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**DEPARTMENT OF ECONOMICS**

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The Honorable Richard Durbin
Chair, Committee on the Judiciary
United States Senate
Washington, DC 20510

December 18, 2022

Dear Senator Durbin,

**Response to Written Questions on "Examining the Competitive Impact of the Proposed Kroger-Albertsons Transaction"**

I am pleased to provide written answers to the questions sent to me on December 6. I do not have access to the facts that the FTC will have discovered in its investigation of this transaction. Therefore, I can only speak in general terms about some of the important issues raised. My answers are in *italics*.

**Questions from Senator Tillis**

1. What impact, if any, would the combined Kroger and Albertsons have on (a) barriers to entry in the grocery market and (b) on existing, smaller competitors in the grocery market?

*Barriers to entry: There is no generally accepted definition of "barriers to entry" (Viscusi, Harrington and Sappington, 2018, pp. 188-191[1]), but, for the current purpose, we can think of barriers as reflecting additional costs, in time, money or other resources, that a new firm would need to incur to enter a market, which existing incumbents do not have to pay.*

*Barriers to entry can exist in grocery markets. For example, in some geographic markets there may be only a limited number of sites suitable for a large grocery store, or entry may require very large investments in establishing distribution networks. An agency might be concerned about a merger if it was believed that the merger would make entry more difficult*

[1] Viscusi, W.K., J.E. Harrington, Jr. and D.E.M. Sappington, "Economics of Regulation and Antitrust", 2018, MIT Press

*in a way that was not due to the merger making the incumbent stores more efficient. Even if the merger does not exacerbate entry barriers, agencies will consider entry barriers when they assess whether new entry is likely to be able to offset anticompetitive effects that a merger may have in a local market.*

*I am not aware of information that bears on the question of whether a Kroger/Albertsons merger will increase entry barriers. However, a 2012 FTC study characterized the U.S. grocery retail industry "as one in which entry and expansion should be relatively easy." I would also note that the U.K. CMA considered this question in the context of the U.K. grocery industry when considering the Sainsbury's/Asda merger.[2] In the U.K., planning restrictions and land covenants make it particularly difficult to build large stores in many areas of the country. However, my reading of the CMA's report is that they did not find evidence that the merger would raise these types of entry barriers even further.*

<u>*Effect on smaller competitors*</u>*: Merger analysis is primarily focused on the likely effects of a merger on consumers. The fact that competitors may be hurt if a merger results in the merged firm being more competitive should not necessarily lead to a merger being blocked if consumers are likely to benefit in the short-run and the long-run.*

*However, an agency could be concerned about a merger whose effects will be to make rivals less competitive (for example, because they may find themselves unable to secure important inputs).*

*In the context of grocery store mergers, I am aware of a couple of arguments of this type that have been made. One is the so-called "waterbed" theory that a larger merged retailer will be able to secure larger discounts (or some other more preferential treatment), and that an effect of this will be that suppliers raise prices to smaller retailers. An alternative, but similar argument, is that the merged firm will be able to use enhanced bargaining leverage to secure early or exclusive access to new products.*

*Economic theory has established that the waterbed effect is possible (Inderst and Valetti, 2011[3]). However, I am not aware of empirical studies that have identified that it is important in practice, although this may reflect that the types of data needed to test the theory are not available to academics. The U.K. CMA decided that the effects on competing retailers were not likely to be significant in the context of the Sainsbury's/Asda merger.*

2. Smaller grocery stores have claimed that Walmart, the largest grocery store chain in the country, uses its size to obtain better discounts on products than its smaller competitors.

a. If the acquisition is completed, will a combined Kroger and Albertsons have sufficient market power to demand better discounts?

*Quantity-based discounts are a very common business practice that is seen in many industries, whether or not suppliers in those industries bargain over prices. Economists*

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[2] "Anticipated Merger Between J Sainsbury PLC and Asda Group Ltd Final Report", UK Competition and Markets Authority, 2019.

[3] Inderst, R. and T.M. Valletti, "Buyer Power and the 'Waterbed Effect", Journal of Industrial Economics, 59(1), 2011, pp. 1-20.

*believe that quantity-based discounts can be efficient, especially when they reflect cost differences to supplying customers of different sizes, or advantages that come from selling through larger retailers.*

*I understand that in the supermarket industry there may be some variation across chains in both unit prices and promotional support packages, but I am not aware of any academic research that identifies how large these differences are.*

*I would not be surprised if larger supermarket chains tend to pay lower unit prices than smaller chains for at least some products. A merged firm might be able to lower its input prices for some products by either using the cheaper of the contracts that the merging parties have in place, or by negotiating better prices for larger quantities in new contracts.*

b. If the combined companies can get better discounts, how will that affect their competition with Walmart?

