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Subcommittee on Antitrust, Competition and Consumer Rights

Hearing on

The Consumer Welfare Standard in Antitrust: Outdated or a Harbor in a Sea of Doubt?

Prepared Statement

of

Abbott B. Lipsky, Jr.
Antonin Scalia Law School
George Mason University

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Mr. Chairman and Members of the Subcommittee:

I am honored by your invitation to present views at this hearing. I am appearing only in an individual capacity, and my views do not represent those of any other individual or entity, including (without limitation) the Scalia Law School or George Mason University.

Consumer welfare is a term with a long, complex and interesting history. Its relevance and utility to antitrust law have been much debated, and within that debate many twisting and sometimes frayed threads can be identified. But the essence of the consumer welfare standard – at least as I understand it – is both reasonably clear and worthy of the very strongest defense. While scholars rightly concern themselves with a variety of definitional issues regarding consumer welfare as an economic concept, as a description of antitrust goals, or as a functional legal test, no alternative criterion comes close to being a plausible candidate to be the guiding principle for construction and application of antitrust law.

In providing this strong endorsement I have in mind a specific understanding of consumer welfare – namely, the ultimate policy objective of maximizing the long-run economic welfare of our society. There can be no serious question that the central operational mechanism of the antitrust laws is to maintain a vigorous competitive process as the organizing principle for our market economy. This is what led Justice Thurgood Marshall to describe antitrust law as the "Magna Carta" of free enterprise. *United States v. Topco Assocs., Inc.*,

405 U.S. 596, 610 (1972). Antitrust law prohibits certain broadly described classes of competitive restraints (agreements in restraint of trade, monopolization, etc.), but there is no specific statutory definition that can be applied to individual cases. Restriction of competition must be defined in a manner that permits identification and application of a specific rule for decision in each case. It is essential for courts to provide workable and predictable definitions of illegal conduct to allow the agencies to enforce and guide antitrust compliance. The consumer welfare standard is the proper aiming point for courts in construing and applying the antitrust laws in every specific case.

To say that the antitrust statutes are too general to provide a specific standard for the assessment of individual cases is not a criticism, but a mere statement of fact. The antitrust laws apply to numerous forms of conduct by almost every private-sector business throughout the economy. Any attempt to define by legislation how every conceivable real-world market scenario subject to antitrust scrutiny should be assessed would be futile. In some cases, definition of a specific rule is relatively easy – as for example with pure-and-simple minimum price agreements entered into by competitors (a classic type of "naked cartel restraint"). But in other cases it can be a serious challenge, requiring extensive analysis of market facts and circumstances, and exploration of a variety of alternative economic explanations for what is observed.

When competitors enter into joint ventures, for example, the ultimate effect of the agreement is not always clear. Most joint ventures are competitively harmless. Characteristically they lead to reduced costs, accelerated innovation, expanded distribution, higher output, greater product variety, improved product

quality or other similarly desirable results. Sometimes the coordination that occurs within the venture can lead to reduced output or product quality, less innovation, or other undesirable results, for example where the coordination is comprehensive and the venture partners hold a commanding position in the affected markets. Courts are frequently called upon to determine whether a specific joint venture is anticompetitive and to assess challenges to such ventures using the tools provided by statute (government injunctions or criminal remedies, private civil injunctive relief and/or treble damages). Similar examples could be drawn from cases involving unilateral conduct (judged against the monopolization prohibition in Sherman Act Section 2), or corporate combinations (Section 7 of the Clayton Act).

Given the difficulty of making such judgments with regard to particular episodes of business conduct, it is essential for agencies and courts to have some basic principled guidance to fashion the best rules for decision in close cases. The best approach is to define the greatest economic benefit to society as the fundamental objective of antitrust-law construction and application. This is what I understand to be the appropriate definition of the consumer welfare standard.

This use of consumer welfare as an ultimate policy objective must be kept distinct from the use of consumer welfare maximization as an operative antitrust rule in specific cases. The antitrust laws themselves define the operative rule – preservation of the competitive process – as best as could be defined on a broad statutory basis, given the incredible and virtually limitless diversity of products, industries, technologies, and other competitive circumstances that characterize and will characterize our enormous, growing and rapidly evolving economy.

Society has limited resources with which to satisfy the diverse wants of its citizens. Antitrust is best concerned with the maximization of the total value of what we produce with those scarce resources.

If antitrust enforcement focuses on maintaining a well-tuned economic engine capable of maximum performance, distribution of the benefits of that performance can be left to other institutions. But if antitrust does not focus on maximizing what can be produced, it is highly unlikely that any other institution will undertake that function. By virtue of its long history, its focus on empirically based economic analysis, and its extensive experience with a wide variety of enforcement approaches over more than a century, the antitrust enforcement process is best suited to identifying and prohibiting business conduct that imposes economic cost on society through restrictions of competition. Although effective competition has a number of incidental and collateral benefits, none would qualify as a proper basis for defining the appropriate line between procompetitive and anticompetitive conduct in specific cases. Mixing in such objectives as full employment, redistribution of wealth, or preferences for particular regions, sectors or other interest groups would hopelessly confuse the enforcement process and render compliance uncertain, costly, and potentially impossible. Mixing objectives would be a formula for handing over the most basic rules of competitive conduct to unaccountable political processes. Such a policy would attract to our competitive economy all the risks and disadvantages of central planning. The economic incompetence of that approach – which sank the only other superpower and led other societies into economic ruin and political oppression – is among the clearest and most profound lessons of 20th Century history.

