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# **An Alternative Focus for Antitrust: Addressing Harmful Competitive Advantage**

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## **An Alternative Focus for Antitrust: Addressing Harmful Competitive Advantage**

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## Introduction

A current controversy in antitrust is use of the consumer welfare standard (CWS). CWS in effect states that a merger or anticompetitive business practice is illegal if it makes consumers worse off than they would be otherwise (Wilson, 2019). Salop (2010) holds that Congress intended something like CWS to be the goal of antitrust, but others disagree (Khan, 2017; Wu, 2018). Regardless, early antitrust cases often concerned themselves primarily with business size (Shapiro, 2010; Wu, 2018) and explicit application of CWS did not arise until the 1970s (Steinbaum & Stucke, 2020). CWS is often credited to Bork's (1978) critique of antitrust, which held, among other ideas, that antitrust needs an underlying goal, especially when applying rule of reason (Blair & Sokol, 2012).

Practitioners apply CWS on a case-by-case basis, generally by considering how a proposed merger or business practice would affect consumer prices. Opponents of using the standard argue that it has failed by allowing firms to grow larger, increase their market power, increase profits, and lower their product quality and innovativeness. (Khan, 2017; Baker & Morton, 2019)

The controversy has led some scholars and practitioners to search for revisions of or alternatives to CWS. The options offered include controls on industry structure and business size, restrictions on business models, and adopting rebuttable presumptions that certain actions are illegal.

This paper presents an alternative to CWS for antitrust. Focusing on harmful competitive advantages, the proposed approach seeks to eliminate circumstances that lead to sustained market power, i.e., the ability to avoid competitive pressure despite rivals offering greater efficiencies and greater value. In this alternative, antitrust regulators would conduct industry and regulatory studies to identify and address harmful competitive advantages before they manifest themselves in market power. CWS could still be used in situations where the antitrust officials failed to address the harmful competitive advantages. This approach has several advantages over today's approaches that emphasize discovering market power by examining symptoms case by case. The proposed approach also emphasizes allowing market forces to determine business winners and losers.

## Problems with CWS

Numerous criticisms have been levied against CWS, but most critics embrace CWS's core logic,<sup>1</sup> namely that antitrust is about benefitting consumers through high quality, low prices, and innovation (Salop, 2010; U.S. Department of Justice & Federal Trade Commission, 2010).

Critics point to studies that find evidence of rising market power since the 1970s (Baker & Morton, 2019), with possible negative impacts on employees (Gutierrez, 2018). But other research challenges the studies that find rising market power. Shapiro (2018) and Carlton & Heyer (2020) argue that the studies use flawed industry, profit, and market definitions. Carlton & Heyer (2020) add that the evidence found is consistent with efficient markets. Bailey & Thomas (2017), Chambers, McLaughlin, & Richards (2018) and Goldberg, Johnson, & Shriver (2019) find that rising regulatory controls, not poor antitrust, cause mounting industry concentration. Rajgopal, Srivastava, & Zhao (2022) challenge the conclusion that high Big Tech profits result from market power: They find that the profits are correlated with both increasing innovation and rising Herfindahl-Hirschman indices. Beltran (2022) argues that CWS creates racial and gender inequalities. Her analysis is incomplete in that it ignores the net effects of a merger, and that consumer welfare can be weighted by group if regulators so desired.

Steinbaum & Stucke (2020) argue against CWS in part because there are disagreements on its definition. But Salop (2010) and Wilson (2019) explain that such disagreements are reasons for debate and refinement rather than for abandonment. Zingales (2017) and Khan (2017) hold that the CWS ignores damages caused by the political power that firms might accumulate as they grow financially. But if it is legitimate for democratic governments to seek to limit specific stakeholders' political influence, and if it is legitimate to do so through antitrust, this would be a reason for adding criteria to CWS, not for discarding CWS.

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<sup>1</sup> For examples of criticisms of CWS that nonetheless embrace its logic, see Khan (2017) and Stigler Center (2020).

