EconoFact Chats: The State of Anti-trust Regulation

Dan Richards, Tufts University

Published on 13th February 2022

Michael Klein:

I'm Michael Klein, Executive Editor of EconoFact, a nonpartisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

Adam Smith, considered by many to be the founder of economics, is often portrayed as an advocate for unfettered capitalism. But in his book, The Wealth of Nations, he wrote, "people of the same trade seldom meet together for merriment and diversion, but that the conversation ends in a conspiracy against the public or in some contrivance to raise prices." Of course, Smith did not think that this was a good thing. Antitrust legislation -- laws to prevent companies colluding in a conspiracy against the public, have been on the books in America since the Sherman Act of 1890, and the Clayton and Federal Trade Commission Acts of 1914.

Michael Klein:

President Biden has spoken of addressing issues of non-competitive behavior. Can he do so with current laws? What are they? And are they at all appropriate today, especially for the tech giants, Meta, formerly Facebook, Alphabet, formerly Google, and other companies like Amazon? To address these issues, I'm joined today by Professor Dan Richards, my colleague at Tufts University. Dan is an expert in the field of industrial organization, a topic that covers issues like monopolies, and laws that attempt to regulate them. Along with his wife and colleague, Lynne Pepall, he's a co-author of the leading textbook in the field of industrial organization. Dan has served as a consultant to government agencies, including the Federal Trade Commission. Dan and Lynne have written a number of memos for EconoFact on antitrust policy.

Michael Klein:

Dan, very nice to have you on the podcast.

Dan Richards:

It's great to be here, Michael. Thank you.

Michael Klein:

Dan, let's begin by discussing why monopolies, or more broadly, companies that have a lot of market power, are viewed suspiciously, not just by Adam Smith, but by generations of economists, and the public at large.

Dan Richards:

Well, I think for the public, it's a question of having choice. When there's just one firm selling a product, there's no choice and you feel fairly powerless against a firm that has that much concentrated economic power. But economists have recognized, for a long time, that when firms have to compete, they have a greater incentive to come up with new quality or higher quality products, to keep prices low, to create a greater variety of products. And all those are benefits that competition brings to society at large. And, if we don't have competition, we lose those benefits. The estimates by some are that, not having those benefits cost the American economy on the order of 5% of its annual GDP every year.

Michael Klein:

So, in recognition of this, governments have antitrust legislation. What are the main facets of US antitrust legislation?

Dan Richards:

Well, the US has a set of laws, and you may know, all of the individual states have their own antitrust laws as well. But, the US has basically two major laws. One is the Sherman Act of 1890, and the other is the Clayton Act and Associated Federal Trade Act of 1914.

Michael Klein:

And what do these laws do, Dan?

Dan Richards:

Well, they're meant to preserve those benefits of competition that we talked about earlier. The two sections of the Sherman Act are very explicit. One is directly aimed at preventing colluding among firms to fix prices and to keep them high. And the other is aimed at practices that firms might engage in to, abuse or obtain monopoly power.

Michael Klein:

What about the Clayton Act?

Dan Richards:

So, the Clayton Act came, as I said, many years later, 24 years later to be precise. And it was aimed at trying to deal with practices that might give rise to monopoly power, that didn't seem to be covered by the Sherman Act. Explicitly, that involved mergers, so instead of colluding, firms might just join together into one effective combination, price discrimination, which means selling at different prices to different people, which may use that differential pricing to harm competitors, tying arrangements, so that if you buy my printer, you also have to buy my print cartridges, and that may extend monopoly power from one market to the other. All those were practices that the FTC was created to police, and to make sure that they weren't being used to extend or abuse monopoly power.

Michael Klein:

Of course, it's not just the legislation, but also the way in which the rules are enforced. What's been the history of this?

