



**DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**Working Party No. 3 on Co-operation and Enforcement**

**ROUNDTABLE ON THE USE OF ECONOMIC EVIDENCE IN MERGER CONTROL**

**-- The United States --**

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1. This paper explains briefly the use of economists at the U.S. antitrust agencies, the Antitrust Division of the Department of Justice and the Federal Trade Commission, including how they are organized within the agencies and how their skills are employed in the course of investigations.

### **The Structure of the Antitrust Division's EAG**

2. The economics arm of the Antitrust Division is its Economic Analysis Group ("EAG"). This is a group of approximately 50 career economists and a small number of financial analysts, supported by research assistants, interns, and computer, administrative, and secretarial support staff. The ratio of economists to attorneys in the Division's has varied over time, but is currently approximately 1:6. The economists work primarily on merger investigations, allegations of monopolization or anticompetitive monopoly maintenance, and competition advocacy—which typically involves commenting formally or informally on legislative proposals or regulatory proceedings at other federal agencies. EAG also provides support during litigation and assists in criminal investigations and trials. In addition, it has a very active research program and its economists frequently make presentations at conferences and publish in scholarly journals.

3. There are a total of six EAG managers: a chief and assistant chief for each of three sections. They are supervised by two economists in the Division's Front Office. The first is a career Division economist who serves as Economics Director. The second, and the Division's highest ranking economist, is the Deputy Assistant Attorney General for Economics. The latter is a political appointee with a professional background in industrial organization and antitrust chosen from academia for a term of, typically, two years.

4. Despite its organization into three sections, EAG operates essentially as one integrated section with six managers. The staff operates as a common pool, working for any or all of the managers. We have found this arrangement to be more efficient than assigning individual staff to specific managers, specific industries, or specific legal sections. The approach allows management to take advantage of the staff's availability and expertise when making assignments, and permits each economist to work with multiple legal sections and multiple EAG managers, allowing maximum flexibility either to specialize or to diversify the work he or she handles. In essence, we view the benefits of added flexibility—including the personal and professional satisfaction to economists who value diversity—to exceed those of rigid specialization.

5. The six EAG managers specialize somewhat by industry, with each sharing primary responsibility for a portion of the matters within two (of the Division's six) legal sections. This partial specialization allows the managers to develop industry-specific human capital while at the same time allowing for variety in management assignments and flexibility in dividing up EAG's overall workload across managers.

6. The management structure in EAG is relatively flat, with the managers dividing the work amongst themselves rather than, as is the case in many of the Division's legal sections, having the Chief and Assistant Chief work together on the same investigations. The managers supervise the economists assigned to work on their investigations, and they report regularly to the Economics Director and/or the Deputy for Economics. The Director and Deputy tend to divide primary responsibility amongst themselves for particular investigations, although they frequently work together and interact regularly with the Division's Legal Deputies and with the Assistant Attorney General for Antitrust. They maintain an involvement throughout the progress of all significant investigations, receiving weekly reports and having weekly meetings with management to discuss resource allocation, staffing, and the status and economic analysis of active matters.

## **The Structure of the FTC's BE**

7. The Federal Trade Commission is organized into three functional bureaus. The Bureau of Consumer Protection and the Bureau of Competition are comprised of attorneys responsible for the FTC's consumer protection and competition missions, respectively. The third bureau, the Bureau of Economics (BE), contains the economists responsible for supporting both missions.

8. The approximately 55 non-managerial career staff economists in BE are divided into two antitrust divisions (about 35 economists), one consumer protection division (about 12 economists), and a division of economic policy analysis (about 8 economists). As the economists in the division of economic policy analysis work primarily on antitrust matters, more than three-quarters of the FTC's economists are doing antitrust work, including analysis of mergers and horizontal restraints as well as conducting research relevant to the FTC's overall mission. The Bureau contains also a number of research analysts, financial analysts and administrative and secretarial support staff.

