

11/4/05

**Question: What is the Real and Proper Antitrust Welfare Standard?
Answer: The *True* Consumer Welfare Standard**

Steven C. Salop¹

I. INTRODUCTION

There has been long-standing antitrust controversy regarding the economic welfare standard. This issue may be raised in the discussions at the AMC regarding efficiencies in merger analysis. Some commentators favor the *aggregate economic welfare* standard, (sometimes called the “efficiency” or “total surplus” standard). Other commentators favor what I will refer to as the “*true*” *consumer welfare* standard (sometimes called the “pure consumer welfare” or “consumer surplus” standard). I am using the “true” qualifier because of the confusion that has resulted from Judge Bork’s usage of the term “consumer welfare” in referring to the aggregate welfare standard.²

The aggregate economic welfare standard would condemn conduct if it decreases the aggregate welfare of consumers (i.e., buyers) *plus producers* (i.e., sellers plus competitors), *without regard to any wealth transfers*. In contrast, the true consumer welfare standard would condemn conduct if it actually reduces the welfare of buyers, irrespective of its impact on sellers.³ Efficiency benefits count under the true consumer

¹ Professor of Economics and Law, Georgetown University Law Center. I would like to thank Jonathan Baker, Dennis Carlton, Aaron Edlin, Joe Farrell, James Kearl, Andrew Gavil, John Kirkwood, Robert Lande, Robert Pitofsky and Rick Rule for helpful conversations and comments.

² Robert H. Bork, THE ANTITRUST PARADOX 372-4 (1978).

³ Most analysis of competing welfare goals takes place in a simple framework in which there are firms selling products to final consumers. In this case, the consumers are the buyers and the firms are the sellers. Much economic conduct involves producers at one level selling products that are used as inputs by intermediate sellers, who produce their own products. In that case, the analysis of welfare standards would

welfare standard, but only if there is evidence that enough of the efficiency benefits would be passed-through to consumers so that consumers (i.e., the buyers) would benefit from the conduct.

For example, consider a merger to monopoly that permits the merged firm to reduce costs significantly but also endows the selling firm with the ability and incentive to raise its price above the pre-merger level. That merger would violate the true consumer welfare standard. Even though there are efficiency benefits, consumers are harmed because the cost-savings are not large enough to lead the monopolist to reduce its price, relative to the pre-merger outcome. It cannot simply be assumed that cost savings will lead to consumer benefits.

However, the merger to monopoly would pass muster under the aggregate economic welfare standard if costs were reduced sufficiently to raise the selling firm's profits by more than the higher prices harm the consumers who buy the product.⁴ For example, if conduct raises prices and reduces the welfare of customers by \$100 but increases the profits of the monopolist by \$110 because it enjoys higher prices and costs fall slightly, that conduct would be blessed by the aggregate economic welfare standard but would be condemned by the true consumer welfare standard.

The two standards also differ dramatically in the way that they deal with injury to competitors. The true consumer welfare standard is indifferent to conduct that harms competitors, unless the conduct also likely harms consumers, say by causing prices to

be a partial equilibrium analysis that treats the purchasers as the "consumers" and the sellers as the "producers." To keep the analysis simple, this article generally will focus on products sold to final purchasers. It will refer to the buyers as the "consumers" and the seller as the "firm."

⁴ This is the standard Williamson-diagram trade-off. Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968).

rise. In contrast, the aggregate welfare standard is equally concerned with the harm to competitors as it is to the benefits or harms to consumers and the defendant firm. This is because consumers, the defendant and competitors all contribute equally to *aggregate* welfare.⁵ This is another key difference between the two standards.

This article will discuss the differences between the two welfare standards from both a positive (i.e., descriptive) and a normative viewpoint. The positive analysis reviews the evidence the standard adopted by the Congress in the Sherman Act and currently used by the antitrust agencies and the courts is the true consumer welfare standard. The normative analysis explains why the true consumer welfare standard is the better standard for achieving the goals of the antitrust laws.

II. POSITIVE ANALYSIS

Professor Robert Lande provides evidence that Congress focused on true consumer welfare, not aggregate welfare or efficiency by analyzing the legislative history of the Sherman Act, including Senator Sherman's characterization of monopoly overcharges as "extorted wealth."⁶ Most commentators agree.⁷ Indeed, even Judge Frank Easterbrook appears to agree:

The choice [Congress] saw was between leaving consumers at the mercy of trusts and authorizing the judges to protect consumers. However you slice the legislative history, the

⁵ Of course, to the extent that the harms to the competitors are offset by gains to the defendant firm, then those offsetting effects would wash out. This issue is explored in more detail in subsequent examples, including situations where the firms have different costs.

