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REMARKS OF

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* The views expressed are my own. They do not necessarily reflect those of the other Commissioners.

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The topic I have been asked to address today is the antitrust enforcement policy of the Federal Trade Commission. As you no doubt expect, I will give my own perspective of the Commission's enforcement policy and I do not -- indeed cannot -- speak for the Commission or for either of the other two sitting commissioners. In addition to this traditional caveat, I should alert you to a more fundamental question: Is there or should there be such a thing as a Federal Trade Commission enforcement policy? Perhaps the most interesting development concerning the FTC, which recently has been pushed to the forefront, is the question whether -- as a constitutional matter -- the Commission should have an enforcement policy at all.

In January of this year, the Commission issued an administrative complaint against six title insurance companies alleging that the companies had violated Section 5 of the FTC Act by fixing prices for title search and examination services. On September 26th, these same title insurance companies asked a federal district court to declare the Commission's law enforcement activities unconstitutional. 1/ According to the plaintiffs, the Constitution assigns to the President and the executive branch exclusive authority to enforce federal laws.

1/ Ticor Title Insurance Co. v. FTC, No. 85-3089 (D.D.C., filed Sept. 26, 1985).

The complaint alleges that the Constitution does not permit Congress to grant law enforcement power to officials who are beyond the ongoing supervisory control of the President. The President appoints the members of the Federal Trade Commission, but Section 1 of the FTC Act allows the President to remove a commissioner only if he or she is guilty of "inefficiency, neglect of duty or malfeasance in office," a statutory limitation on the President's power that was upheld by the Supreme Court, in 1935, in Humphrey's Executor. 2/ The title insurors claim that the separation of powers doctrine prevents Congress from imposing such limitations on the President's authority to remove law enforcement officials from office. Besides seeking a declaration to this effect, the plaintiffs seek to enjoin the Commission, permanently, from prosecuting ongoing enforcement proceedings or initiating future prosecutions under the FTC Act.

The plaintiffs in the Ticor lawsuit have raised intriguing and fundamental constitutional questions. If their suit ultimately is successful, the Commission would still be able to issue economic reports but would not be able to enforce the FTC Act -- that is, not unless Congress amended the Act to provide that Commissioners serve at the pleasure of the President. The consequences of such a change -- not only for the FTC, but for other so-called "independent" agencies -- would be dramatic. It may be that I have the honor of giving the nineteenth and final

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2/ Humphrey's Executor v. United States, 295 U.S. 602 (1935).

presentation by an FTC commissioner, before this audience, on the Commission's enforcement policy.

For the time being, however, the Commission still has its enforcement authority and remains active in pursuing antitrust cases. We devote most of our antitrust resources to areas that carry the greatest risk of anticompetitive effects -- horizontal restraints and mergers.

In recent years, the Commission has expanded its enforcement resources to emphasize the service sector of the economy as well as the traditional manufacturing and sales industries. Because of the growth of the service industries, the potential gain from increased antitrust enforcement in this area is large.

This greater emphasis on the service sector began back in the 1970s when the Commission initiated its health care antitrust program. Since 1980, the Commission has entered approximately 19 orders relating to the health care industry. These orders address a variety of conduct, including boycotts to affect physician reimbursement and cost-containment efforts, attempts to restrain competition from allied health professionals and alternative delivery systems, restrictions on truthful advertising and anticompetitive hospital mergers.

More recently, the Commission has built on this record by challenging similar types of restrictions involving non-health professionals.

The Commission is also examining activities of trade associations. Trade groups play a valuable role in our economy, but their activities may occasionally restrain competition among their members. In particular, the FTC staff is reviewing membership conditions, codes of ethics, and exchanges of price, cost, or similar data among association members.

In addition, the Commission has been evaluating conduct near the fringes of the antitrust exemptions -- such as labor and insurance -- in light of recent court decisions. Although we carefully avoid areas that the Congress intended to protect from the antitrust laws, the Commission should not abdicate its enforcement responsibility in the areas not covered by the exemptions.

In the area of predation, I see a strong potential for worthwhile enforcement actions involving nonprice predation. This type of conduct -- actions designed to raise the costs of competitors -- may be more likely to occur than traditional price predation, because firms may engage in it without suffering the losses that below-cost pricing entails. The Commission recently issued one complaint under a non-price predation theory, and several investigations are pending.

There is less emphasis today on certain kinds of antitrust cases -- such as Robinson-Patman and vertical restraints -- that do not seem to promise significant consumer benefit. Contrary to some reports, however, the Commission has not abandoned these areas of antitrust enforcement.