A Stigler Center (2022) panel addressed the question “What is the Future of the Consumer Welfare Standard?”<sup>2</sup> Most panelists offered protecting competition as the primary purpose of antitrust. When asked for practical definitions of what that means, the panel members’ answers emphasized markets that enhance consumer welfare by incentivizing high quality products, low prices, and innovation – the principles underlying CWS.

There are concerns that CWS is unworkable in digital markets. Khan (2017) argues that digital firms pursue power and dominance rather than profits. However, her primary evidence is a misquote of Amazon’s founder (Jamison, 2020a). Also, Rajgopal, Srivastava, & Zhao’s (2022) finding that that large digital firms – including Amazon – receive extraordinary profits relative to the rest of the economy challenges her thought that large tech firms do not behave as profit maximizers.

The primary challenge to applying CWS appears to be the rapid evolution and rising complexity of industries as they become digitized. Evans (2003, 2017) explains that the multisided natures of many digital firms, and the speed at which they change their products and product mixes, make using traditional antitrust tools quite difficult. Teece & Coleman (1998) and Jamison (2020b) explain why digital markets change quickly and why the rapid evolution makes empirical studies, including analyses of CWS, largely irrelevant for antitrust decisions affecting current and future markets. Thus while CWS may be an appropriate concept, its direct application will become increasingly illusive as digitization becomes a key to success in more and more businesses.

### **Proposals for Reform**

The reform proposals I have reviewed, in general, fail to develop an alternative to CWS’s goal of promoting high quality, low prices, and innovation. Instead, they suggest specific legal restrictions and instruments without an underlying principle. The proposals generally suggest combinations of limits on firm size (Wu, 2018; Stigler Center, 2022), structural separation of

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<sup>2</sup> Panelists included Alden Abbott of George Mason University, Doha Mekki of the United States Department of Justice, Fiona Scott Morton of Yale University, and Zephyr Teachout of Fordham University.

vertical relationships (Khan, 2017; Teachout, 2020), ensuring a minimum number of competitors (Steinbaum & Stucke, 2020; Stigler Center, 2022), greater restrictions on business strategies through rebuttal presumptions or outright prohibitions (Khan, 2017; Steinbaum & Stucke, 2020), limits on diversification (Teachout, 2020), and requirements that certain firms provide others with access to valuable resources (Khan, 2017; Competition and Markets Authority, 2020).

These proposals fail for various reasons. There is, to the best of my knowledge, no set of facts and logic that lead to the conclusion that it is always or even generally bad for a firm to have value or revenue larger than \$X or to serve more than Y customers. Vertical integration is a dynamic process that often improves innovation and efficiency (Jamison, 2022; Miller, 2022), but not always (Miller, 2022). And imposed vertical delineations become arbitrary as markets evolve and slow innovation in dynamic industries (Jamison & Sichter, 2010; Prieger, 2002). It is unlikely that governments can ensure the presence of multiple competitors. Constant changes in and extensions of product mix are basic features of competition in dynamic industries (Evans, 2003, 2017). Finally, restrictive regulations conferring resources to rivals without proper economic pricing can result in underinvestment, especially in thin markets (Prieger, 2016).

Steinbaum & Stucke (2020) suggest an effective competition standard, perhaps in the spirit of Clark's (1940) and Sosnick's (1968) workable competition framework. Clark views atomized perfect competition as ideal, but unachievable, and so identifies market criteria that he believed would reasonably emulate the ideal. Stigler (1956) correctly points out workable competition lacks a coherent market theory, which Clark implicitly admits in embracing pragmatism.

The key features of effective competition, in addition to those already cited, appear to be identifying market power through the use of indicia (such as demonstration of the ability to unilaterally set prices, wages, contractual terms, and restrict output, and the abilities to exclude rivals and to receive profits above the "cost of capital for an extended period of time"), and preserving opportunities and autonomy for competitors, consumers, and producers. The approach is problematic in that, in addition to its lack of an underlying principle, its long list of

rules, concepts, and aspirations generally lack specificity and so would need to be resolved in cases without the help of an underlying theory.

