Opening Statement of Professor Carl Shapiro

House Committee on Small Business

"Competition and the Small Business Landscape: Fair Competition and a Level Playing Field"

1 March 2022

Chairwoman Velázquez, Ranking Member Luetkemeyer, and Members of the Committee, thank you for giving me the opportunity to testify in front of you today.

My Background

I am an economist who has been studying competition policy for over 40 years. I am a Distinguished Professor of the Graduate School at the University of California at Berkeley. I have published extensively on issues related to antitrust, competition policy, and intellectual property. My writings and biography are available on my UC Berkeley website, https://faculty.haas.berkeley.edu/shapiro/.

I served as the Deputy Assistant Attorney General for Economics in the Antitrust Division of the Department of Justice during 1995-1996 and again during 2009-2011. In 2009-2010, I led the working group at the Antitrust Division that, together with the Federal Trade Commission, revised the DOJ/FTC Horizontal Merger Guidelines. I also served as a Senate-confirmed Member of the President's Council of Economic Advisers under President Obama during 2011 and 2012.

I have been an advocate of vigorous, principled antitrust enforcement for more than 25 years. Since leaving government service in 2012, I have provided testimony in Federal court as an economic expert witness on behalf of the government in a number of important antitrust cases.

Year	Antitrust Enforcement Case	Testitifed on Behalf of
2019	State AGs challenge to T-Mobile/Sprint Merger	Multiple State AGs
2019	FTC challenge to Qualcomm's licensing practices	FTC
2018	DOJ challenge to AT&T/Time Warner Merger	DOJ
2018	FTC monopolization case against AbbVie	FTC
2017	FTC pay-for-delay case against Actavis	FTC
2016	FTC challenge to Staples/Office Depot Merger	FTC
2013	DOJ challenge to BazaarVoice acquisition of PowerReviews	DOJ

Protecting and Promoting Competition

Our antitrust statutes talk explicitly about economic concepts: monopolization, restraint of trade, and lessening of competition. They are fundamentally *economic* in nature, and they contain prohibitions on conduct, not on status, such as being large or a monopoly. I encourage the Committee to reaffirm that the goal of the antitrust laws is to *protect and protect competition throughout the American economy*.

But what does that mean?

Competition is messy. Competition can be rough-and-tumble. Competition can feel deeply unfair when one loses. We all *say* we like competition, but who really welcomes a formidable, rival in any domain?

Competition is inherently an economic concept. My field of economics, industrial organization, studies competition and its absence, monopoly. We also study government policies to control monopoly power, through antitrust and regulation. Economists stress that competition is a *dynamic process*:

- Competition is the process by which businesses strive to attract *customers* by better serving their needs. These customers might be consumers or they might be small businesses.
- Competition also is the process by which businesses strive to attract *workers* by offering them attractive wages and fringe benefits. Today's small business owners certainly appreciate that they must compete to attract workers.

In many markets, the competitive process naturally results in a market structure with lots of suppliers. We see this outcome in markets for restaurants or dry cleaners or legal services in urban areas. In many other markets, where economies of scale are sizeable, the competitive process naturally results in a market structure with just a few large firms. We typically see this outcome in the manufacturing of highly sophisticated equipment, from aircraft to farm machinery to advanced microprocessors. There is nothing inherently wrong with that outcome, so long as it results from legitimate competition rather than anticompetitive mergers or exclusionary conduct. Moreover, government policies that try to prevent firms from exploiting economies of scale and scope would be both futile and counterproductive.

The key is to focus on the competitive process, not the resulting market structure. Economists and policy makers learned this many years ago, but it seems to be lesson very much in need of repeating today.

I favor replacing the term "consumer welfare standard" with the term "protecting competition standard" to clarify that the goal of antitrust is to promote and protect competition. More specifically:

> **Protecting Competition Standard**: A business practice is judged to be anti-competitive if it harms trading parties on the other side of the market as a result of disrupting the competitive process.

Promoting competition does not mean shielding *any* businesses from the buffeting winds of legitimate competition, be they large firms with outsize political influence or small firms that are struggling to compete against larger rivals with lower costs. As a champion of competition, I am instinctively skeptical of pleas by politically powerful businesses to be shielded from competition.

Promoting competition also does not involve hobbling a successful firm just because it has grown large, even if has come to dominate a market, so long as it gained that position fair and square.

How Antitrust Lost its Way – Twice

My recent paper, Antitrust: What Went Wrong and How to Fix It, explains how the courts lost their way in interpreting the antitrust laws, first in the 1960s and then again over the past thirty years.