Dan Richards:

So, that history is a rich one and somewhat complicated. From the 1930s to the 1960s, antitrust policy, as practiced by both the courts and the antitrust agencies, was very rigorous. It lacked, however, a sort of solid foundation in economic theory to permit it to really accurately distinguish between actions that might be very pro-competitive and actions that might be anti-competitive. And as a result, there were a number of actions taken that were not terribly sound from a policy standpoint. So the agencies blocked some mergers that involved very trivial market shares. They actually penalized some firm for lowering prices. And, there was increasing dissatisfaction with that aggressive approach.

Michael Klein:

So, did that lead to a backlash?

Dan Richards:

Yes, it did. The backlash took the initial form, by way of what is often called the Chicago School led by Robert Bork in his book, The Antitrust Paradox, which argued that markets generally performed pretty well.

Michael Klein:

Is that the same Robert Bork who had been nominated to the Supreme Court, but did not get that seat?

Dan Richards:

Well, it is the same Robert Bork. I don't think his not getting to the Supreme Court was so much because of his antitrust views. But basically, the Chicago School shared with the earlier antitrust enforcement regime a very negative view of price fixing conspiracies, and felt that that was where antitrust policies should be focused. But it felt that, when firms decide to merge or when they engage in price discrimination, they're really doing it for a reason that often is pro-competitive that that's what the markets are generating, and markets are a pretty good mechanism in this view to generate good results.

Michael Klein:

So they only believed in basically one part of the Sherman Act?

Dan Richards:

More or less. That's a good way to put it, I think. They typically thought that price fixing is something that we need to be aggressively prosecuting. But, other than that, the antitrust laws could be pretty relaxed.

Michael Klein:

And did this view come to dominate?

Dan Richards:

It came to dominate the courts and, to some extent, infiltrated even into the agencies themselves. It is not, what I would say, is the view that dominates the academic profession these days. A more modernist view, which is much more nuanced, that recognizes that tying arrangements, as we said, requiring the buyers buy not only my main product but associated products, mergers, can have anti-competitive effects. They're not always the market working well.

Michael Klein:

So that's fine for the ivory tower, but when the rubber hits the road, the Chicago view has been dominating. And so, given lax enforcement, have we seen increased concentration in US industries?

Dan Richards:

Yes. I mean, there's two parts of your question, I think. Have we seen increased concentration? And have we seen, as a result, decreased competition? We've certainly seen some increase in concentration. The top firms in many markets now have bigger market shares than they did 25 years ago. And that's, to some extent at least, due to the fact that we've been permitting more mergers to take place than we used to. A very well-known study by The Economist magazine that came out in 2016 looked at 900 industries and found that concentration had increased in over two thirds of those. Roughly, the way they measure concentration is by looking at the share of total output in the industry that goes to the top four firms, what's called the 'four-firm concentration ratio,' and across all industries that's increased on average from 26% to 32% and some industries much more than that.

Michael Klein:

That's a really catchy name, the four-firm concentration ratio.

Dan Richards:

No comment.

Michael Klein:

Dan, what about the so-called superstar companies, Walmart, Amazon, Microsoft?

Dan Richards:

That goes back to the point I made just a moment ago that, part of the increase in concentration is due to perhaps relaxed mergers, but it's also due to the fact that superstar companies, like the ones you just mentioned, have emerged. And, as they've grown bigger, that's increased the concentration, but it may not be a reflection of a decline in competition, in the sense that, one reason they grew bigger is because they may have had a superior product that they could sell at the same price, or they had the same product that they could produce at a lower price. And so, as they have those advantages, they naturally grow bigger, but that's the process or the forces of competition working themselves out. And that makes it a little bit difficult to work out, whether the increased concentration, what that means for the degree of competition.

Michael Klein:

So there's a distinction between anti-competitive behavior, and the fact that some of these firms just would sort of naturally become monopolies because they have these advantages.