This quick review summarizes the Commission's major antitrust programs except for merger enforcement. Approximately 40 percent of the Commission's budget for its Bureau of Competition is spent on merger enforcement, and this is a subject

I will address at somewhat greater length. I do not presume that I could teach this audience anything about merger law. Before coming here today, I spent some time pondering what I might tell you that would provide a new insight into -- or at least a different slant on -- analyzing the competitive effects of mergers. In fact, however, I have nothing either momentous or new to say. But perhaps it will be useful, or of at least some interest, if I tell you something of my own approach to enforcement under Section 7 and comment briefly on certain aspects of the competitive analysis of mergers that we engage in at the Commission.

The government's merger policy is currently under attack from all sides. It is simultaneously accused of being too strict and too lenient. It is thought by some to be irrelevant and by others to be non-existent. Few would disagree, however, about what we should seek to achieve in this area. The proper goal is simple: we seek to protect competitive opportunities for American business.

In pursuit of this goal, I try to keep one overall principle in mind: above all, do no harm. It is not our purpose to stop mergers indiscriminately. Although some mergers may prove unwise from a business perspective, the government is not well suited to second guessing such decisions. The willingness of people in business to take risks is essential to the competitive vigor of the economy. In enforcing Section 7, the FTC should foster, not chill, the competitive instinct to experiment and respond to the play of the market.

Mergers differ in their effects on competition. Recent theoretical work suggests that most mergers are either benign or beneficial. Enforcement statistics tend to bear this out. They show that the vast majority of transactions do not raise competition policy problems. In 1984, for example, roughly 95 percent of reported mergers went through the premerger notification process without issuance of requests for additional information by either the FTC or the Department of Justice.

Plainly, merger policy has changed as our understanding of the role of mergers in the economy has evolved. The changes, although not evincing perfect agreement among antitrust authorities on every particular, are based on a refined ability to predict economic effects and, by and large, are here to stay. Let me touch briefly on four developments. First, the decline of "structuralism;" second, the integration of foreign competition into merger analysis; third, the significance of ease of entry; and fourth, the increasing importance of efficiencies.

"Structuralism" is the term I will use to describe a mode of analysis in which predictions of competitive effects are based almost exclusively on certain static market conditions -- such as market share and concentration. In the early years of enforcement under the amended Clayton Act, the prevailing wisdom among both the legal and economic professions was that concentration by itself was sufficient to generate the market power necessary for increased prices. Most economic studies of the time indicated that profits were indeed positively related to concentration. The possibility that higher profits might result from economies of scale was not considered.

The antitrust agencies and the courts, relying on the prevailing wisdom, made prevention of concentration their almost exclusive concern. The first set of merger guidelines issued by the Department of Justice in 1968 reflected the dominant thinking of the economics profession at the time. The 1968 guides announced that the "primary purpose" of Section 7 enforcement was to "preserve and promote market structures conducive to competition," because conduct "tends to be controlled" by structure. The guides gave "primary significance" to market shares, which were deemed virtually the only necessary predictors of competitive effects.

Gradually, we have come to recognize the importance of factors other than market structure to industry performance. Early economic studies that had found a strong relationship between concentration and profits solely as a result of market power have been questioned. More recent work shows that increased concentration often results in both lower costs and higher profits. These conclusions suggest that mergers can result in both increased efficiency and market power. The net effect on prices varies from industry to industry.

New data, disaggregated to the firm level, show that a large market share of one or two leading firms is a more accurate predictor of average industry profits than is the overall concentration level. Within many industries, larger firms experience greater profits than their smaller counterparts, which suggests economies of scale. According to at least one recent study, 3/ the existence of a third large firm in an industry -- as opposed to only one or two -- reduces industry profits. This suggests that supra-competitive pricing may be more likely to occur where there are dominant firms than where there is an oligopoly. Finally, markets simulated in economic experiments reach a competitive outcome with relatively few firms. 4/

As the "new economic learning" gained support, the courts moved away from the structural approach taken in the 1968 guidelines. Government enforcement policy also relied less on structure, as demonstrated in 1982, when both the Department of Justice and the Federal Trade Commission announced new merger guidelines, and in 1984, when the Department revised its guidelines.

As you know, in evaluating mergers, both the Department and the Commission now conduct a broader inquiry, looking beyond the market shares and concentration statistics, to other qualitative factors that affect ability to exercise market power, potential for effective collusion and likelihood of countervailing procompetitive effects.

