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Should The Merger Guidelines Be Scrapped?
Introduction to a Debate

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It is a pleasure to introduce these five thought-provoking articles to readers. The papers debate whether the current Merger Guidelines should be scrapped and replaced by the "Productivity Paradigm" of Professor Michael Porter. Aside from being outnumbered (Baker, Einhorn, Salop, Werden), Porter and Weller face a tough job. They need to convince their audience that they have a clear alternative, that the alternative corrects whatever deficiencies that the current Merger Guidelines have, and that the alternative can be implemented. In my view, Porter and Weller fail at all three tasks but in doing so raise several criticisms of existing practice that, though they have already received attention, certainly deserve more.

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Porter and Weller propose replacing the current Merger Guidelines with Porter's "Productivity Paradigm." As described by Porter and Weller, this paradigm has a focus on productivity and productivity growth and the "Five Forces" — i.e., (1) entry, (2) intensity of rivalry, (3) substitute products, (4) bargaining power of buyers, and (5) bargaining power of suppliers. Yet, as far as I can tell, these are all standard factors that would be taken into account in any merger analysis, and they all certainly are included in the Merger Guidelines, which Porter and Weller want to scrap. Porter and Weller might prefer to emphasize factors other than those now stressed or to analyze certain economic factors differently than is now typically done. But the reader will not be able to figure out why that requires scrapping the current Merger Guidelines.

As Werden points out, Porter and Weller provide no clear suggestions for how to use the "Five Forces" to evaluate the competitive impact of a merger. How would they measure the competitive consequences of a merger between firms that produce substitute products? How would they measure the price effect? Although they refer to various indices to measure each "force" (though not the impact of these forces), they offer no recommendation whatsoever as to how to balance the changes that a merger could induce in the various "forces." How, for example should a merger authority proceed, if one index rises but another falls?

Porter and Weller's attack on market concentration is entirely misplaced. I am not aware of any merger in which the FTC or DOJ took the position that concentration alone matters, that investigation of the industry's economic circumstances is unnecessary. Moreover, it is simply wrong to assert, as Weller does, that there is no
evidence for individual industries that price rises as concentration increases, although he is correct that many factors other than price also can be affected by a merger.

Porter and Weller dismiss the price effect too quickly as a principled basis to analyze mergers and they are unclear how they would focus on the importance of productivity growth, instead of price. In several industries, as Einhorn points out, the price effect is the important one. Porter and Weller seem unaware of Hall's (1988) finding that industries undergoing mergers tend to be less R&D intensive than typical industries, so perhaps Porter and Weller are overemphasizing productivity growth associated with mergers. Still, I am sympathetic to Porter’s and Weller’s point about the importance of predicting dynamic efficiency. My question is: How? Economists' ability to forecast long-run technological change by firms is pretty poor which is why I have testified before the FTC that the concept of innovation markets is too unreliable to be helpful. My only suggestion is a time series study of an industry in which productivity is related to industry structure — a topic on which there is little consensus. Short of that, I fear that prediction of dynamic efficiency effects will be so subjective as to be useless.

Porter seems to suggest that it would be alright to make mergers more difficult to consummate because businessmen frequently misjudge their profitability. That is a horrible suggestion. Mistakes may well be made. That is the nature of business. But

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2 Even though I have been a critic of many price-concentration studies, it is not possible to dismiss all of them. See, e.g., Dennis Carlton & Jeffrey Perloff, MODERN INDUSTRIAL ORGANIZATION, at ch. 8 (Addison-Wesley 3d ed. 2000).


4 See, e.g., Dennis Carlton & Jeffrey Perloff, MODERN INDUSTRIAL ORGANIZATION, at ch. 16 (Addison-Wesley 3d ed. 2000).
a government should use antitrust policy only to prevent competitive harm not to second guess what is profitable. Although it may be hard to predict the profitability of a merger, I put my money on the businessman whose money is on the line, not on the government official.

Porter and Weller correctly point out the artificiality of defining a market as is required by the Guidelines. Market shares are a crude way to describe the competitiveness of a market and in practice they are only the first step, not the last or only one, and sometimes not even necessary. But, as Baker and Salop point out, Weller provides no “safe harbors,” while using market definition at least provides some guidance in identifying mergers that warrant further analysis. For Weller, everything is subjective. What a mess! However, I agree with Porter and Weller in their criticism of market definition under the Guidelines as lacking in precision. As I have seen it practiced, DOJ and FTC often ask customers to identify the substitute products they would turn to if prices rose 5%, and the government agencies include those products in the market. Assuming one can believe survey answers, this can be a useful step in identifying substitutes. But defining a market in this way technically will not conform to the smallest market definition of the Merger Guidelines. The theoretical precision in the Guidelines’ market definition (smallest market that enables a hypothetical monopolist to raise price by a significant nontransitory amount (e.g., 5 percent) is not achieved by its implementation in this way. This is probably desirable given the crudeness of market share analysis and given the massive data requirements typically needed to define markets precisely according to the Guidelines. Of course, if one has the data needed to define a market according to the Guidelines, then direct tests of market power likely are possible that avoid the need for market definition.\(^{5}\)

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\(^{5}\) For example, direct estimates of price and cross-price demand elasticities may be possible.
The key point to remember is that, by its very nature, market definition will always be a crude tool to use to measure competitiveness.

Let me turn to Weller's last point about junk science. As far as I can tell (and several of the other authors agree with me), Porter's and Weller's proposal supplies no new methodologies for assessing mergers. I can't conceive that courts will endorse the use of Porter's analytical tools as acceptable science while dismissing use of the Merger Guidelines as junk science. To me, an analysis along Porter's lines fits very well into the Guidelines. At most, Porter and Weller are asking to place more emphasis on dynamic efficiency than is currently done.

In closing, I wish to thank both Porter and Weller for their willingness to debate several economists who are antitrust specialists. Such debate can improve our thinking and lead to improved merger policy. I know that readers of these articles will find them to be thought-provoking.