9. The head of BE is the Bureau Director, who is appointed by the Chairman of the FTC and serves at the Chairman's pleasure. There are two Deputy Directors who manage the antitrust and consumer protection groups, respectively.

10. Within the antitrust group in BE, there are two line divisions that are dedicated to antitrust work, each managed by an Assistant Director who reports to the Deputy Director for Antitrust (and ultimately the Bureau Director). Each division has two Deputy Assistant Directors who, along with the Assistant Director, manage cases. Each of the two divisions is roughly the same size with about 15-20 economists. They are also each roughly the same size as one of the legal divisions in the Bureau of Competition, and experience suggests that this is a fairly efficient size from a managerial perspective. The organization of the antitrust economists has alternated over time between having all housed in one division with six managers, and the current system of two separate divisions. While flexibility in assignments is maximized with the one division system, the FTC has found that its current two division system preserves flexibility and diversity of experiences for the staff economists while being more managerially efficient than the one division system.

11. Substantively, both BE antitrust divisions perform the same kinds of economic analysis, but there is some specialization according to industry. This specialization helps to maintain institutional memory and expertise in certain industries which are of repeated focus of Commission concerns (e.g. petroleum, health care services, pharmaceuticals, supermarkets). This specialization mirrors some of the industry specialization of the BC divisions. Economists, however are not segregated by type of competitive practice (e.g. mergers and non-merger competitive practices).

12. Generally, for each case, a staff economist is assigned fairly early. Either an Assistant Director or a Deputy Assistant Director is assigned to manage the case. Throughout the investigation or litigation, the staff economist interacts extensively with the legal staff assigned to the case as well as the manager assigned to the case and with senior BE management. Most cases have only a single staff economist assigned. However, for big cases or cases headed toward litigation multiple economists may be assigned.

13. EAG and BE managers are in charge of the allocation of economic resources within their agencies. They make staff assignments to cases or tasks and directly manage the work of the economists and all economic projects or analyses. They also control the hiring of economics staff, subject, of course, to overall budget constraints and government hiring regulations. Performance evaluations, promotions, and bonuses for economic staff are determined by economics management.

*Why not Instead Integrate the Economists Into the Legal Sections?*

14. The most important role of economists in the U.S. is as independent members of the investigatory team who approach matters using an economic framework for the analysis. Although the economists work closely with attorneys in the appropriate legal section on virtually all investigations, they have the specific role of identifying and developing the economic theory of the case and testing it with the evidence obtained in the course of the investigation.

15. Why, given that they are working closely with attorneys, have a separate Economics Section? Wouldn't it be more efficient to simply distribute our economists permanently in and among the legal Sections themselves? Notwithstanding the close working relationship our economists have with our attorneys, we find there to be several persuasive arguments for operating within distinct economics sections, and with economists reporting up through economist supervisors. Among these are:

i. Quality Control

16. Division and FTC economists are directly supervised by, and report to, fellow economists rather than legal section chiefs. The process of working directly under fellow economists and being subject to their suggestions, demands, review and overall quality control exerts an important intellectual disciplining force on the staff's work. The degree of rigorous economic analysis that we expect and receive from our staff would likely weaken in a regime where supervisors were attorneys rather than fellow economists.

ii. Enhancing Incentives to Invest in Human Capital

17. Because it is difficult for noneconomists to distinguish between qualities of economic analysis, they are less able to reward high quality and punish low quality analysis. Thus, having economists report to (and be evaluated by) noneconomists reduces staff's return to investing in the human capital necessary to keep abreast of developments in the field.

iii. Independence

18. Having staff economists instead located within legal Sections would increase the pressure on them to compromise and, at the margin, to "bend" their analysis and/or recommendations. Satisfying and getting along better with colleagues (and direct supervisors) in one's "permanent" legal section can interfere with the rigorous, objective, independent analysis and judgment we demand of our staff.

iv. Flexibility and Efficiency

19. Employing a common pool of economists permits flexibility in making assignments and in evening out workloads across staff. Having the economics staff supervised by economist-managers, professionals who know and can evaluate the strengths and weaknesses of individual performers, better matches staff to assignments and enhances overall office productivity.

v. Recruiting, Retention, Maintenance of Talent

20. Many of our best candidate hires are economists with attractive options at universities or research institutions. EAG and BE are set up, and in significant respects operate, as large academic institutions. The economists are physically located in the same place, they regularly interact with one another on a daily basis, they bond and rely upon one another, and rather than being "employed" as one of a few economists in a large sea of legal talent, they are instead part of a prestigious collection of fellow Ph.Ds. They find attractive this challenging setting, which helps keep their skills sharp.

