THE ROLE OF ECONOMISTS IN ANTITRUST: GETTING THE MOST FROM YOUR ECONOMIC EXPERT

Michael R. Baye
Director
Bureau of Economics
Federal Trade Commission

Prepared Remarks before

The Economics and Federal Civil Enforcement Committees of the American Bar Association's Antitrust Section Brownbag

Kirkland & Ellis
Washington, DC
October 17, 2007

I am grateful to Liz Callison, Mark Frankena, Pauline Ippolito, Paul Pautler, and Patrick DeGraba for helpful comments and conversations.

I am delighted to have this opportunity to share my views on the role of economics in antitrust investigations and litigation. My remarks today are not intended to be exhaustive, but to provide you a glimpse of how I think about these issues. Please keep in mind that what I say today is drawn from only three months of experience at the FTC; my views are mainly shaped by several decades of interaction with economists and lawyers on antitrust matters.

Before I begin, let me say that I appreciate the efforts of the Economics Committee in setting this up, and thank David Scheffman for extending me an invitation to speak at this gathering. I have only been the director of the Bureau of Economics for a little over three months now, a tenure that pales in comparison to past Directors like Dave. Considering this, and the cumulative antitrust experience of all of you, I realize the most likely value of my remarks today is simply providing an indication of how this newcomer to the FTC views the role of economics in antitrust. By my nature—and if you ask anyone that knows me at the FTC or Indiana University I am confident that they will confirm this—I am a very straight-shooter. This does not mean I always hit the bulls-eye, but rather that I am not afraid to express my opinions. There is a marketplace for ideas and I am confident that this market is capable of separating the good ideas from the bad ones. But since this is my first official "speech" as Chief Economist of the FTC, I hope you will forgive me for being cautious in my remarks and in the Q and A that follows. I have practical experience in antitrust litigation that dates back to the mid 1980s, but I want to stress that I am first and foremost an academic economist. That is my comparative advantage, and as you will hear today, it shapes my view of the role of economics in antitrust investigations and litigation.

One additional caveat before I get started. The only thing I'm going to say today that I am certain Chairman Majoras and the other Commissioners will agree with is this: The remarks that follow are my own, and do not necessary reflect the views of the Federal Trade Commission or any of the individual Commissioners.

With that disclaimer out of the way, you will be happy to know that I only have three main—and rather simple—points. First, the economic landscape is complex, and as a consequence, economists are both necessary and useful inputs in the analysis of antitrust matters. Increasingly, the agencies and the courts focus on more complete and complex analyses of markets, and on how the behavior of firms—their actions or conduct—are likely to affect competition. Lawyers today are more economically sophisticated. A mere 25 years after the publication of the Horizontal Merger Guidelines, lawyers, as well as courts, are familiar with the language of economic theory; economic jargon increasingly shows up in legal briefs and court decisions. But, over a century of theoretical and empirical research in economics and industrial organization indicates that there is not a "one size fits all" theory for purposes of antitrust. A great deal of expertise in economics is required to get things right. Let me repeat that: A great deal of expertise in economics is required to get things right.

As an example, consider a hypothetical "3 to 2" horizontal merger. As a matter of economic theory, any reputable economist will agree that anticompetitive effects *can* arise *purely* through *unilateral* effects. The same economist will also agree that in some "3 to 2" mergers, anticompetitive effects *only* arise through *coordinated* effects. And if asked, our trusted economist will also agree that anticompetitive effects can arise through *both unilateral* and *coordinated* effects. And if all this is not enough to make your head spin, consider that that the same reputable economist would also agree that some “3 to 2” mergers entail *neither* unilateral *nor* coordinated anticompetitive effects.

