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Comment on the Draft Mergers Guidelines
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Executive Summary:

On July 19, 2023, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) jointly released the 2023 Draft Merger Guidelines for public comment. This document outlines our views on the following three aspects of the guidelines:
(1) Guideline 11 - Mergers and the Labour Market
(2) Guideline 7 - Mergers and Entrenchment of Dominant Position
(3) Rebuttal Evidence – Procompetitive Efficiency

The economic analysis on which this contribution is based mainly on the theoretical analysis and empirical findings of our recent papers, Tong and Ornaghi (2021, 2023).

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Carmine Ornaghi is Professor of Economics at the University of Southampton. His papers have been published in leading scientific journals, including Energy Economics, Journal of Applied Econometrics, the International Journal of Industrial Organization and the Journal of Industrial Economics. Prof. Ornaghi has done extensive research on the impact of Mergers and Acquisitions (M&As) on innovation [see Ornaghi (2009a) and Ornaghi (2009b)]. In the last three years, Prof Ornaghi has been Principal Investigator in an ESRC funded research on "Mergers and Inventors' Productivity in the Pharmaceutical Industry", which aims at evaluating how mergers influence innovation output of scientists working in the research labs of pharmaceutical companies using patent data.

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Jian Tong is a Lecturer in Economics at the University of Southampton. He has published in leading peer reviewed economics journals such as Rand Journal of Economics, Economic Journal, and International Economic Review, spanning fields from industrial organization, economic growth, to information economics. Dr Tong's expertise lies in the areas of market structure and market power, technological progress, and endogenous economic growth, and public policy decision under uncertainty and information constraints.

Guideline 11 - Mergers and the Labor Market

1. Merger Guideline 11 states that "*When a merger involves competing buyers, the agencies examine whether it may substantially lessen competition for workers or other sellers*." Furthermore, it indicates that "*Where a merger between employers may substantially lessen competition for workers, that reduction in labor market competition may lower wages or slow wage growth, worsen benefits or working conditions, or result in other degradations of workplace quality*."

2. We agree that competition law should limit practices, including merger deals, which harm free and fair competition not only in the product markets - to the detriment of consumers, but also in the labor markets - to the detriment of workers.

3. In Tong and Ornaghi (2021, 2023), we show that in imperfectly competitive markets where firms have both product price mark-up power and wage mark-down power, the introduction of a Worker Welfare standard on a par with the Consumer Welfare standard (as far as such a standard de facto exists) can boost productivity and reduce inequality, which has been strategical goals of many governments across both sides of the Atlantic. In our opinion, this goal is consistent with the promotion of workable competition that antitrust law serves.

4. One important insight from our analysis relates to the welfare implication on the cost saving on labor expenditure following mergers of competing employers: in the absence of genuine technical increase of productivity, such savings have nothing to do with efficiencies, but merely a transfer from worker surplus from employers' profit. This means that efficiency justification for this type of mergers may be naive if not misleading.

5. Furthermore, we propose that if merging firms include labor cost saving as a procompetitive efficiency in their rebuttal evidence, the burden of proof to show that there is no increase of merging firms' monopsony (wage setting) power underlying the labor cost saving, should be carried by the merging firms, NOT the enforcement Agencies. That is, there should be rebuttable presumption that labor cost saving is, at least in part, caused by increase of merging firms' monopsony (labor market pricing) power. We believe, this presumption can be justified by the Agencies' assessment that "[i]n light of their characteristics, labor markets are often relatively narrow", which we agree.

6. To make Guideline 11 operational, the definition of relevant antitrust market and the calculation of market shares and concentration need adequate adaptation. Specifically, the new terminology Significant and Non-transitory Increase in Price ("SSNIP") or other worsening of Terms ("SSNIPT") may need further clarification and/or explanation. For instance, the phrase "other worsening terms" is primarily used to include both "decrease in wage" and "decrease in input price" which are necessary for operationalizing Guideline 11. If this is the case, it should be explained explicitly to avoid confusion, e.g., some commentators think it refers to non-price considerations, probably, in product markets. Additionally, guidance on the calculation of market

shares and concentration in input markets, and particularly, in labor market, should be added to Appendix 4.