The evolution away from presumptive indicators of anticompetitive effects to more detailed, industry specific analysis continues. The initial screen of concentration

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3/ Kwoka, "The Effect of Market Share Distribution on Industry Performance," 61 Rev. Econ. & Statistics 101 (1979).

4/ Plott, "Industrial Organization Theory and Experimental Economics," 20 J. Econ. Literature 1485 (1982).

statistics is simply that. Indeed, even the analysis of ease of entry and possible efficiencies that might result from a given acquisition do not end the process. As a regular matter, the Commission now evaluates specific scenarios of the increased likelihood of successful collusion or the creation of a dominant firm that might result from a merger. As new predictors of competitive effects are shown to be reliable, no doubt we will adopt them.

Current economic conditions make consideration of foreign competition in merger policy more important than ever. Economic performance in the United States has been improving since 1982, while the inflation rate has declined. One of the consequences of the performance of the U. S. economy has been an increase in the value of the dollar relative to the currencies of our trading partners. As a result, many goods produced in the United States now face greater competition from foreign producers.

Increased competition from abroad has significant implications for merger policy. The potential for anticompetitive consequences from a domestic merger may be reduced or even eliminated in many instances by competition from foreign producers in the domestic market. Moreover, increased competition from foreign firms increases the pressure on American industry to reduce the cost of production.

Both the Department's guidelines and the Commission's statement concerning horizontal mergers, of course, explicitly include competition from abroad in defining geographic markets. Protectionist trade policy and long shipping distances can raise the cost of foreign goods relative to U. S. products sufficiently to allow collusive pricing by American firms. When this happens foreign firms do not exert enough competitive pressure on a particular domestic market to deter significant anticompetitive behavior. Where, however, the presence of foreign competition or potential competition from foreign firms eliminates the likelihood of significant anticompetitive price increases in the United States, a merger should not be challenged.

Let me turn for a moment to entry conditions. As you know, if new producers can enter a market easily and quickly in response to a restriction of output, existing firms in the market are unlikely to restrict output and there is little danger of substantial consumer injury. Absolute barriers to entry are not necessary for a merger to be anticompetitive. If entry takes so long that existing firms have the ability to restrict output profitably for a considerable period of time, significant consumer injury can result.

Ease of entry was the basis of the Commission's decision last summer in the Echlin/Borg-Warner 5/ case. Echlin's acquisition of the automotive-aftermarket operations of Borg-Warner resulted in a firm that held 47% of a highly concentrated market for carburetor kits. Although the concentration figures were high, the Commission found that entry into the market was easy. Production of the kits requires nothing more than obtaining various carburetor parts and assembling them into a

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5/ Echlin Manufacturing Co., FTC Docket No. 9157, 3 Trade Reg. Rep. (CCH) ¶ 22,268 (1985).

package. Five firms had entered the market over the past decade. One entrant, who assembled kits in his home, needed only $500 to get started. Another entrant made its first sale just three months after it decided to enter the market. Because of the ease of entry into the market, it was clear that this merger did not threaten a "substantial lessening of competition."

The majority opinion, written by Commissioner Douglas, uses George Stigler's definition of entry barriers -- "additional long-run costs that must be incurred by an entrant relative to the long-run costs faced by incumbent firms." The opinion goes on to discuss the importance of any impediment to entry "that necessarily delays entry into a market for a significant period of time and thus allows market power to be exercised in the interim." In the Echlin case, even such impediments did not exist. In other cases, however, where entry could not be prevented indefinitely but could be deterred for a considerable period of time, the Commission will oppose the transaction. 6/

We have seen similar results in the Waste Management 7/ and the Calmar 8/ cases. In Waste Management, for example, although the acquisition in question gave Waste Management a 48.8% share of the relevant market, the Second Circuit found that entry was

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6/ E.g., Hospital Corp. of America, FTC Docket No. 9161 (Oct. 25, 1985).

7/ United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984).

8/ United States v. Calmar, Inc., 612 F. Supp. 1298 (D. N.J. 1985).

"so easy that any anti-competitive impact of the merger would be eliminated more quickly by . . . competition than by litigation." 9/

Although the definition and delineation of entry barriers are still matters of some dispute, we have learned a great deal about their effects. The Echlin, Waste Management and Calmar decisions are the only cases of which I am aware in which ease of entry has been held dispositive of liability even though a prima facie statistical case for liability was established. The cases left open some difficult questions that undoubtedly will need to be addressed in the future.