Finally, Khan (2017) suggests public utility or common carrier approaches for digital platforms. This suggestion fails because these approaches are sustainable only when technologies are stable, and the industry is comprised of government-sanctioned monopolies (Jamison, 2011).

### **Harmful Advantages**

I suggest that antitrust emphasize removing harmful competitive advantages. Khan (2017) was correctly critical of current antitrust practices for “ignoring whether and how [market power] is being acquired.” In times of constant change, the source of market power becomes more important than its symptoms because, by the time symptoms are detected, markets have moved on (Hauge & Jamison, 2016; Khan, 2017). In a sense, an antitrust policy based on sources of market power rather than symptoms takes the concern over monopolies back to economics’ earliest roots: Smith’s (1776) monopoly concern was about the British East India Company’s government sanction, and Mill’s (1848) concerns were with government-created barriers to competition and with exclusive access to critical, unique resources.

Following Hauge & Jamison (2016), Mill, Smith, and Teece & Coleman (1998), I consider sources of market power to be valuable competitive advantages that one firm enjoys and that other firms do not and cannot have. These advantages can be necessary features of the industry or supply chain, of the firm in question, or of other firms.

There are at least four types of competitive advantages, namely Ricardian, Schumpeterian, Porterian, and Smithian (Teece & Coleman, 1998; Jamison, 2020b). Ricardian advantages are those resulting from supply limitations for an idiosyncratic resource, such as a unique natural resource (Mill, 1848) or unique knowledge (Teece & Coleman, 1998). Ricardian advantages should be of little concern to antitrust as they often are transitory until an innovation imitates or supplants the limited resource (Teece & Coleman, 1998).



There are two types of Schumpeterian advantages: Those from product innovation and those from process innovation. Product advantages can be from new products protected by a superior ability to produce the new product for some period of time. Likewise, process innovations can be protected by the time and costs it takes for rivals to learn to imitate. It is not necessary that rivals actually imitate the innovation as the rivals might find it more profitable to close, sell some or all of their business to another firm, or buy or develop another innovation that supplants the innovation in question.

Schumpeterian advantages should not be a concern of antitrust as incentivizing innovation is a recognized goal of antitrust policy (U.S. Department of Justice & Federal Trade Commission, 2010) even if the resulting rents are high, as found by Rajgopal, Srivastava, & Zhao (2022): The potential for high and enduring rents is needed to attract innovation-directed capital to an industry marked by high incidence of start-up failure (Jamison, 2020a; Teece & Coleman, 1998).

Porterian advantages<sup>3</sup> arise because rivals have been disadvantaged in a way that makes their entry and/or supply more costly than that of the firm with the Porterian advantage. Teece & Coleman (1998) describe these advantages as resulting from “exclusionary conduct lacking efficiency justifications.” Porterian advantages should be of interest in antitrust, but distinctions should be made between static and dynamic considerations. For example, assertions that platforms should treat their downstream products the same as they treat others’ products often assert static fairness or efficiency claims. From a dynamic perspective, asymmetric treatment is likely to encourage platform innovation and favor downstream products with higher innovation potential. And as Teece & Coleman (1998) note, conduct to create Porterian advantages in a dynamic industry is risky as the advantages increase others’ incentives to create rival Schumpeterian advantages.

Smithian advantages result from barriers to competition that government creates. The name derives from Smith’s (1776) criticism of the British East India Company benefitting from

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<sup>3</sup> My definition of Porterian advantage is narrower than that of Teece & Coleman (1998). They include both privately- and government-created advantages. I give government-created advantages their own category (Smithian) as they are likely to require different antitrust approaches.

government patronage, though the advantage easily could be called Stiglerian based on Stigler's (1971) criticism of regulation hindering competition.