## **The Role of Economists and Economics in an Investigation**

21. Effective and efficient economic analysis begins with identification of a logically consistent candidate theory, or theories, of competitive concern. This is closely followed by the identification of evidence or information necessary to test the various potential theories and help focus the investigation on obtaining this information. Aimlessly scouring the files of private parties for “hot documents” evidencing bad intent can occupy considerable time and scarce investigative resources on evidence which is often of limited value. Firms competing aggressively and/or trying to become more efficient will often express an intention to “kill the competition,” and even relatively unambiguous statements can at times be “explained away” as mere puffery, or the exaggerated ambitions of some ill-informed mid-level manager. Evidence of actual marketplace conduct fitting a carefully delineated candidate theory of harm, particularly any relevant historical empirical evidence, can be far more telling.

22. Shortly after receiving pre-merger notification of proposed acquisitions that seem potentially troublesome, the assigned economist, working with others on the investigation, is tasked with focusing the investigation. At least one economist and typically only one—unless the matter is highly complex and/or involves sophisticated econometric work—is assigned at the outset to all investigations.

23. In the Antitrust Division, economists formally focus investigations early on not merely through discussion, but by preparing a relatively short, albeit formal, “Issues In” memo. These memos, which incorporate input from the attorneys working with EAG on the matter, provide an overview of the basic facts (names of parties, products they produce, where they produce and sell them), a statement of the candidate theory (or theories) of harm, a discussion of the types of evidence that would tend to support or refute these theories, and an indication of projects contemplated to help form a case recommendation.

24. With respect to merger investigations specifically, both agencies have a formal process for determining whether a request for additional information (2<sup>nd</sup> request) should be issued. At this point, which by law must be no later than thirty days from the filing of a merger notification form, the economist will often write a short memo outlining the known basic facts, identifying the candidate theories, outlining the evidence that needs to be gathered in the investigation to test the theories, and recommending whether to continue the investigation. Together with a recommendation memo from the legal staff, this helps provide a basis for determining next steps.

25. Economists in both agencies are involved in identifying all types of relevant evidence that may help test candidate theories; particularly, though not exclusively, quantitative evidence. For example, if we are examining a proposed merger between two of several firms selling differentiated products throughout the country to a large number of small consumers, a natural investigative focus would be on possible unilateral effects. Relevant economic evidence would be the extent to which product offerings of the merging firms are the first and second choices for consumers. Contemplated projects might include collecting and analyzing scanner data to determine historic substitution patterns in response to changes in relative prices. Obtaining through compulsory process internal documents, such as surveys conducted by the merging parties (or others in the industry) in their normal course of business would also be of interest. We may at times even propose devising and conducting a survey of our own.

26. Another project might be to obtain evidence from other relevant natural experiments—such as price and/or share effects from the entry or exit of particular brands. Past evidence on the cost, frequency and economic motivations for repositioning (as well as, of course, de novo entry) by competitors would be candidates for investigation and any evidence on competition in promotions may be relevant as well.

27. In other circumstances, particularly where the products in question appear to be more homogeneous, an initial focus may be more on coordinated effects (including “tacit” as well as explicit

collusion). Here we would look for evidence not merely on whether marketplace factors appear to make coordination feasible, but also, importantly, on whether the proposed merger appears likely to make coordination significantly *more* feasible. In the former category would fall factors such as the ability of competitors to reach agreement—perhaps by allocating customers along dimensions suggested naturally by their plant locations or historical sales patterns—their ability to monitor and react to one another’s prices before too many sales are “stolen” by a cartel defector, and whether available data are consistent with current or past coordinated pricing. Past criminal conspiracy by the incumbents, combined with a lack of significantly changed circumstances, would be of obvious relevance.