During the 1960s, the Supreme Court issued a number of antitrust decisions in favor of plaintiffs were badly misguided. These decisions suffered from serious deficiencies in economic reasoning, or a complete lack of economic reasoning. These grave shortcomings caused the Court to reach faulty conclusions about the real-world economic effects of various business practices.

The fundamental problem is that the Court did not have a coherent view of the competitive process and thus lacked reliable principles to distinguish procompetitive business conduct from anticompetitive exclusion. The per se rule prohibiting a manufacturer from allocating geographic regions to retailers was not supported by microeconomics. Likewise, the Court's method of distinguishing legitimate price competition from predatory pricing was flawed, and its hostility to vertical and conglomerate mergers was unsupported by economic theory or evidence. Fortunately, from the late 1970s through the mid-

1980s the law changed significantly and became much better aligned with economic theory and evidence. The Harvard School and the Chicago School both deserve credit for this shift, although during this period of time the courts followed the Harvard School more closely.

But then, starting in the late 1980s, the courts increasingly came under the influence of a group of lawyers associated with the Chicago School. Antitrust law lost its way a second time. The drift was in the opposite direction, but the underlying cause was again a failure understand the real-world economic effects of various business practices. That judicial narrowing of the Sherman Act continues to this day.

A Positive Program to Strengthen Antitrust Enforcement

What is to be done? In broad terms, there are three choices: (1) continue with the status quo, (2) strengthen antitrust law to better promote and protect competition in the modern economy, or (3) dramatically change antitrust law by adopting bright-line rules to deconcentrate our economy.

As explained in my attached paper, Antitrust: What Went Wrong and How to Fix It, the Chicago School, which has persistently advocated to narrow the reach of antitrust law and raise obstacles to antitrust plaintiffs, is associated with the status quo. The Modern camp, to which I belong, favors the second approach. So far as I can determine, the Neo-Brandeisians advocate the third approach.

In my opinion, the approach taken by the courts to the Sherman Act over the past 25 years never had a sound basis in economic evidence or theory and has now been proven to be a failure. So I reject (1). On the other hand, calls for the courts to rewind the clock and restore antitrust from the 1960s ignore the fact that the approach taken back then proved to be confused, unworkable, and harmful. So I reject (3).

My attached paper lays out a positive program for option (2), strengthening antitrust law to better promote and protect competition in the 21st century economy.[1] If the courts were receptive, these changes could be effectuated through the evolution of the case law in the common law tradition. But that would be a slow process and would require a judiciary that is willing to acknowledge recent errors. Enabling legislation would be far better from a democratic perspective and far faster. If done right.

The basic idea is to establish a number of *rebuttable presumptions* in favor of antitrust plaintiffs that would simplify the analysis needed in court and eliminate the excessive obstacles that the courts have placed in front of the antitrust enforcement agencies.[2] I generally favor rebuttable presumptions over per se rules because per se rules are only appropriate for conduct that almost always harms competition. If per se rules are applied too broadly they stifle pro-competitive conduct.

Here are a few examples of rebuttable presumptions, taken from my attached paper:

- Create a rebuttable presumption against any large transfer of value from a branded pharmaceutical company to a potential generic entrant as part of their settlement of a patent infringement case. This would build on the Supreme Court's decision in the *Actavis* case.[3]
- Create a rebuttable presumption that when a firm with market power prevents its trading partners from steering their customers to lower-priced alternatives, that disrupts the competitive process and violates the Sherman Act. This would overrule the Supreme Court's decision in the *American Express* case.[4]

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[1] My attached paper is the third in a trilogy. The first paper is Antitrust in a Time of Populism (2018). The second paper is Protecting Competition in the American Economy: Merger Control, Tech Titans, Labor Markets (2019).

[2] In some cases, per se rules can be used to condemn certain practices. However,..

[3] *FTC v. Actavis*, 133 S. Ct. 2223 (2013)

[4] *Ohio v. American Express* 138 S. Ct. 2274 (2018).