There are several Smithian advantages, including government occupational licenses (Biden, 2021; Henderson, 2019), control of prices or market entry (Beatty, Reim, & Schapperle, 1985; Crampton, 2002; Moore 1978; Pustay 1985; Wheelen & Hunger, 2011), supply management schemes (Crampton, 2002; Wheelen & Hunger, 2011), labor codes (Crampton, 2002), product and technical standards (Crampton, 2002), corporate benefits for local economic development (Bartik, 2017; Crampton, 2002; Porter, 1998; Shambaugh, Nunn, Breitwieser, & Liu, 2018), high degrees of regulatory oversight (Bailey & Thomas, 2017; Chambers, McLaughlin, & Richards, 2018; Goldberg, Johnson, & Shriver, 2019; Porter, 1979), regulations that re-enforce particular market structures (Pulaj, 2014), and business subsidies (Bertrand, T.J. & J. Vanek, 1971; Peltzman, 1976).

These and other Smithian advantages hinder competition and thus should be major concerns of antitrust. Of course, attention to these advantages could be problematic for antitrust regulators because the political system that enables antitrust also creates the barriers to competition that favor powerful interest groups (Peltzman, 1976) and co-partisans (Reingewertz & Baskaran, 2020). Less likely to be controversial would be instances where hindering competition is an unintended consequence of government actions.

With few exceptions, such as the breakup of AT&T, Smithian advantages appear to be underrepresented in antitrust investigations, implying that competition would benefit from antitrust authorities investigating these advantages and providing a transparent accounting of the sizes and distributions of the benefits and costs of the government policies that hinder competition. Such investigations might draw uneven partisan opposition because each political party is likely to have its favored beneficiaries, such as Democrat presidents being more inclined to favor co-partisans than are Republican presidents (Reingewertz & Baskaran, 2020).

The economic landscape is ripe for serious inquiries into Smithian advantages. The 2020 Coronavirus Aid, Relief, and Economic Security Act<sup>4</sup> provided \$2.2 trillion to certain healthcare providers, manufacturers, non-profits, and individuals. The \$1.9 trillion 2021 American Rescue Plan Act<sup>5</sup> included monies for healthcare, agriculture, transportation, and cyber security institutions. The 2021 Infrastructure Investment and Jobs Act<sup>6</sup> provided \$1.2 trillion in funding for organizations involved in broadband access, climate change efforts, clean water, electric grid renewal, and environmental justice, to name a few. With this much money at stake, representing about 10% of the U.S. gross domestic product each year, it is likely that some are used in ways that hinder competition.

Antitrust authorities should identify harmful competitive advantages by conducting industry and regulatory studies that examine government and private conduct. Where governments hinder competition, the antitrust authorities should provide the public and government officials with descriptions of the obstacles, the costs of the hinderances, and the benefits of the policies, and the identities of those that bear the costs and those that receive the benefits and provide recommendations for pro-competitive improvements. Where businesses are building Porterian advantages, the authorities can warn the firms involved, and act against them if warnings are unheeded.

### **Summary**

This paper suggests that antitrust authorities should focus on harmful competitive advantages. These are largely Porterian and Smithian advantages created by firms seeking to disadvantage rivals, governments inadvertently hindering competition, and governments protecting favored stakeholders and partisans without corresponding improvements in economic efficiency. The proposed approach is intended to enable antitrust to get to the heart of market power rather

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<sup>4</sup> Coronavirus Aid, Relief, and Economic Security Act" or the "CARES Act, Pub. L. No. 116-136 (2020), <https://www.govinfo.gov/app/details/PLAW-116publ136>.

<sup>5</sup> American Rescue Plan Act of 2021, Pub. L. No. 117-2 (2021), <https://www.govinfo.gov/app/details/PLAW-117publ2>.

<sup>6</sup> Infrastructure Investment and Jobs Act, Pub. L. No. 117-58 (2021), <https://www.govinfo.gov/app/details/PLAW-117publ58>.

than address symptoms, address market power concerns in dynamic situations, and to make up for antitrust's tendency to ignore competition problems created by governments. This approach would reorient some antitrust resources away from investigating and prosecuting cases and towards investigations that identify problems and develop solutions before harms occur. It would not be a wholesale replacement of CWS as CWS might still prove appropriate in situations where antitrust enforcers have failed to head off market power.

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