28. In the latter category would fall evidence on whether the merger would make significantly more symmetric the costs, market shares, or other characteristics of the key competitors in the market. Also highly relevant would be information on whether the merger might eliminate a firm whose characteristics and/or demonstrated past behavior make it unusually disruptive, or maverick-like. Where, for example, one of the merging parties has a relatively large share of the market’s unutilized capacity and only a modest share of current sales, merging it into a firm with substantially greater sales (and thus substantially more to lose from a price war) would, all else equal, increase our concerns.

29. Differentiated product unilateral effects and homogeneous product coordination are not, of course, a complete list of candidate competitive concerns. Certain oligopoly models, such as that developed by Cournot, predict (in the absence of efficiencies) unilateral anticompetitive effects from horizontal mergers even where products are not differentiated. Thus, one candidate project might be to examine the extent to which the predictions of a Cournot model seem consistent with how firms compete in the marketplace. Do they compete by setting quantities rather than prices? Are firm price-cost margins and market shares (currently, and historically in response to entry or exit) consistent with the predictions of a Cournot model?

30. In addition, even with homogeneous products, unilateral effects may be of concern if there are indications that nonmerging firms are capacity constrained or unable to expand at constant cost in response to a post-merger price increase. An extreme situation of this sort would be where most existing competition involves imports, but foreign sellers are constrained by binding quotas. To help test such theories we would collect information on the economic capacities of non-merging firms in the market, including not only their rated or reported capacities, but also their sales levels in the past—e.g., when prices may have been somewhat higher than they are today.

31. A similar process takes place in the case of monopolization and monopoly maintenance investigations. However, unlike in the case of proposed mergers, these matters do not involve statutory deadlines. With more time to decide even whether to begin a formal investigation, early economics memoranda laying out candidate theories and describing the (limited) information currently available can either begin the process of focusing the staff’s efforts or, at times, provide a basis for not opening a formal investigation in the first place. Simply describing the types of evidence one might need to prove a theory can at times provide sobering discipline on investigators, preventing costly, unpromising, overly ambitious investigations from getting off the ground.

32. Where a monopolization case merits serious attention, the economic focus will again vary as a function of the particular theory, or theories, that the economist has helped identify at the outset. Consider an exclusive dealing investigation where the concern is that a dominant firm has locked up numerous available dealers and thereby raised its rivals’ costs. One economic approach is to go through a standard market definition exercise *with respect to the channel of distribution subject to the exclusive dealing agreements* (rather than on the product being distributed). One might probe this evidence so as to answer, ultimately, a version of the question “would we object to a hypothetical merger of all these distributors?”

33. Many monopolization theories require that there be significant scale economies in the to-be-monopolized market; otherwise an at-risk customer or small group of customers might be able profitably to sponsor efficient entry (or enter themselves). In such cases it is useful to obtain data relating to the extent of scale economies relative to the size of at-risk customers. If scale economies are nontrivial and customers are relatively small, one might then inquire into the coordination costs to customers of protecting themselves by jointly sponsoring entry. Under any theory of harm from vertical practices, we try early on to answer the pointed question raised by the Chicago School: Why would customers agree to facilitate a practice that is ultimately harmful to their interests?

### **Working closely throughout with economists hired by the parties**

34. In the course of an investigation the economists will regularly update and modify their theories and evidence as more information becomes available. And in virtually all investigations of significance the parties under investigation will have retained their own consulting or testifying economists. As a rule, we try to work closely with these analysts throughout the course of our investigation; sharing candidate theories of harm and (consistent with the confidentiality promises we have made to obtain data) the preliminary results of our empirical analyses.

