BUSINESS at OECD
THE BUSINESS AND INDUSTRY ADVISORY COMMITTEE

Discussion Points

Presented by the Business at OECD (BIAC) Competition Committee to the OECD Competition Committee

Market Concentration

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Business at OECD (BIAC) appreciates the opportunity to submit these comments to the OECD Competition Committee for its session on market concentration.

I. Introduction

1. The current hearing on market concentration focuses on a new line of commentary which argues that market concentration has increased in recent years as a result of consolidation by firms. The argument continues by suggesting that this increased market concentration has led to higher prices and less competition and implies that lax antitrust enforcement is the root cause of all of these problems. As noted in the Secretariat's Issues Paper, "[t]here is a growing contention that big is bad, and that the growth of large firms with high market shares is increasing concentration and weakening competition, driving up profits, damaging innovation and productivity, and increasing inequality."[1] This movement has often been dubbed the "Hipster Antitrust" movement. This school of thought, however, has been called into question—for good reason—by many notable antitrust economists and scholars.

2. Indeed, the Secretariat Issues Paper correctly notes that "the imprecision of [the measures used to assess market concentration] means that, taken in isolation, they tell us little about whether competitive intensity has changed or not."[2] If that is the case, as it appears to be, then the further related conclusions—including higher prices, increased profits, harmed innovation, greater inequality and lax enforcement—must all be viewed with skepticism or dismissed entirely. Moreover, any attempt to adjust regulatory approaches based on this flawed analysis is likely to have serious unintended consequences.

3. While competition authorities should rightly be concerned about the improper acquisition or abuse of market power, and act to prevent it, they should also be cautious not to attribute current societal concerns about perceived market concentration to the wrong cause

[1] OECD, *Market Concentration–Issues Paper by the Secretariat* ¶ 7, *available at* https://one.oecd.org/document/DAF/COMP/WD(2018)46/en/pdf [hereinafter *OECD Issues Paper*].

[2] *Id*. ¶ 2.

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without convincing evidence. In other words, dubious, generalized studies suggesting an increase in market concentration should not be a basis for agencies to act in any given case, or to abandon decades of sound antitrust enforcement policy. And it should be remembered that the existence of a concentrated market (or market power) is not sufficient, standing alone, for competitive harm to exist. While these can represent a useful screening tool, improper conduct or an abuse of market power is required to establish harm to competition.

II. Economic Studies and Industry Codes

4. In the Issues Paper, the Secretariat reviewed Paper recent economic studies on the calculation of market concentration based on changes in HHI levels. These studies focused on the North American Industrial Classification System grouping of industries, which catalogs company industrial activity by increasingly focused codes up to six levels (or "digits" within the NAICS system) of specificity. The economic studies focused on two-, three-, or four-digit industry categories.[3] Of particular interest was the October 2015 study by Jason Furman and Peter Orszag which was based on two-digit categories.[4] This study argues that "[c]onsolidation may be contributing to the changing distribution of capital returns and the increased share of firms with apparently super-normal returns."[5] But this study divided most of the economy into only 13 broad industry sectors.

5. Another study mentioned is the May 2015 study (revised in August 2017) by Gustavo Grullon, Yelena Larkin and Roni Michaely which focused on three- and four-digit categories.[6] This study concluded that the "nature of U.S. product markets has undergone a structural shift that has weakened competition across a majority of industries."[7] But it must be recognized that the product categories used in these studies are fundamentally flawed because they include many products that have no competitive nexus to one another, and not conceivable potential to cause a price or margin increase due to an increase in concentration. They bear no resemblance to "relevant product markets." Indeed, if merging parties approached a competition agency arguing that a relevant product market was as broad as the categories reviewed in these studies, they would be laughed out the door.

6. For example, in the 2017 North American Industry Classification System (NAICS),[8] there are only 24 two-digit categories—in total—for the entire U.S. industrial economy. Within each two-digit code, there are numerous other categories. For example, NAICS code 44 for retail trade includes 8 three-digit codes, 14 four-digit codes, 39 five-digit codes and 43 six-digit codes.

[3] *Id.* ¶¶ 22-30.

[4] Jason Furman & Peter Orszag, *A Firm-Level Perspective on the Role of Rents in the Rise in Inequality*, Presentation at "A Just Society" Centennial Event in Honor of Joseph Stiglitz Columbia University (Oct. 16, 2015), *available at* http://gabriel-zucman.eu/files/teaching/FurmanOrszag15.pdf.

[5] *Id*. at 11.

[6] Gustavo Grullon, Yelena Larkin & Roni Michaely, *Are U.S. Industries Becoming More Concentrated?* (Aug. 31, 2017), *available at* https://ssrn.com/abstract=2612047.

[7] *Id*. at 1.

[8] *North American Industry Classification System – 2017 NAICS*, U.S. CENSUS BUREAU, *available at* www.census.gov/cgi-bin/sssd/naics/naicsrch?chart=2017.