Of course there are difficult issues involved in developing specific rules of conduct consistent with the consumer welfare standard in borderline cases. The most obvious wrinkle concerns the contrast between static and dynamic analysis. Controversies within the antitrust community regarding law and policy aside, there is essentially zero disagreement among serious analysts that innovation and technical progress are the single most important determinants of improvements in the economic well-being of citizens in our society. Marking the changes in any field of endeavor over the last few decades or centuries – medicine, agriculture, transportation, construction, communication – makes it clear that the most profound improvements in the economic well-being of individuals are attributable to innovation. Agreement on this relationship covers the entire spectrum of expert economic opinion, excluding only the farthest extremities.

Given the absolutely critical role of innovation in improving our economic well-being, it is incumbent on those entrusted with the implementation of our antitrust laws to apply the long view of their enforcement actions and how they affect our economy. Difficult questions in our antitrust enforcement system must be resolved with regard to their long-run effect on economic productivity, including most specifically the possible effects on innovation, as well as output, product quality, and other key economic variables. In my understanding of the term ”consumer welfare”, this is the approach to antitrust enforcement that will best serve society.

Now please observe that I offered a definition of consumer welfare as an ultimate guide to antitrust enforcement, but I have not yet made any reference to pricing (aside from identifying price-fixing cartels as an appropriate object of legal

condemnation). Recent critiques of the consumer welfare standard assert that modern U.S. antitrust interpretation is centrally or even uniquely focused on short-term effects on consumer prices. I believe that assertion is partially misleading and partially wrong. It may be based on a superficial mistake regarding the significance of pricing in antitrust analysis. Let me explain briefly how that mistake should be corrected.

The central mechanism of antitrust is the preservation of a vigorous competitive process. In competitive markets prices will vary according to changes in a wide range of circumstances – consumer tastes, input prices, production technology, etc. But from the standpoint of antitrust enforcement, whether prices increase, decrease or stay the same is all irrelevant so long as the prices in question result from the interplay of dynamic competitive market forces. Thus, for example, the antitrust laws condemn maximum input price-fixing by competitors as well as minimum output price-fixing by competitors, even though the former results in lower prices to the consumer. *Mandeville Island Farms v. American Crystal Sugar,* 334 U.S. 219 (1948). Prices are of course very important in a market economy, because prices signal resource owners and consumers about the desirability of changes in purchasing or production patterns and resource use. But an antitrust policy that uniformly favored low prices for their own sake would encourage practices like input price fixing and tolerate or incentivize other forms of wealth-destroying conduct.

Thus, statements that antitrust focuses excessively on short-term price effects are partially misleading. The key objective of the antitrust laws is to ensure that prices are determined by competitive market processes -- not to

mandate low prices as such. A competitive process will encourage the provision of goods and services at the lowest prices consistent with maintaining the business viability of efficient producers. But antitrust is not intended to foster low prices at any economic cost.

Commentators unfamiliar with the "inside baseball" lingo of antitrust can be forgiven for this mistake. Courts and agencies – in statements that are not focused on the issue of ultimate antitrust objectives – may refer to the possibility of higher consumer prices as if they were an unmitigated evil (as in the assessment of a merger between competitors). Higher prices are in some circumstances an evidentiary signal that conduct may have reduced the vigor of competition. Even in those situations, however, it is usually a mistake to rely on price movements only in assessing the basic issue whether competition has been or is likely to be restricted. If prices have increased following a combination of competing businesses, there are other procompetitive outcomes that could explain this. For example, if the merging parties were empowered to penetrate the highest-quality segment of a market, where products logically and properly command higher prices, that could be evidence of a procompetitive effect (depending on movements in other competitive variables as well.)

In a variety of circumstances short-term price increases are properly regarded as an indication of potential anticompetitive conduct, but restraints of competition are not condemned for the sole reason that prices may increase. Moreover, short-term price increases are not a necessary condition for condemnation of business conduct, as illustrated by a variety of recent merger cases that prohibited transactions due primarily to limitations on innovation that

seemed likely to result. One can debate the accuracy of these predictions, but the potential relevance of the issue to predicting or judging competitive effect is not in serious dispute.

Limiting competition can have a broad variety of results in addition to higher prices, including reduced innovation or limited output. Price changes are often the most apparent sign of a possible change in competitive conditions. But viewed within the overall framework of antitrust and with a full understanding of competitive dynamics, it would be incorrect to conclude that the necessary focus is strictly upon short-term price effects. Adopting the proper orientation is critical to understanding why antitrust cases reach particular conclusions on their specific facts. Thus, neither the presence nor absence of a price effect is conclusive on the broader issue of competitive effect of conduct.

Finally, the statement that the consumer welfare standard commands antitrust to focus exclusively on short-term price effects is in part simply wrong. Our leading Supreme Court case on the subject of predatory pricing implies as much. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). By requiring proof of a reasonable prospect of recoupment of lost profit to establish a claim of predatory pricing, the Supreme Court has defined the elements of the offense in a manner that guarantees that short-term price effects <u>will not</u> determine the outcome of the claim.

Thus, I cannot accept the criticisms of the consumer welfare standard based on assertions that it limits formulation and application of antitrust law to the assessment of price effects, or that it overemphasizes such effects. (If and to the extent any antitrust decision makes such an error, I would regard that

decision as outside the lines of current Supreme Court analysis.) The consumer welfare standard – understood as the principle that antitrust rules should be formulated and applied in a manner that maximizes the long-run economic productivity of our competitive economy – is the best available candidate to be the ultimate guide for antitrust interpretation. If followed carefully, application of the consumer welfare standard has the best to chance to render our generally phrased antitrust statutes useful for the resolution of specific cases in court and to guide enforcement by the agencies. The consumer welfare standard will also be the best guide for the millions of businesses throughout our economy in understanding how to comply with antitrust rules.