



DEPARTMENT OF JUSTICE

"ANTITRUST ENFORCEMENT AT DOJ: AN ECONOMIST'S PERSPECTIVE"

By

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It is a great pleasure to be here with you this evening and to have the opportunity to give you my perspective on the activities of the Antitrust Division during the past year. I would like to begin by putting the current enforcement activities of the Division in perspective, by describing the striking consolidation of economic activity in the United States that has taken place in the past several years. I will then cover a number of significant policy areas that currently face the Division and that are likely to provide important opportunities for the Division under Joel Klein's leadership to make substantial contributions to antitrust enforcement policy. Finally, I will close by giving a brief overview of some important enforcement issues that are likely to face the Division in the next year or two.

The Increasing Consolidation of Economic Activity

Life is busy and becoming busier here at the Division and at the Federal Trade Commission. HSR filings have been steadily growing from 2301 in Fiscal Year 1994 to 2806 in FY 1995, 3094 in FY 1996, and most recently to 3702 in FY 1997. Not surprisingly this has led to a corresponding growth in merger investigations at the Antitrust Division. The number of such investigations has grown from 105 in FY 94 to 134 in FY 1995 to 237 in FY 96 and to 277 in FY 1997. The current number of investigations this year shows a substantial rate of growth over last year.

Is this growth of merger activity likely to be sustained, or are we simply seeing another peak in a cycle of merger activity? It may be too early to answer this question completely, but we can learn something by taking a brief look back at history. As Figure 1 shows, the number of mergers in recent years corresponds roughly to the merger activity of the early to mid 1980s. Note, however, from Figure 2 that there is a

significant difference. Today's merger activity involves deals that are significantly higher in value (in real dollars) than the typical merger of the 1980s; in fact this activity reasonably mirrors the performance of the stock market (as reflected in the Dow Jones Industrial Average).

Moreover, the economic conditions underlying both merger waves were different as well. In the late 1970s inflation was increasing, as was the cost of capital. This was a period of declining economic growth, a relatively low valuation of economic assets, and generally a period of great uncertainty. When the economic recovery began in the early 1980s, the bond market was king. As a result, consolidations, many of which involved conglomerations of relatively unrelated economic activities, were financed in substantial part through the junk bond market. LBOs (Leveraged Buyouts) were the coin of the realm. Today, the acronym LBO is largely forgotten. With the stock market at an all-time high and the economy following a path of continuing growth, many consolidations involve straight stock deals. Furthermore, many of today's deals appear to involve building horizontal and vertical strategic relationships that are consistent with a healthy economy.

International Activity

The Antitrust Division has become increasingly active in the international arena in the past near, and is likely to continue to be active over time. This should not come as a surprise. Over the past several decades the U.S. economy has become increasingly globalized; for example, the ratio of both exports and imports to GDP has generally grown over this period. This globalization necessitates a more vigilant pursuit of consumer welfare by the U.S. enforcement agencies, an effort in which the Division has

been active. Today, more than 30% of the Division's work involves international or transnational issues.

The scope of the Division's international activity has been quite broad. During the past three years, we have successfully prosecuted five international cartels with potential defendants from more than 20 different foreign countries on 4 different continents. (The successful settlement of an international conspiracy to fix prices and to allocate sales volume of food additive lysine led to the payment of a \$100 million fine by Archer Daniels Midland.) Moreover, a number of civil merger and non-merger investigations have significant international consequences; these include, for example, the BT (British Telecom) purchase of a substantial interest in MCI, and the E.C. and Antitrust Division investigations of Microsoft.

Perhaps the most significant challenge facing our international work is our desire to effectively coordinate enforcement activities when appropriate to encourage cooperation among international enforcement activities. There currently are no international rules for resolving disputes relating to international jurisdiction or to international enforcement procedures. Our challenge is to develop a set of procedures that will encourage cooperation among enforcement agencies with the goal of achieving just and efficient outcomes.

One approach -- positive comity -- involves cooperation between the U.S. and other enforcement authorities. Under this approach one nation asks another to investigate, and if appropriate, to prosecute anticompetitive conduct. An example was the Division's investigation into whether A.C.Nielsen had illegally bundled or tied the terms of contracts in one country with those in other countries. (This could have adversely affected U.S. customers.) The European Union's Competition Policy Section

DG-IV also investigated Nielsen. When Nielsen agreed with DG-IV not to tie or link the terms of contract, the Division closed its investigation.