*As a matter of economics, lower supply costs (if realized) could enable a firm to compete more effectively (e.g., through lowering prices, more profitably investing in quality) with larger rivals, including Walmart.*

c. Would the combined companies become a more direct competitor or a tacit ally with Walmart through avoiding competition with each other?

*One can hypothesize mechanisms whereby a merger could result in a firm competing more directly with at least some rivals.*

*For example, in the context of the music radio industry, my research has shown (Sweeting (2010)[4]) that when a radio company purchases stations in the same local market-format (for example, multiple Rock stations in Washington DC), they tend to differentiate their playlists so that they compete more directly with, and take listeners from, rivals rather than each other. In the grocery setting one might imagine that a firm that runs two fascias within a local area might try to position them so that they compete against different local rivals. Indeed, Argentesi et al. (2021)[5] identify this effect on product assortments when two Dutch supermarket chains merged.*

*I do not have access to information that would let me assess whether this type of repositioning may happen after a Kroger/Albertsons merger.*

*The economics literature suggests that there are certain market features that might promote collusion between firms. For example, collusion is believed to be more likely to occur when there are fewer competitors, and when each firm's prices and costs are more transparent to other firms.*

[4] Sweeting, A.T., "The Effects of Mergers on Product Positioning: Evidence from the Music Radio Industry", RAND Journal of Economics, 41(2), 2010, pp. 372-397.

[5] Argentesi, E., P. Buccirossi, R. Cervone, T. Duso and A. Marrazzo, "The Effect of Mergers on Variety in Grocery Retailing," International Journal of Industrial Organization, 79, 2021, 102789.

*As a merger tends to reduce the number of firms, it may tend to make collusion more likely. However, the U.K. CMA was skeptical that the Sainsbury's/Asda merger would increase the likelihood of collusion for in-store groceries in the U.K. or local markets within the U.K.. However, as mentioned in my written testimony, they did believe that the merger might increase the likelihood of coordination in the online/delivered grocery channel where firms make important choices on the price of delivery and the types of time windows that they offer consumers. I expect that the FTC's investigation will consider this issue.*

d. How would the buying power of the combined companies impact the food supply chain, specifically farmers and food distributors?

*Economic intuition suggests that a number of effects are possible. For example, the merged firm may be able to use efficiencies to support the introduction of new or more local product lines. Alternatively, increased bargaining leverage may tend to lower the prices that suppliers receive, and dull their incentives to invest in new products, or lead to firms in the supply chain trying to consolidate.*

*Only a detailed investigation can establish whether any of these effects are likely to be important after a specific transaction. I would note that the U.K. CMA carefully considered these issues in the context of the Sainsbury's/Asda merger and ended up taking the view that it was unlikely that food suppliers would be harmed by the merger.*

3. One of the stated goals of the merger is to improve data collection on shoppers. Following the acquisition, the combined companies could amass data on shoppers nationwide, making them more attractive to advertisers. What effect does that have on competition in the grocery market, particularly on regional stores?

*In general, the value of having national data will depend on exactly how the data is used. For example, if a chain has excellent data on my individual purchase history, data on many other consumers may not have so much incremental value in helping the chain or advertisers determine which products I am most likely to be interested in.*

*However, it is possible that there are some advantages when an advertising platform has national scope. For example, suppliers might incur lower costs when advertising on a platform that has national coverage, rather than two platforms that both have regional coverage. If this leads to suppliers having lower costs, and some of these benefits are passed on to final consumers, in the form of lower prices or better products, this could be viewed as a procompetitive effect. An agency would need to consider whether this type of efficiency would meet the criteria for being cognizable (e.g., the merger is the only effective way to achieve the efficiency).*

*It is hard for me to say how data efficiencies for the merged firm may affect regional rivals as I am not aware of how regional supermarket chains use data or the options that might be available to them to achieve national scale, but I would expect the FTC to evaluate these issues. As a general matter, I would expect large, sophisticated suppliers to have an interest*

*in helping regional supermarket chains to develop platforms that allow suppliers to advertise effectively.*

4. Over the past year, new entrants to the alcohol market – namely large soft drink manufacturers – have begun producing and selling alcoholic versions of some of their more traditional soft drink and beverage brands, which have typically been marketed to minors. These developments have raised regulatory questions at the federal and state levels of government. Since slotting fee payments and other inducements are common in the retail context, but explicitly prohibited in alcohol, there is increased focus on how regulators are adjusting and responding to the new environment.

a. Can you explain slotting fee payments and other inducements? Is there a standard definition? Is there an estimate of how much is paid annually? How are they calculated? Which federal agency regulates this activity? Do states regulate this activity? What should federal and state regulators do to ensure that smaller food and beverage producers are able to compete fairly with larger manufacturers for preferential store placements?