Guideline 7 - Mergers and Entrenchment of Dominant Position

7. Merger guideline 11 states that "*mergers should not entrench … a dominant position. In a market that is already concentrated, merger enforcement should seek to preserve the possibility of eventual deconcentration*." It explains that "*[this] entrenchment doctrine properly blocks artificial competitive advantages … but not simple improvements in efficiency.*"

8. We agree with this entrenchment doctrine and wish to provide further support for it from economic theory and empirical evidence. Provided that entrenchment of dominant position harms workable competition, the illegality of mergers that entrench dominant position is easier to justify. In Tong and Ornaghi (2023), we show that the typical large dispersion in firms' overall market power distribution not only causes concentration of market power, but it has also a static technological/productive inefficiency implication, beyond the conventional focus on deadweight loss. We argue that this additional source of static inefficiency, in combination of evidence of slowdown of productivity growth, warrants a radical reassessment of the view that static efficiency loss is a necessary evil to achieve dynamic efficiency gains. On an empirical ground, rank persistence is a measure of entrenchment of industry leading firms' dominant positions. Our analysis makes clear that prolonged, rank-persistent and excessive dispersion in the distributions of firms' productivity and market power leads to both income inequity and inefficiency, not a trade-off between them. This new insight underscores the importance of addressing market power concentration to promote equitable and efficient economic growth.

Rebuttal Evidence - Procompetitive Efficiencies

9. Section IV.3 provides guidance on using/facing procompetitive efficiencies as rebuttal evidence. It states that "*The Supreme Court has held that 'possible economies [from a merger] cannot be used as a defense to illegality.'*" It observes that "*Congress and the courts have indicated their preference for internal efficiencies and organic growth.*" It explains that Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened [including entrenchment of dominant position], evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market. It also indicates that "*any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners*."

10. We appreciate the preference of the US congress and court for internal efficiencies and organic growth, construed by the new merger guideline. We wish to articulate some economics arguments that support such preference. (1) Given that perfect competition is unattainable in practice and unrealistic as a characterization of economic reality, the neoclassical theory of income distribution between input classes, equating input price to marginal productivity, becomes untenable, and makes distribution always dependent of the state of competition, including the workable competition that antitrust law endeavours to promote. (2) This affects the notion of efficiency that applies to antitrust economics and law. Any notions of efficiency and improvement, short of Pareto efficiency and improvement become dubious, bestowing a healthy dose of scepticism on antitrust legislation and enforcement. This also invalidates the argument that distribution issue is and/or should be irrelevant to antitrust. (3) If taking unfair advantage of the redistribution effect is made too easy by lax merger enforcement, it will dampen firms' incentive to create genuine technical improvements and efficiencies. (4) Similarly, if taking artificial advantage against rivals afforded by merger-aided entrenchment becomes too easy, then it will dampen dominant firms' incentive to invest in socially desirable "hard" innovations and/or genuine technological progress.

References

1. Tong, J. and C. Ornaghi (2021), "Joint Oligopoly-Oligopsony Model with Wage Markdown Power", *University of Southampton Discussion Papers in Economics and Econometrics; No. 2021*; available at: https://www.southampton.ac.uk/~assets/doc/comms%20and%20marketing/2101%20JOOM%20with%20Wage%20Markdown%20Power.pdf
2. Tong, J. and C. Ornaghi (2023), "Market Power and Income Distribution: Lessons from Hybrid Industrial-Labour Economics", *University of Southampton Discussion Papers in Economics and Econometrics, No. 2301*. New version forthcoming at: https://www.southampton.ac.uk/~assets/doc/comms%20and%20marketing/2301-hybrid-industrial-labour-economics-revised.pdf