Positive comity is just one example of the bilateral cooperation that the Division actively pursues when appropriate. We are currently working on E.C. agreements along these lines, and we support the OECD cartel initiative which urges nations to cooperate to enforce laws against cartels. We are also actively providing technical assistance to numerous foreign competition authorities, while keeping in touch with our enforcement counterparts in Japan, Canada, and the European Union.

As Joel Klein has spelled out in his November 1996 speech at the Royal Institute of International Affairs in London, the Division believes that multilateral antitrust enforcement agreements are not likely to work at this time. The vast differences in competition laws and their application are simply too great for an initiative such as that undertaken by the World Trade Organization to be successful. Any multilateral agreement that is reached is likely to reflect lowest common denominator standards, may give risk to unsophisticated dispute resolution panels, and may create a substantial risk that confidential information will be shared. Further, attempts to remedy antitrust problems in many countries may be subject to counterproductive intervention by political interest groups, especially in nations with little history of competition law. Finally, the more sophisticated enforcement countries have themselves adopted a variety of competition policies, involving different goals (e.g., differing emphases on horizontal and vertical behavior) and differing enforcement efforts.

A Period of Active Enforcement by the Antitrust Division

Joining the Antitrust Division at this particular point in time has been very exciting for me. The Division has challenged and is challenging a variety of economic activities

that impede the competitive process. Prior to my arriving here, the Division had blocked the attempt by Microsoft to buy Intuit, the owner of the software Quicken, on a straight horizontal theory involving the personal finance software market. (After the challenge, the parties abandoned the deal on May 20, 1995.) More recently, the Division filed suit against Microsoft claiming that Microsoft violated a prior 1994 Consent Decree with the Division by (among other things) requiring manufacturers of personal computers to bundle Microsoft's web browsing software Internet Explorer with its operating system software Windows 95. The economic issues surrounding this bundling are vertical in nature, involving the alleged ability and desirability of a firm leveraging its monopoly power in one product into the sale of a related, but distinct product.

Another intriguing and potential significant effort by the Division surrounded its attempt to block the combination of two large non-profit teaching hospitals, Long Island Jewish Medical Center and North Shore Health System, Inc. The Division brought the suit on a horizontal theory that focused on the direct harm to managed care (and the corresponding indirect harm to consumers) that it believed would arise from the merger of two "anchor" hospitals in the Nassau and Suffolk county geographic area. The anchor theory emphasizes the fact that managed care plans need to offer the option of a large, sophisticated, high quality hospital to its prospective members to be successful. In the Division's view, this market definition was appropriate. It reflects the fact that hospital services are beginning to be developed through networks of providers. The Court, however, rejected the Division's motion for a Preliminary Injunction, claiming broader product and geographic markets, and essentially adhered to the markets of the past. The implications of this particular decision on the health care enforcement activities of the Division remain unclear at this time.

Consolidations in the radio industry has been numerous since the passage of the Telecommunications Act of 1996. Since that time the Division has actively investigated a number of HSR filings and non-HSR joint ventures. The result has been that five settlements were reached in cases raising anticompetitive concerns, while three deals were restructured or abandoned. Most recently, the Division filed suit (on November 6 of this year) to block Chancellor Media Corporation's acquisition of SFX Broadcasting Inc's four Long Island radio stations. Chancellor and SFX are the two top firms in the market, and Chancellor's WALK-FM and SFX's WBLI-FM and WBAB-FM have been each other's primary competitors in the sale of local radio advertising in Suffolk County, Long Island. The Division believes that the acquisition will increase radio advertising prices, and that these higher prices will eventually be passed on to consumers.

The Division has been especially active in defense, an area in which consolidations are driven by the down-sizing of the military. While there are often clear efficiencies resulting from such consolidations, it is essential that the industry remain one in which there is sufficient competition for current defense-related contracts so that innovation is encouraged. Two recent successes of the Division come immediately to mind. Earlier this year, the Division intervened in Raytheon's \$2.9 billion acquisition of the defense electronic business of Texas Instruments, forcing the divestiture of a business unit that makes MMICs, a key radar system component. Even more recently, a consent decree was issued in Raytheon's \$5.1 billion acquisition of General Motors' Hughes Aircraft subsidiary. The consent decree ensures that Raytheon will sell two critical defense electronic businesses (infrared sensors and electro-optical systems) and set up firewalls to preserve competition on an upcoming bid for a new missile. In

addition, the agreement ensures that efficiencies created by the merger in the production of AMRAAM missiles will be passed on to the Department of Defense.