*In general, these are the types of confidential business-to-business relationships that are opaque to academic economists.*

*At the request of Congress, the FTC produced a report on slotting allowances in 2003, "Slotting Allowances in the Retail Grocery Industry".[6] This report is clearly quite old, but it was based on access to data that would usually be confidential.*

*The FTC report defined allowances as "one-time payments a supplier makes to a retailer as a condition for the initial placement of the supplier's product on the retailer's store shelves or for initial access to the retailer's warehouse space."*

*The FTC report considered a variety of explanations for slotting fees, including those suggested by retailers and suppliers who responded to the FTC's requests for information, and the academic literature. Some of these explanations would suggest that slotting allowances are procompetitive (i.e., they ultimately benefit consumers), whereas other explanations suggest that they could be anticompetitive, at least in some situations. The FTC noted that their data was not sufficient to come to any clear conclusions about why slotting allowances were used. The FTC's estimate was that the nationwide introduction of a new product would require a supplier to pay between $1 million and $2 million in slotting fees (2003 dollars).*

*I am not aware of any state or federal laws, outside of alcohol, that directly govern slotting fees. However, if their use is anticompetitive, then they could fall within the scope of antitrust laws, including the FTC Act and the Robinson-Patman Act. The FTC issued the "Guides for Advertising Allowances and Other Mechandising Payments and Services"[7] (updated in 2014) that deal with related payments and allowances.*

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[6] https://www.ftc.gov/sites/default/files/documents/reports/use-slotting-allowances-retail-grocery-industry/slottingallowancerpt031114.pdf .

[7] https://www.federalregister.gov/documents/2014/09/29/2014-23137/guides-for-advertising-allowances-and-other-merchandising-payments-and-services .

b. How are federal regulators preventing soft drink producers from violating rules on unfair trade practices, including providing slotting fees to retailers for their non-alcoholic beverages to gain preferred access for their alcoholic brands?

*I am not aware of the practices mentioned, or whether they are currently being considered by the FTC or any other agency. However, in my experience, FTC staff pursue investigations when they see evidence that trade practices harm competition.*

c. Do you believe regulators are enforcing bans on alcohol producers providing items of value to retailers, given the soft drink entrants into this market, and their track record of providing retail inducements?

*I believe that the FTC strives to uphold laws against practices that are likely to harm consumers, in both of its competition and consumer protection missions. I am not in a position to know what the FTC, or any other regulator, may currently be investigating in this area.*

d. How can federal policymakers address consumer confusion regarding alcohol products that have brand names and packaging that are popular with consumers under 21 years old?

*The FTC's Bureau of Consumer Protection takes enforcement actions in cases where it believes that marketing is unfair or misleading to consumers.*

*The FTC has, in the past, published reports on self-regulation of marketing in the alcohol industry[8], and its website asks consumers to report instances where they believe codes of conduct are being violated.[9]*

e. Given that alcohol laws are often unique to each state, how do state regulators prevent potential abuses from occurring within their borders? Is there sufficient cooperation between the states and federal regulators?

*State-level regulation of alcohol sales is not my area of expertise. However, when I was at the FTC, FTC staff in all three bureaus frequently engaged with competition, consumer protection and economics staff in the states to promote more effective decision making and investigations.*

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[8] https://www.ftc.gov/system/files/documents/reports/self-regulation-alcohol-industry-report-federal-trade-commission/140320alcoholreport.pdf .

[9] https://consumer.ftc.gov/articles/0391-alcohol-advertising .

**Questions from Senator Padilla**

1. Divestiture is a common antitrust remedy, and in your testimony you said that it would be very fact specific.

a. In two instances, some experts consider divestiture a failed remedy. One is Albertsons's divestiture of stores to Haggen which went bankrupt shortly after, and the other was the 2013 Hertz divestiture of a small rental car operator, which also then filed for bankruptcy. What are your views of those circumstances?