Dan Richards:

Yes, these firms enjoy a number of advantages. And you don't want to penalize firms, [inaudible] or the compete... and, by coming up with a lower cost way of doing things or coming up with a higher product, firms exploit those advantages. You don't want to penalize them from doing that. So, that makes life a little bit more difficult for the antitrust authorities.

Michael Klein:

So, economics would suggest that this greater concentration would result in rising profit margins. Is that what's happened?

Dan Richards:

I think there's no question that that's happened. That's some of the most startling evidence or striking evidence that we have is that firms, particularly the superstar firms, generally enjoy a high ratio price to cost. The mark-up has increased by anywhere from 20% to 40% over cost. But again, that's partly because these firms have figured out a way to do things that, Amazon and Walmart in particular figured out a way to do things at a lower cost than their earlier competitors. And in part, it's because of less competitive actions that mergers and so forth that have given them monopoly power and enabled them to raise the price above the cost.

Michael Klein:

So, if companies are more concentrat[ed] and have a bigger slice of the pie, do the workers in those companies also tend to benefit?

Dan Richards:

Well, what we can say is that, in standard microeconomic modeling, the labor share of the income that a company generates or that industry generates is negatively related to the price cost margin. And, as we've seen price cost margins rise, we would expect to see labor share fall. And we have seen labor share fall. The data very clear on that, that labor share of the national income has fallen from 64% to 59%. And it's also very clear that the share profits in the national income has increased and perhaps reached a very close to an all time high.

Michael Klein:

Dan, when you're talking about concentration data, you're discussing it at the national level. But monopolies or concentrated industries can operate in local markets as well, right?

Dan Richards:

They can. And I think one of the drawbacks of the national concentration data is that it may not give an accurate picture of what's happening at the local level. We may have a fair bit of competition in local markets, where there are the same number of competitors as there always have been. But, if the parent companies of those local competitors join at the national level, then the concentration at the national industry level will go up, whereas again, as the local level may still be fairly competitive. Many markets like grocery stores, restaurants, medical services, legal services, are all organized at the local level. It takes a little bit of effort to figure out what's going on within individual geographic local markets, and that gives us a little bit of caution about how we interpret the national increase in concentration. The other thing I would say is that, the national data is generally focused on the share of domestic firms and domestic production. It leaves out the potential pro-competitive effect of imports.

Michael Klein:

Another issue related to local markets and market concentration isn't with firms as sellers, but firms as buyers, what economists call monopsonies. And in particular, the issue is whether or not a big firm in a local area has a lot of control over hiring. And by doing that, it can keep wages low. Is there much evidence on the role of firms in labor markets as monopsonies as one of the biggest buyers of labor, or perhaps even the biggest buyer of labor in a particular area, and the consequences for that?

Dan Richards:

There are a number of studies that show that the buying power, the buying monopoly power in local markets of firms has increased to the disadvantage of workers. And so what we call monopsonies, as you pointed out, seems to have increased in local markets across the board. And, some of the evidence that goes with that is we've seen a proliferation of no poaching clauses where, say, McDonald's will ensure that the owners of one franchise location are not allowed to hire other McDonald's workers from another franchise location, that are not allowed to bid for their services in a way that would raise their wages. We've seen that proliferation of no compete clauses, whereby workers have to agree that they leave the firm, they won't go to a competitor. And in general, we've seen increased concentration at the local level that has certainly disadvantaged workers over the last 20 to 30 years. And again, that's part of the explanation for why we've seen a decline in labor share of income.

Michael Klein:

Dan, the Sherman and the Clayton Acts were prompted by railroads and oil companies. Is there a fundamental difference in antitrust when we think about big tech, rather than big oil or a railroad cartel?

