schmalensee agreed about the profession's ignorance, but seemed to argue that the role of innovation in some markets is too important to ignore. While he urged more research into predicting when Schumpeterian-like innovation would disrupt the existing market structure, he noted that such requests have been made for the last fifty years with little result.

The participants also seemed to agree that separating the parties' rhetoric from reality in efficiency claims was both important and difficult for merger analysis. FTC General Counsel Bill Kovacic suggested a novel way to acquire the data to perform post-mortems on efficiency claims on mergers cleared by the agencies and all of the participants seemed to agree that some effort at post mortems could be instructive. (But, speaking of separating rhetoric from reality, it's not clear from the discussion that the agencies would actually pay attention to efficiency defenses.)

In other areas, Mike Whinston—a leading force in exclusionary behavior modeling—provided

a nice summary of the intellectual history of the theory of anticompetitive exclusion, but also opined that we are not empirically sophisticated enough to predict when a vertical merger will significantly increase the likelihood of such behavior. UCLA's Ben Klein discussed the role and significance of slotting fees.

And there were occasionally some interesting if seemingly off-point discussions. One such discussion addressed the implications of price discrimination for market definition and how to distinguish systematic from unsystematic discrimination. Another exposed how little we know conceptually and empirically about the entry process. ●