Where Do We Go From Here?

As the author of a textbook of econometric forecasting I have learned over the years that it is easier to teach forecasting than to do it yourself. Nevertheless I would like to briefly sketch out some of the broad economic issues that are likely to face the Antitrust Division in the next year.

Deregulation

The deregulation of traditional natural monopoly industries continues to be an active area of Division concern. During the past year the Division concerned itself with a range of topics relating to telecommunications policy including whether to allow mergers between local telephone exchange carriers and the determination of an appropriate policy for allowing local exchange carriers into long distance markets. These and other telecom issues are likely to remain significant in the forthcoming year. Electric utility deregulation is also likely to be a regular subject of discussion as the Division provides evaluates mergers and provides guidance to FERC concerning aspects of regulatory policy. If there is an overarching theme to the Division's efforts it is to determine how to manage the transition to deregulation in a manner that will ensure that truly competitive markets will eventually emerge.

Technology and Dynamic Markets

There is little doubt that technology issues in dynamic markets are likely to stay in the forefront of the Division in the next year. Markets in which technology is rapidly

changing are particularly difficult to analyze from an economic perspective, for several reasons. First, network effects, whereby consumers benefit from using the same product as other consumers, are often significant. With network effects, product standardization can (but need not) be socially beneficial, and it is not unusual to see markets in which firms, competing in winner take all markets, enjoy substantial market power. Second, because there is an ongoing competition for new markets, it is especially important to evaluate the behavior of firms as they compete for a dominant position in related markets to which they may have an incentive to extend their market power. Whatever the source of competition, the Division's concern is that the competition be conducted on the basis of efficiencies, not market power. Third, in dynamic markets it is vital that firms be encouraged to innovate in ways that are in the long run interest of consumers. Innovations that create new and improved products that are highly valued by consumers should be distinguished conceptually from innovations that protect a firm's existing market power. Further, with dynamic markets it is important to understand the inherent tension between short run and long run goals; as the joint DOJ-FTC Intellectual Property Guidelines suggests, there may be some short-run static inefficiencies that will be created if one is to achieve significant long-run dynamic efficiencies.

Unilateral Effects

In recent years there has been a move within DOJ (and the FTC) towards giving greater emphasis on unilateral effects, i.e., the likelihood that the combined merged firm will raise prices unilaterally as the result of a merger -- with the merger a portion of the sales that would be diverted to other competitors when a price increase is now captured

by the merged firm. It is important to stress, of course, that coordinated effects -- the ability of firms to behave collusively (tacitly or overtly) -- remains an active concern. There are, for example, a number of merger cases currently on our agenda in which coordination issues play a significant role.

While I believe it unlikely that there will be a move to revise the Horizontal Merger Guidelines in the foreseeable future, I do think it fair to say that we are continuing to evaluate and reevaluate Guidelines issues. Within the unilateral effects area, I personally have a number of areas of interest. First, unilateral effects analyses in certain industries have allowed the Division to use econometric estimation and simulation techniques to predict the likely effects of mergers. (Of course, such quantitative analyses are by no means necessary for an effective unilateral effects case to be made.) I strongly support the Division's efforts to upgrade the software that we use in such analyses and to develop a deeper understanding of the methodological issues involved. Second, the relationship between the merged firms' shares and the likely magnitude of unilateral effects deserves further consideration. I believe that unilateral effects could be substantial (in some cases) when the merging firms have smaller joint shares, and could be insubstantial (in some cases) when the shares are higher. Third, the role of market definition in unilateral effects cases needs to be fleshed out. In coordinated effects cases, the relevant market is a crucial starting point for any collusive theory and therefore any competitive effects analysis. In unilateral effects cases where coordination is not an issue, market definition plays a somewhat different role; it provides guidance as to the products that should be included in the pricing analysis and it tells one something about the volume of commerce involved.

Thus, delineating the precise bounds of a product market appears less important in this instance than in the coordinated effects analysis.

Conclusion

I think that I have taken up a sufficient amount of your time for now. I want to thank you for the opportunity to speak with you, and to provide some personal comments about life at the Antitrust Division. Thank you very much.