Dan Richards:

I don't think there's a great difference, in the sense that we're really worried about monopoly power either way. There is a difference in that, the railroads, perhaps oil, became monopolistic in part because they were able to exploit scale economies that naturally gave rise to large firms, particularly the railroads, I think, in that case. Whereas the effects that give rise to monopolies amongst some of the big tech firms, like Microsoft, Apple, Facebook, now Meta, are what we call network effects, whereby through the demand side, there's a scale effect by which, as more people use Facebook, for example, more other users get more value from Facebook, and so they want to use it. And so there's a natural feedback effect on the demand side that makes these companies large. So I don't think there's a difference in the fundamental concern about monopoly, but there is a difference in the source of the market dominance that these companies have. Another common element is that, in both cases, people are worried about the large political power that these large firms can exercise, outside of their market power.

Michael Klein:

So there's a political and not just an economic dimension to antitrust.

Dan Richards:

Well, there certainly is. In the current environment, people are very, very worried about the political power and influence that large companies like Google and Apple and others may exercise. I don't think that should be the focus of antitrust policy. But it is certainly something that informs our views of these very large corporation[s] .

Michael Klein:

So, Dan, what do you think should be happening with antitrust laws now?

Dan Richards:

Well, I think that we need to adopt more of the modernist view than the Chicago view in our enforcement and in the courts. I think that would basically mean that we continue to be diligent about price fixing conspiracies. I think we've done a reasonably good job there. I think it means also that we should be stricter in our merger controls, that we should challenge more mergers, in particular mergers that might be cases in which a large firm like Facebook is acquiring somebody that could be a potential competitor, by way of example, Facebook when they acquired Instagram several years ago. Instagram could have emerged as a competitor of Facebook. And I think it would've been better had that merger been challenged. Maybe too little too late to do anything about that, but we can look to be attentive to those opportunities in the future.

Michael Klein:

There's a concern there that the merger squelched innovation.

Dan Richards:

Yes. I think that is a general concern that we need to be paying more attention to. It's not just prices, because it's very difficult to show that there's been much impact on prices, particularly to the users of Facebook because they don't really pay anything. But, the fact that we may have suppressed innovation in the development of new ways of providing social networks and new social networking attributes and features, those kinds of concerns are something that we need to have more on the radar of antitrust enforcement.

Michael Klein:

And as we're recording this, there is news today of a possible merger between two low-cost airlines, Frontier and Spirit. So this merger too would be anti-competitive, but not necessarily along the dimension of innovation but of prices, right?

Dan Richards:

Well, I think that, that is a concern. I'm sure that Frontier and Spirit will try to present the case that they have cost efficiencies that will make them a more competitive airline and be able to bring prices down. But I think that, together, they will comprise the fourth or fifth largest airline in the US market, and that will give them considerable power. And of course, you're merging together two of the low-cost competitors, so there's a concern that you're directly putting together two firms that really were providing competition, and so eliminating one of them by virtue of subtraction. So, yes, I think that's a merger that the FTC will be very, very likely to challenge.

Michael Klein:

And what about regulations and rules for what we've called this monopsonous behavior; behavior that limits the ability of workers to move from one firm to another?

Dan Richards:

Well, we've seen the FTC and DOJ take more of those cases on recently, and to challenge those practices. Remains to be seen how the courts will deal with them. But I think there's hope that those kinds practices will be increasingly challenged by the antitrust authorities. And I think that's a good thing.

Michael Klein:

So, what we're facing is a possible wide range of regulations and rules, and maybe even some new laws, to address anti-competitive behavior by companies, both for hiring people and for selling things, and as you mentioned, for lots of other things like tying arrangements or price discrimination. So, Dan, you really helped lay out these issues in a very comprehensive and clear way, and thanks for doing so, and thanks for being on EconoFact Chats.

Dan Richards:

It's been my pleasure, Michael, thank you.

Michael Klein:

This has been EconoFact Chats. To learn more about EconoFact, and to see the work on our site, you can log into www.econofact.org. You can subscribe on our site to our newsletter, that will let you know when we publish new memos and new podcast episodes. Please feel free to share this podcast and our memos with friends, colleagues, and on social media. EconoFact is a publication of the Fletcher School at Tufts University. Thanks for listening.