Despite what my undergraduates think—not to mention many lawyers—this doesn’t mean that economists are schizophrenic or have more hands than octopuses. Rather, economists recognize that different facts about the institutional environment in which our three hypothetical firms compete are consistent with different economic models that indicate entirely different competitive effects. Underlying institutional facts are critically relevant to a reputable economist charged with identifying potential competitive effects. Expressed differently, there is a plethora of “off the shelf” static and dynamic oligopoly models that *could* be relevant—each with different implications for competitive effects in our hypothetical “3 to 2” merger. (If you don’t believe me, ask a trusted economist if the competitive effects of a “3 to 2” merger are the same in the classical Cournot oligopoly model and the classical Bertrand oligopoly model). A reputable economist needs to know relevant institutional facts about the industry in order to choose the *right* economic theory for the case. Facts in one case might be consistent with one economic model but inconsistent with the model that is appropriate for a different case with different facts. And real-world cases are often (but not always) more complex than off-the-shelf economic models. Economic theories often have to be refined to account for the complexities of real-world facts. For all these reasons, the competitive effects of a “3 to 2” merger depends on a variety of “facts,” which in turn, are related to explicit or implicit “assumptions” in different economic models. These “facts” include things like whether firms make quantity or pricing decisions—or both; whether prices are determined through contract negotiation, a posted-price, or auction; and so on. And the right answer depends on a host of other factors economists are well-positioned to identify, including the transparency of firms' decisions and the speed with which firms can respond to one another, own- and cross-price elasticities of demand, and more.

Economists, by virtue of our training and the way we think about issues, have a significant comparative advantage in helping lawyers sort all of this out. An exceptional economist can explain the relevant issues in terms that anyone can understand. Lawyers who attempt to economize by using their own knowledge of economics to sort all this out are *not* getting the most out of their economists. Economics is a necessary input in determining which facts are important in a case, and which ones are not. Since the right facts and evidence are pivotal in the law, economists are a necessary input in antitrust investigations and litigation.

My second point—and some economists might view this as blasphemy—is that lawyers are also essential and useful inputs in antitrust investigations and litigation. Lawyers not only have necessary legal expertise, but are uniquely positioned to use that expertise to gather information and facts—and to get those facts into evidence. You all know the tools of this trade far better than I: subpoenas, interrogatories, depositions, interviews, civil investigative demands, discovery requests, 6b requests, and so on. Without facts to discern which economic theory is relevant in a specific case, an economist is unlikely to be able to discern a good "3 to 2" merger from a bad one. And facts and theories residing in an economist's head—but not admitted into evidence—are of little value in helping nonexperts sort out the truth.

So, there is a symbiotic relationship between economists and lawyers. In words more familiar to my MBA students at Indiana University, to create real value, antitrust investigations and litigation must fully exploit the synergies that exist between economists and lawyers. In utilizing their legal and fact-finding expertise, lawyers should work with economists to ascertain the sorts of information required to identify the appropriate theory in a particular case.

A strong case will ultimately be accompanied by a sound economic theory of the case that can be communicated to nonexperts as a story that is not steeped in technical economic terminology, but that is supported by an underlying economic methodology that is rooted in scientific research. The story, in turn, will be supported by facts uncovered during the fact-finding phase. This will include various forms of evidence supporting the use of a particular economic model instead of alternative models. In our hypothetical "3 to 2" horizontal merger, for instance, this will include evidence on the nature of competition – for example, whether price, quantity, or quality competition is most relevant. It will also include institutional details about the industry, such as the transparency of decisions, price discrimination, the importance of location or transportation costs in buyer decisions, and so on. It will include qualitative evidence from documents and deposition testimony that supports or rebuts the assumptions that underlie particular theories of competitive interaction. Where feasible, it will also be supported by qualitative and quantitative evidence regarding likely competitive effects.

The punch line is that econometric evidence – which is increasingly viewed by some as the "holy grail" of antitrust investigations and litigation—is only one potential piece of a strong case. Not all cases lend themselves to econometric evidence; a lack of data required for econometric analysis does not diminish the value of economists in antitrust investigations and litigation.

A lawyer left to his or her own devices is unlikely to identify the right facts or get the most out of the available data—regardless of whether it is qualitative or quantitative data. An economist, without the fact-finding expertise of skilled attorneys, is unlikely to obtain the information needed to identify and test relevant theory. And without the aid of attorneys, economists—no matter how certain they are that the their economics is exactly right in a given case—are likely to deliver expert testimony that is unintelligible by nonexperts, does not meet the required legal standard, or is irrelevant because of existing legal precedents.