- Create a rebuttable presumption that if a dominant firm imposes costs on its customers when they purchase from the dominant firm's rivals, that disrupts the competitive process and violates the Sherman Act. This would overrule the Ninth Circuit's decision in the *Qualcomm* case.[5]
- Create a rebuttable presumption that if a dominant firm requires its customers to deal with it exclusively, that disrupts the competitive process and violates the Sherman Act.
- Create a rebuttable presumption that if a dominant firm acquires a significant actual or potential rival, that may substantially lessen competition and violates the Clayton Act.
- Create a rebuttable presumption that if a dominant firm sacrifices profits by pricing below incremental cost, that such pricing is predatory and violates the Sherman Act. This would overrule the Supreme Court's decision in the Brooke Group case.[6]
- Allow the government to successfully challenge a horizontal merger based on direct evidence of competition between the two merging firms without the necessity of defining a relevant market.
- Clarify that, in horizontal merger cases where the government has established its prima facie case that the merger may substantially lessen competition, clear and convincing evidence is required to rebut that presumption.

The evidence required to rebut these presumptions will vary from one practice to another. For example, a dominant firm might defend below-cost pricing by pointing out that selling one product below cost generates profit margins on a complementary product, so it was not actually losing money on the sales in question. That defense could apply if the dominant firm is offering a free service to consumers to generate advertising revenue or selling a piece of durable equipment to generate profitable aftermarket sales of parts and service. My point is that the burden would rest on the dominant firm to explain why it is sacrificing profits by pricing below cost, not on the plaintiff to prove that entry barriers are sufficiently high that recoupment will be possible in the future.

My recent paper with Nancy Rose, What Next for the Horizontal Merger Guidelines?, explains how the DOJ and the FTC can strengthen merger enforcement in a manner that is well grounded in recent economic evidence, supported by economic theory, and consistent with the evolving case law.

Implications for Small Business

With these principles in mind, let me turn specifically to the implications for small and mid-sized businesses, which I will refer to as SMBs.

Competition policy, done right, is neutral with respect to firm size. Smaller firms should not be disadvantaged, but nor should they be favored. By way of contrast, competition policy is *not* neutral with respect to market power. Protecting competition means limiting how a firm with market power can use that power, and protecting competition means preventing firms from colluding to exercise market power or merging to enhance their market power. Naturally, these restrictions on the behavior firms with market power tend to fall more heavily on larger firms.

I do not envy the position many SMB owners find themselves in these days. Starting and running a small business has never been easy, and the disruptions caused by the pandemic have made things harder than ever for many SMB owners and for their employees. I commend Congress for providing substantial support to many SMBs in the two years since the pandemic gravely disrupted our economy.

[5] *FTC v. Qualcomm Inc.*, 969 F.3d 974 (9th Cir. 2020).

[6] *Brooke Group vs. Brown & Williamson*, 509 U.S. 209 (1993).

However, our commitment to competition should not flag during tough times. We made that mistake back in the 1930s by allowing many firms to collude under the National Industrial Recovery Act. That prolonged the Great Depression.[7] I do not support antitrust exemptions for smaller firms to collude.

The truth is, SMBs in many sectors of our economy face formidable competition from larger businesses. The economic evidence shows that much of the growing share of economic activity accounted for by large businesses likely results from highly efficient "superstar" firms growing at the expense of other firms.[8] That competitive process has been fueled by massive advances in information technology, the growing importance of intangible assets, and globalization.[9] Consistent with this, increases in concentration at the national level have in many cases been associated with decreases in concentration in more local geographies and at the level of relevant antitrust product markets.[10]

While it may be tempting for this Committee to take actions to shield SMBs from competition from larger firms that may have lower costs or other competitive advantages, that would not be consistent with promoting and protecting competition. Instead, I encourage the committee to consider actions in three areas of antitrust: (1) enabling SMBs to cooperate so they can compete more effectively against larger firms; (2) preventing dominant firms from engaging in exclusionary conduct directed at SMBs, and (3) preventing anti-competitive mergers that harm SMBs by reducing their options for acquiring customers or distributing their products and services.

Regarding (1), the Supreme Court's decision in the *Topco* case provides an cautionary tale of how antitrust law can mistakenly disfavor SMBs.[11] Topco was a cooperative association of small and medium-sized regional supermarket chains. These chains formed Topco to develop a private label products so they could compete more effectively against larger national and regional chains. Under their agreement, Topco members had the exclusive rights to sell Topco-branded products in their assigned areas. The evidence clearly showed that this arrangement promoted competition and benefitted consumers, but the Supreme Court struck it down as a per se violation of Section 1 of the Sherman Act. A better approach – for competition, for consumers, and for SMBs – would be the following:

> **Rebuttable Presumption in Favor of Cooperation Among Small Businesses**: If a group of businesses agree to cooperate to better serve their customers by replicating what their larger rivals do internally, that is presumptively pro-competitive.

