Paper Trail: Working Papers and Recent Scholarship

***This edition of the Paper Trail** summarizes the papers presented on June 10, 2002, by past and present senior agency leadership (mostly economists) on the occasion of the 20th anniversary of the 1982 Merger Guidelines. These papers were presented following brief but interesting opening remarks by Assistant Attorney General Charles James, who likened the development of the Guidelines to John Coltrane's composition of* Giant Steps *that revolutionized modern jazz. (Kudos to the AAG for helping to dispel the illusion that antitrusters are only interested in green eye-shade topics.) In addition, we summarize two recent and interesting papers raising questions about the scope of network effects. As always, suggestions for papers to include in the Paper Trail are encouraged. Email those suggestions to John Woodbury, jrw@crai.com, or to William Page, page@law.ufl.edu.*

20th Anniversary of the 1982 Merger Guidelines: The Contribution of the Merger Guidelines to the Evolution of Antitrust Doctrine (June 10, 2002), http://www.usdoj.gov/atr/hmerger.htm.

Oliver E. Williamson, The Merger Guidelines of the US Department of Justice. In this collection, the short paper by Oliver Williamson reminds the antitrust community that the roots of the 1982 and after Guidelines are found in earlier days, in particular when Don Turner upgraded the status of economic analysis within the Antitrust Division in the mid- and late 1960s. These must certainly have been heady intellectual times, with the likes of Williamson, Turner, and Posner all steering antitrust enforcement towards waters more friendly to economic analysis.

William Kolasky and Andrew Dick, The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers. Where the Williamson paper ends—describing the potential importance of efficiencies in merger analysis—is where the paper by William Kolasky and Andrew Dick begins. The Kolasky-Dick paper describes the 1968–1997 transformation of the Guidelines' approach to efficiency claims, from being only an exceptional defense to potential anticompetitive harm to being integrated as part of the Guidelines' competitive effects analysis. Interestingly, the paper suggests that the 1997 revisions do not obviously support only a consumer welfare approach in evaluating efficiency claims. (This is the view that the efficiencies must be such as to result in lower prices to consumers; because fixed cost savings are not likely to result in lower prices within the Guidelines' time horizon, such savings, in this view, do not "count.") Instead (citing note 37 in the 1997 revision to the 1992 Guidelines), the authors suggest that the "real" Guidelines' approach should be considered a hybrid of the total welfare approach (which would count fixed cost savings) and the consumer welfare approach. In addition to suggesting that the efficiencies analyses play an important role in merger analysis at the agencies, the paper also describes how the courts have "increasingly" accepted the idea that efficiencies can be used offensively. Yet, it's not hard to recall the D.C. Circuit's characterization of the efficiency analysis in the *Baby Food* case as "novel." *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001). Perhaps Kolasky and Dick are sending practitioners a signal that it's safe to use efficiency arguments before the agencies if they conform to the 1997 revisions.

Gregory J. Werden, The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm. A brief paper by Gregory Werden details the intellectual antecedents to the hypothetical monopolist paradigm and how that paradigm became the "organizing principle" for merger analysis before the agencies. In addition, Werden documents the paradigm's almost wildfire-like spread (in antitrust time) to foreign antitrust agencies, as well as the now-conventional use of critical loss/critical elasticity analysis for market definition purposes, an analysis that derived from the hypothetical monopolist paradigm.

David Scheffman, Malcolm Coate and Louis Silvia, 20 Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective. A longer paper by David Scheffman, Malcom Coate, and Louis Silvia takes a broader look at the legacy of the 1982–1997 Guidelines at the FTC in particular and how the application of the Guidelines has been refined through the use of critical loss analysis, econometric demand estimation, bidding models, "natural" experiments or event analyses, MVS implementation, and unilateral effects models. For each of these, the paper cites investigations and cases that relied on one or more of these approaches. In discussing the role of concentration in merger analysis, the paper offers some interesting factoids. It notes that in a sample of 113 enforcement actions (i.e., either settlements or complaints) between 1983–2000, the lowest HHI in these actions increased from 1566 in 1983–84 to 2545 in 1985–86 "and remained well over 2000 for the remainder of the time period." For 107 closed investigations during the same period, the highest HHIs "generally exceeded 4000 throughout the sample." While discussing the role of efficiencies, the paper does not cite any evidence that any apparently Guidelines-conforming efficiency analysis played a key role in FTC investigations. No surprise there.

Jonathan B. Baker, Responding to Developments in Economics and the Courts: Entry in the Merger Guidelines. Finally, in a shorter paper, Jonathan Baker provides a concise and informative history of the role of entry in Guidelines' merger analysis. The paper discusses the significance of the distinction between uncommitted and committed entrants and the evolution of the "likely, timely, and sufficient" test. The paper closes with an important observation that the 5 percent MVS test is indeed arbitrary, with no Guidelines guidance on how to adjust that threshold to particular market circumstances.

—JRW

Stan J. Liebowitz, Network Meltdown: A Legacy of Bad Economics (April 19, 2002)
http://papers.ssrn.com/paper.taf?abstract_id=309879.
Liebowitz is a long-time critic of the network externalities and increasing returns literature. In this paper, excerpted from a forthcoming book, he argues that the dot.com bubble formed because entrepreneurs accepted the economists' extravagant claims that Internet markets are characterized by "lock-in" and a strong "first mover advantage." Liebowitz shows that, as a theoretical matter, these effects have a much narrower applicability than many believed. He argues for caution in accepting claims of paradigm shifts that upset the settled truths of traditional microeconomics, concluding that "[t]he laws of supply and demand are not so fragile as to be overcome by anything so small as a new method of communicating with one another." Much of the paper is familiar—Liebowitz trots out his famous debunking of the myth of the QWERTY keyboard—but the paper does include an entertaining collection of quotations from economists during the heyday

of the dot.coms. For example: "Earnings are a decision variable, not a requirement. . . . If everyone thinks you're doing fine without earnings, why have them?"

—WHP

Venkatesh Shankar & Barry Bayus, Network Effects and Competition: An Empirical Analysis of the Home Video Game Industry (January 2002)
http://papers.ssrn.com/paper.taf?abstract_id=296534.

This is another paper that challenges claims about the strength of lock-in resulting from gaining the larger installed base. The authors examine the role of network effects in competition between incompatible technologies, focusing on Sega and Nintendo. The study examines not only the size of the competing networks, but their strength—that is, "the marginal impact of a unit increase in network size on demand." In other words, networks of a given size can have asymmetric network effects depending upon their relative strength. Strength depends on a variety of sociological factors that foster brand loyalty; firms that have strong networks can exploit that strength as a resource in competition with other networks. Nintendo's network (installed base) was smaller than Sega's but stronger because it was composed of younger teenagers who were fiercely loyal. By marketing to that base, Nintendo was able to outpace the sales of Sega, even though it had a smaller installed base and even though it waited to introduce its new generations of products until after its competitors had done so. ●

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