35. This is particularly important in matters where data analysis plays an important role. Early interaction helps to minimize the parties' burdens of complying with our data requests and helps us understand what data are available and how suitable they are for the analysis we are considering.

36. We interact closely with the parties' attorneys and economists not merely out of a sense of "fairness" or "good government" (though those aren't bad reasons either), but because we find it to be in our own best interest to learn about any deficiencies in either our theories or our evidence from those who may be in the best position, and who surely have the strongest incentive, to know. Relatively open interaction with outside economists also helps inform us of the type and effectiveness of defenses we will face if/when we litigate. Efforts to hide our concerns, our theories or our evidence so as to be better positioned to "surprise" the parties during litigation tend, for these reasons, to be largely disfavored. In any event, the typically competent and experienced economists we find on the opposite side of us when we go to trial are not easily surprised by relevant arguments and evidence.

37. One approach that we have used at times, though perhaps not regularly enough, to "market test" our analyses and tentative conclusions is to conduct formal mock arguments for and against antitrust intervention. Ideally, such an exercise would take place once the investigation is far enough along so that there is significant evidence to be presented and debated, but before a final decision has been reached (e.g., a case actually filed). The purpose would be to identify perhaps more clearly than through written memoranda the strengths and weaknesses of a proposed case. Ideally, such exercises would not pit economists against attorneys, but would involve economists and attorneys in preparing arguments for both sides. Exercises of this sort would play to the natural strength, training and inclination of attorneys, which is to engage in advocacy (rather than the economist's frequent "on the one hand, on the other hand" approach) and would help inoculate the economist(s) on the investigation from having to serve, if only by default, as the loyal opposition or Devil's Advocate.

### **Use of outside economists**

38. Both DOJ and the FTC frequently retain outside economists to prepare and serve as expert witnesses in matters likely to go to trial, though we have not infrequently used agency staff in this role as well. We seldom, though occasionally, retain outside experts purely as "consultants." In those circumstances where an outside economist has particular expertise not available in-house and the investigation requires those particular skills, we may depart from our usual custom. In the vast majority of

situations, however, we rely entirely on our professional career staff. We find our staff fully capable of providing the requisite analysis that goes into Front Office decisions as to whether a case ought to be brought and we view excessive use of outside experts as something that would lower the morale and performance of staff. It would ultimately impact adversely on our ability to recruit and retain the highest quality talent. Finally, hiring outside economists can be very expensive, frequently costing considerably upwards of \$300 per hour.

39. Where an economist is to be retained in a testifying capacity and the skill set of a member of our own staff seems to fit the particular demands of the case, there are a number of tradeoffs in deciding whether to employ an outside economist or to instead use the staff economist. Outside experts are far more expensive and tend also to immerse themselves less fully in the investigation and case preparation. In-house staff selected to prepare as testifying experts will typically not be assigned other matters and will devote themselves more or less full time to preparing for deposition and trial. Outside experts tend to work on multiple matters at the same time and to have outside support staff (which are, collectively, often far more costly than the expert him/herself) do much of the preparatory work—with considerable assistance from the prosecuting agency's staff.

40. On the other hand, outside economists are often more experienced at testifying and generally have greater prestige in the profession. The latter characteristic can, however, cut two ways, as a judge may expect more from a prominent economist and be particularly harsh towards those who appear not to have prepared fully and be largely "mailing it in," i.e., essentially renting out their name and resume. Also, there can at times be concerns that, by using its own employee to testify, the government will have unduly influenced the expert's independence and objectivity. Of course, there are others who suspect that an expert being paid hundreds of dollars an hour to testify will be no more "independent and objective" than will a government employee.

41. The relevance to antitrust of economic analysis, and the importance of economists to antitrust enforcement, are growing dramatically worldwide. The U.S. antitrust agencies have had considerable experience in trying effectively to integrate economists and economic analysis into our investigations, enforcement decisions and litigation. This paper has described some of the ways in which we in the U.S. employ economics and economists. As competition authorities in other jurisdictions continue to develop internal economics expertise of their own, they may find some of it helpful.