Now, my third and final point. Economists also play an important role in antitrust because their research—what I'll call "economic R&D"—advances our understanding of the virtues and limitations of markets. Economic R&D sometimes yields immediate payoffs by illuminating potential benefits or costs of certain types of behavior. This can have an immediate impact on the decisions of agencies and the courts. But more frequently, economic R&D has a longer-term impact on antitrust and the law. As one example, the fruits of past economic R&D are now enshrined in the Horizontal Merger Guidelines, their revisions of 1984, 1992, and 1997, and in the 2006 "Commentary on the Horizontal Merger Guidelines."

A second example of the long-term impact of economic R&D concerns Robinson-Patman cases, which as you know have their roots in an Act passed in 1936 to amend Section 2 of the Clayton Act. During the first three decades of Robinson-Patman, the FTC vigorously enforced this law. Over time, economists have increasingly persuaded others in antitrust circles that there is an important difference between protecting competitors and protecting competition. Thanks to these efforts—and the courage of former Bureau of Economics Directors F.M. (Mike) Scherer and J.M. (Mac) Folsom who had to explain to Congress why the FTC was not enforcing the Robinson-Patman Act—the number of Robinson-Patman cases brought by the FTC declined from about 100 formal investigations and 30 complaints per year in the mid 1960s to virtually none today. As a result of economic R&D, the Antitrust Modernization Commission's Report in 2006 recommended the repeal of the Robinson Patman Act.[1]

A final example that illustrates the longer-term impact of economic R&D on antitrust law is the area of resale price maintenance. Since the *Dr. Miles* case in 1911 and the Albrecht case in 1968, a large body of economic research has shown that resale price maintenance can benefit consumers.[2] Maximum resale price maintenance can benefit consumers by lowering retail prices through the elimination of double marginalization in the vertical chain. Minimum resale price maintenance can prevent firms from free-riding on the services offered by rivals, thereby increasing quality and consumer welfare. It took decades for this economic R&D to impact antitrust law, but it ultimately did: In 1997, the Supreme Court overturned *Albrecht* in *State Oil Co. v. Khan,* adopting a rule of reason for maximum resale price maintenance.[3] Only a few months ago, in its *Leegin* decision, the Supreme Court overturned *Dr. Miles,* definitively putting resale price maintenance under a rule of reason.[4] I'm proud to say that research done by FTC staff in the 1980s and early 1990s was part of the R&D that informed the Court. A 1983 FTC Report by BE Staffer Tom Overstreet, and a paper published in the *Journal of Law and*

---

[1] Antitrust Modernization Commission, *Report and Recommendations*, 330, 334 (2007), *available* at http://www.amc.gov/report_recommendation/toc.htm.

[2] *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911) and *Albrecht v. Harald Co.*, 390 U.S. 145 (1965).

[3] *State Oil v. Khan*, 522 U.S. 3 (1997).

[4] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, __ S. Ct. __ (2007) (slip op.), *available* at http://www.supremecourtus.gov/opinions/06pdf/06-480.pdf.

Economics in 1991 by the Bureau of Economics' very own Pauline Ippolito, were both cited by the Court in its 2007 *Leegin* decision.[5] Pauline's paper, in particular, makes it clear that there is not a "one size fits all" theory of resale price maintenance, and that in many cases—but not all— resale price maintenance has pro-competitive effects.

To conclude, economists and lawyers are both essential inputs in antitrust investigations and litigation. There are strong complementarities between economists and lawyers. In the short run—and by that I mean in cases at hand—the best way to exploit these synergies is for each of us to recognize our own comparative advantages and disadvantages. Lawyers must avoid the temptation of "pigeon holing" cases based purely on concentration or HHI numbers or legal precedent. Institutional details matter in economics; there is not a "one-size-fits-all" economic framework for analysis. Economists must explain relevant theories clearly, identifying the sorts of facts needed to identify the right theory and to rebut theories inconsistent with evidence. And economists must be patient and continue to invest in economic R&D, recognizing that there is frequently a long-lag between economic knowledge and its impact on outcomes in antitrust. Economic R&D is important at the Bureau of Economics, and I can assure you that we will continue that theme during my tenure as Director.

Thanks again for giving me this opportunity. I look forward to your questions.

[5] Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence,* (FTC 1983), Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J. L. & Econ. 263 (1991), and Pauline M Ippolito and Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. L. & Econ. 285 (1996).