And often times, the relevant product market defined in a competition proceeding (such as a merger review) is much narrower than the six-digit NAICS code. Furman and Orzag focused on the increased concentration among the top 50 firms at the 2-digit level, without any evaluation of which of the 43 potential 6-digit codes (or narrower markets) were impacted. Thus, it is difficult to conclude that there is any substantial increase in concentration in anything that could constitute a relevant product market (let along geographic market) in the antitrust sense.

7. Concerns have also been identified with the study's conclusions on increased profits. First, the study utilized accounting data to determine profit margin, which generally are viewed as unreliable indicators of economic rents. The study also fails to account for innovation gains, product quality enhancements, or other factors that may have delivered substantial gains to consumers well in excess of the return on those investments. None of these factors are captured by the Furman and Orzag study or those that followed it.

8. Yet, while Furman and Orzag themselves are cautious about the implications of their study, it is the starting point from which others would seek to abandon 50 years of economic analysis and study of product markets and competitive effects. The most fatal flaw of their study, and the others that follow, is that they do not attempt to evaluate the <u>causation</u> of the increase in concentration. Without an analysis of the causal effect of the increase in concentration, there is no basis to conclude that any increase in concentration in any given market, if one exists in any case, resulted from lax antitrust enforcement. Again, an increase in market concentration, standing alone, does not imply anticompetitive harm. And, even when there is an indication of net price increases (or other consumer harm), alternative causes of market failure would have to be evaluated before competition enforcement failure could be established as the reason for the harm.

III. Import of Concentration

9. Decades of analysis have taught that an increase in market concentration can be an indication of concern but is not, standing alone, a competition concern. Rather, it is a necessary but (alone) insufficient pre-condition to certain competitive harms. Increased market concentration may lead to an increased propensity for firms to coordinate on pricing or output, either explicitly or tacitly. But whether coordination exists in practice depends on many well-understood competitive variables, including geographic constraints on competition, products homo- or heterogeneity, the mode of customer acquisition (e.g., bidding markets), the size and strength of customers, relative costs of production, entry barriers, ability to price discriminate, and several other factors that can be meaningful or dispositive in an individual case. Concentration ratios are therefore a useful <u>starting point</u> for evaluating specific types of competitive harm, principally the potential for coordinated effects in merger cases.

10. Economic analysis also has taught us that firms achieving economies of scale have the potential to operate more efficiently and have the potential to deliver more competitive pricing and higher quality of products and services. This can occur even where the efficient competitor is able to maintain a higher return on investment than firms that cannot achieve scale.

Moreover, larger firms often are able to increase investment in innovation, expand into new products or new geographies, and invest in ways that smaller firms sometimes cannot. Indeed, some economics theories predict an inverted relationship between innovation and competition in highly competitive markets.[9] For highly concentrated markets, an increase in competition may have a positive impact on innovation whereas increased fragmentation exerts the opposite effect, hampering the rate of innovation due to reduced margins and operator's scale.

11. Taking as an example the mobile telephony sector, there is economic evidence that the relationship between the intensity of competition among operators and the level of their investment is non-linear and is maximized at a certain value of profitability of network operators.[10] There are elements to suggest that the European mobile industry is currently operating, on average, with an excessive level of in-market fragmentation and an insufficient level of investment to provide the best network technology and support the highest level of usage.[11]

12. For these reasons, concentration ratios are not an end-point for any evaluation of potential competitive harm. Yet, the studies raising concerns about market concentration do not seriously examine any of these countervailing factors.

IV. Conclusion

13. Evaluation of ratios in the absence of a solid theory of harm would cast back antitrust analysis a half century or more to the days of the 1966 U.S. Supreme Court's decision in *Von's Grocery*, which prohibited a merger of two "large and powerful" grocery chains despite a combined market share of just 7%.[12] That case has been recognized as the epitome of a decision lacking analytical rigor, trading on a fear of "incipient concentration" as opposed to an evaluation of anticompetitive effects. Competition law enforcement cannot afford to move backward in time to satisfy ill-defined populist notions.

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[9] Philippe Aghion, Nick Bloom, Richard Blundell, Rachel Griffith & Peter Howitt, *Competition and Innovation: An Inverted-U Relationship*, 120 Q. J. OF ECON. 701 (2005).

[10] François Jeanjean & Georges Vivien Houngbonon, *Market Structure and Investment in the Mobile Industry*, 38 INFO. ECON. & POL'Y 12 (2017).

[11] HSBC, SUPERSONIC–EUROPEAN TELECOMS MERGERS WILL BOOST CAPEX, DRIVING PRICES LOWER AND SPEEDS HIGHER (Apr. 2015), *available at* www.orange.com/fr/content/download/33263/1086075/version/2/file/Supersonic+13.04.15.pdf.

[12] United States v. Von's Grocery Co., 384 U.S. 270 (1966).