Regarding (2), see my discussion above about establishing rebuttable presumptions against exclusionary conduct by dominant firms. SMBs may be especially vulnerable to conduct such as predatory pricing or exclusive dealing simply because they are not as well capitalized. Young, innovative firms also may be especially vulnerable. That is particularly worrisome as they can grow into disruptive forces that erode to power of entrenched incumbent firms, delivering substantial benefits to the public along the way.

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[7] See my May 2009 speech, Competition Policy in Distressed Industries, when I was at the DOJ during the Great Recession.

[8] *E.g.*, David Autor, David Dorn, Lawrence Katz, Christina Patterson, and John Van Reenen, *The Fall of the Labor Share and the Rise of Superstar Firms*, 135 Q.J. ECON. 645 (2020). John Van Reenen, *Increasing Differences Between Firms: Market Power and the Macroeconomy*, (Ctr. for Econ. Performance Discussion Paper No. 1576, 2018).

[9] *E.g.*, Nicolas Crouzet and Janice Eberly, *Understanding Weak Capital Investment: the Role of Market Concentration and Intangibles* (NBER Working Paper No. 25869, 2019).

[10] C. Lanier Benkard, Ali Yurukoglu, and Anthony Zhang, *Concentration in Product Markets* (NBER Working Paper No. 28745, April 2021) (median concentration levels in consumer products have declined since the mid-1990s, reflecting modest declines in concentration for the most highly concentrated product markets at the start of that period); Esteban Rossi-Hansberg, Pierre-Daniel Sarte, and Nicholas Trachter, *Diverging Trends in National and Local Concentration*, 35 NBER MACROECONOMICS ANNUAL 115 (2020) (showing declines in concentration measured at the local level across most sectors).

[11] *United States vs. Topco Associates*, 405 U.S. 596 (1972).

Regarding (3), the DOJ and the FTC could devote more resources to investigating whether mergers harm SMBs by reducing their options for acquiring customers of distributing their products and services. The groundwork for doing this was laid in 2010 when a new section was added to the Horizontal Merger Guidelines, "Mergers Between Competing Buyers." For example, if a merger combines two important distributors for the products or services sold by SMBs, that merger could harm competition and harm SMBs, quite apart from any resulting harm to consumers. Analytically, this type of harm to SMBs from a merger is very similar to how workers can be harmed by a merger between competing employers. For further details, see my paper with Nancy Rose, What's Next for the Horizontal Merger Guidelines?

Antitrust Enforcement in Just One Component of Competition Policy

Many of those who are calling for stronger antitrust enforcement are motivated by concerns about the political power of large corporations, or about the extreme levels of inequality in income and wealth found in the United States today. I very much share these concerns. We very much need campaign finance reform, and greater transparency regarding money in politics, to control the excessive political power of large corporations (and of billionaires). We very much need a more progressive tax system. We very much need to provide better nutrition, health care and educational opportunities for all Americans, especially children, to reduce levels of inequality.

But asking antitrust to solve these problems is very likely to be counterproductive. Antitrust enforcement agencies and courts are ill suited to handle these broader problems. Those who over-promise what antitrust can realistically deliver are doing a disservice to the very people they profess they are trying to help. They also threaten to breed skepticism regarding the value of antitrust policy and enforcement if antitrust fails to deliver the broader social and economic transformation that has been promised. Furthermore, the core mission of antitrust, to promote competition, could easily be undermined if we ask antitrust to solve problems unrelated to competition. For example, asking the DOJ to block mergers that enhance political power, as distinct from economic power, would necessarily politicize antitrust enforcement, which strikes me as extremely dangerous and unwise.

Finally, it is important to recognize that antitrust enforcement is just one arrow in the quiver of available policies to promote competition and protect consumers. The Federal Communications Commission has the authority to promulgate rules that protect media diversity, and the Federal Energy Regulatory Commission can promote competition in wholesale electricity markets. The Food and Drug Administration can promote competition in pharmaceutical drugs and medical devices. The Department of Transportation has the authority to promote international airline competition. And so on.

President Biden's Executive Order on Promoting Competition in the American Economy (July 2021) identifies a large number of policies that can and should be used to promote and protect competition, above and beyond antitrust enforcement. For a wide-ranging set of recommendations for reinvigorating competition policy, see Restoring Competition in the United States: A Vision for Antitrust Enforcement for the Next Administration and Congress (November 2020).

Antitrust rules necessarily apply across the entire economy. They cannot and should not substitute for tailored rules needed to regulate specific sectors, including the tech sector.