*It may be useful to think of the prospective analysis of a potential divestiture in two parts.*

*The first part involves identifying the assets that need to be divested in order to avoid the merger leading to anticompetitive effects in defined relevant markets. Economic models provide a framework for making these assessments.*

*The second part involves making sure that the purchaser of the divested assets will be willing and able to operate the divested assets competitively in both the short-run and the long-run. This part involves not only assessing economic incentives, but also making business assessments of finances and acumen.*

*In my experience (which comes from the period after the two mentioned divestitures were implemented) financial analysts at the agencies do try to assess financial viability of buyers under a variety of scenarios. But, one should bear in mind that these forward-looking assessments will never be perfect, and that there can be situations where it is tough competition in the market that leads businesses to fail.*

b. Are there any lessons you think the Federal Trade Commission and Albertsons and Kroger should take away from the 2015 Albertsons merger with Safeway?

*As I highlighted in my written testimony, merger retrospective studies conducted by the agencies or academics are very important as they can guide better decision making when similar mergers are proposed in the future. In my experience, when a merger is proposed, the agencies will look back at what happened after comparable mergers, even if the results of these analyses are not made public.*

*I am not aware of a published study of what happened to prices or assortments after the Albertsons/Safeway merger, but it is well-known that Haggen, which purchased many of the divested stores, went bankrupt. I am sure that this experience is informing the analysis being conducted by the FTC, and it should also inform the type of divestiture proposal that the parties are making.*

c. Do you think divestiture would be an appropriate remedy in this proposed merger?

*I believe that divestitures can be an appropriate remedy in retail mergers, when it is believed that (i) there is a viable purchaser that is very likely to operate the divested assets competitively in both the short-run and the long-run, (ii) the agency is confident that the divestiture will eliminate the anticompetitive effects that the merger would otherwise generate.*

*It is not the case that these conditions are always met. For example, in the proposed Sainsbury's/Asda merger, the CMA concluded that*

"It is unlikely that a suitable package of assets could be found, or a suitable purchaser (or purchasers) found to operate the assets as a competitor to the Parties, to provide an effective and comprehensive remedy to the widespread SLCs we have found. A divestiture remedy would therefore carry a significant and unacceptable risk of being an ineffective remedy." (Paragraph 116 of U.K. Competition and Markets Authority, "Anticipated Merger Between J Sainsbury PLC and Asda Group Ltd Final Report", 2019)

*Of course, the facts in the current case are different. For example, both Sainsbury's and Asda compete in almost all regions of the U.K. whereas there are more regions where only one of Kroger and Albertsons are present. Therefore, based on the evidence available to me, it is unclear whether or not the CMA's conclusion applies to this case.*

2. Additional consolidation in the grocery market risks creating more food deserts and limiting consumer access to nutritious meals. Albertsons reportedly closed more than 160 grocery stores nationwide after its merger with Safeway, which, according to some assessments created food deserts, or areas without access to a grocery store. I am deeply concerned that this deal will lead to the closure of divested stores that are perceived as redundant, or that simply cannot compete against the market power of a newly merged Kroger-Albertsons. Too often, such closures have a disproportionate impact both economically and on the health of communities that are already disadvantaged.

a. What measures do you think the FTC can take in investigating this merger and in designing a remedy to avoid the creation of food deserts?

*In my experience, the FTC takes seriously the possibilities that the merged firm would want to close stores or that a buyer of divested stores will not want to keep operating all of the stores that are included in a divestiture package. They will also consider the fact that consumers in disadvantaged areas already have very limited options and so may be affected disproportionately by store closures. It is often difficult to solve these concerns using behavioral remedies, which can be difficult to craft and monitor, and which may introduce further distortions into the marketplace.*

3. Significant fractions of Kroger and Albertson's grocery stores have pharmacies attached, including stores across California.

a. Do you think there is a significant possibility that this merger could reduce the availability of pharmacies accessible to consumers if the merger leads to consolidation of store locations and/or divestment doesn't successfully result in sustainable competitors?

*I am confident that the FTC will be considering the sales of additional products, including pharmacy products, general merchandise and fuel, in their competitive assessments. They will take into account that grocery stores may be important sources of pharmacy products, especially in neighborhoods that lack more specialist pharmacy stores.*

b. What factors should the FTC consider when analyzing the impact of this merger on the market for pharmacies?

*The FTC will consider how the set of competitors for pharmacy sales may be different from the set of competitors for grocery products. For example, Walgreens and CVS are very likely to account for a much larger proportion of pharmacy sales than they do for grocery products. However, the FTC will also recognize that there may be particular types of pharmacy products, or particular types of consumers, for whom grocery stores provide particularly close substitutes for purchasing pharmacy products so that the merger might potentially create a significant reduction in competition. They will also likely consider how regulation, or the availability of suitably trained pharmacists, may make it difficult for new pharmacy stores to enter or for grocery stores that currently lack pharmacies to add pharmacy service.*

Yours sincerely,

Andrew Sweeting