Just how easy must entry be in order to overcome a prima facie showing of anticompetitive effects? What kind of evidence is relevant to show entry conditions? What level of proof is required? How soon must new entry be likely to occur to forestall the threat of anticompetitive restrictions of output? The Echlin opinion raises but does not answer this question.

In analyzing a merger, the Commission also considers the efficiencies that may result. It is now generally recognized that mergers may sometimes permit firms to achieve efficiencies that would be more costly to achieve by other means. Efficiencies from mergers may take many forms. Operating efficiencies can occur when mergers permit firms to take advantage of economies of scale or scope, consolidate production,

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9/ 743 F.2d at 983.

eliminate duplication or excess capacity, or consolidate distribution.

Both the Commission and the Department take efficiencies into consideration in the exercise of their prosecutorial discretion. If there is convincing evidence of significant efficiencies, we may decide not to challenge a merger even though it might otherwise be subject to challenge.

Potential efficiency benefits were a basis for a majority of the Commission's decision to accept the consent agreement in the GM-Toyota case. 10/ This case involved a joint venture, which, of course, was not analyzed in the same way as a horizontal merger would have been. The majority concluded that the potential benefits from the venture -- notably GM's opportunity to learn Japanese manufacturing and management methods -- outweighed any possible anticompetitive concerns. At the same time, by limiting the duration of the joint venture and placing strict controls on the nature of the interaction between the firms, the majority concluded that the potential anticompetitive effects were minimized.

Despite the Commission's 1982 Statement that the "analytical ambiguities" of efficiencies make them inappropriate as a legal defense, the Commission considered an efficiencies defense in the American Medical International case. 11/ The Commission found no

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10/ General Motors Corp., 103 FTC 374 (1984).

11/ FTC Docket No. 9158, 3 Trade Reg. Rep. (CCH) ¶22,170, modified, 3 Trade Reg. Rep. (CCH) ¶22,209 (1984).

substantial evidence of the existence of cost savings and no showing that the efficiencies outweighed the substantial increase in market power. To the best of my knowledge, no litigated decision cites efficiency considerations as a ground for dismissing the case.

My own view is that potential efficiencies can be difficult to measure and to prove. This is the principal reason a number of commentators have opposed the introduction of an efficiencies defense in merger litigation. 12/ In many cases, potential efficiencies could be realized absent acquisition or through a less anticompetitive merger. I believe we have much to explore about efficiencies in the future.

The analysis of mergers is one of the most difficult tasks with which the Commission is charged. Merger policy has changed as our knowledge and understanding of mergers has increased. It is important that we continue to study the issues I have mentioned today. The Commission's Bureau of Economics makes an important contribution in this area. For example, a Commission economist has recently co-authored a paper that describes a method for using historical data to define geographic

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12/ E.g., R. Bork, The Antitrust Paradox 124-29 (1978); R. Posner, Antitrust Law 112 (1976); Fisher & Lande, "Efficiency Considerations in Merger Enforcement," 71 Calif. L. Rev. 1580 (1983). But see IV P. Areeda & D. Turner, Antitrust Law ¶¶ 939-62 (1980); Muris, "The Efficiency Defense Under Section 7 of the Clayton Act," 30 Case W.L. Rev. 381 (1980).

markets. 13/ Others have written on entry conditions 14/ and efficiencies. 15/ Their work contributes immensely to the development of merger analysis.

The purpose of merger enforcement, like that of antitrust enforcement generally, is to preserve a competitive environment. Although the Commission must avoid doing harm by challenging mergers without good reason, it is equally important that the Commission avoid doing harm through neglect of its enforcement responsibilities. As long as there is a Federal Trade Commission antitrust enforcement policy, I believe the Commission will do its best to attain this balance in a responsible manner.

13/ Scheffman & Spiller, "The Delineation of Geographic Markets Under the DOJ Merger Guidelines," Bureau of Economics Working Paper (September, 1985); see also Klein, Rifkin & Uri, "A Note On Defining Geographic Markets," 15 Regional Sci. & Urban Econ. 109 (1985).

14/ Noether, "Effect of Government Policy Changes on the Supply of Physicians," Bureau of Economics Working Paper No. 118 (September, 1984).

15/ Fisher & Lande, "Efficiency Considerations in Merger Enforcement," 71 Calif. L. Rev. 1580 (1983); Fisher, Johnson & Lande, "Mergers, Market Power, and Property Rights: When Will Efficiencies Prevent Price Increases?", Bureau of Economics Working Paper No. 130 (September, 1985).