⁶ Robert H. Lande, *Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust*, 58 Antitrust Law Journal 631, n. 27 (1989). More generally, see Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: the Efficiency Interpretation Challenged*, 34 Hastings L.J. 65, 74-77 (1982).

⁷ Robert H. Lande, *Proving the Obvious: The Antitrust Laws Were Passed to Protect Consumers (not Just to Increase Efficiency)*, 50 Hastings L.R. 959, 963-66 (1999) ("citing over twenty scholars who agree with the wealth transfer thesis").

dominant theme is the protection of consumers from overcharges.⁸

Many courts and the federal enforcement agencies today appear to have opted for the true consumer welfare standard.⁹ This can be seen by examining a number of specific antitrust issues.

A. Substantive Merger Standard

The Merger Guidelines promulgated by the FTC and DOJ are explicit that mergers that raise prices generally would lead to enforcement irrespective of their impact on the costs of the merging firms.¹⁰ Cost savings can save a merger even in a highly concentrated market, but only if they are passed-through sufficiently that prices do not rise. Several merger opinions also explicitly use a test that focuses on the price impact of the merger.¹¹

B. Horizontal Restraints

⁸ Frank Easterbrook, *Workable Antitrust Policy*, 84 Michigan L.R. 1696, 1702-3 (1986)

⁹ John Kirkwood, *Consumers, Economics and Antitrust*, 21 Research in Law and Economics 1 (2004). Kirkwood's survey results are underestimates how widespread the usage of the true consumer welfare standard is because he did not also use findings that higher prices and reduced restrictions are *sufficient* for antitrust liability as evidence that the court was applying the true consumer welfare standard.

¹⁰ Federal Trade Commission and Department of Justice, Horizontal Merger Guidelines § 4 (rev. ed. 1997), reprinted in 4 Trade Reg. Rep. (CCH) § 13,104 (Apr. 8, 1997). However, Guidelines include a footnote that the agency in its prosecutorial discretion may in rare cases consider "inextricably linked" efficiencies outside the relevant market, when these benefits "are great and the likely anticompetitive effect in the relevant market(s) is small." *Id.* at n.36. The general thrust of the Guidelines is to require price pass-through of efficiencies. The Guidelines do include a footnote that would permit the agencies to count (albeit on a discounted basis) cost-savings with no short-term, direct effect on prices but that reduce prices in the longer run. However, this footnote relates to the timing of consumer benefits, not whether consumers are expected to benefit at all. *Id.* at n.37.

¹¹ For example, see *FTC v. University Health, Inc.* 938 F.2d 1206 (11th Cir. 1991); *See also United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121, 149 (E.D.N.Y. 1997) (finding that efficiencies will benefit consumers because merged hospitals will "pass on cost savings"); *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997).

Support for the true consumer standard is indicated by the general focus in *NCAA* and elsewhere on the “price and output” effects of allegedly anticompetitive conduct.¹² Increased price and reduced output generally are sufficient to conclude that purchasers are harmed and that the conduct is anticompetitive. This is consistent with the true consumer welfare standard. In contrast, this factual finding would not be sufficient to conclude that aggregate welfare has fallen. The relevant inquiry would also have to consider whether the conduct sufficiently reduces costs.

For example, suppose that a group of sellers undertakes some joint conduct that reduces their fixed costs by \$1 while simultaneously and inextricably also raising their prices by \$10. Suppose that output does not fall because demand is *perfectly inelastic* in the relevant range.¹³ In this case, true consumer welfare would fall while producer welfare would rise by \$1 more than the consumer loss, so that aggregate economic welfare would rise on balance (i.e., by \$1). It is unlikely that a court or antitrust enforcement agency would permit the fixed cost-savings of the producers (and the resulting increase in aggregate economic welfare) to trump the direct consumer harm.¹⁴

¹² As the Court stated in *NCAA*, “[r]estrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit.” *NCAA v. Board of Regents of the Univ. of Oklahoma*, 468 U.S. 85 (1984)

¹³ If a naked seller-side cartel increases the price of a product with perfectly inelastic demand over a significant price range, so that there is no output restriction, then there is no reduction in aggregate economic welfare. When demand is perfectly inelastic, there is no deadweight loss in consumer surplus. The cartelization simply expropriates wealth from consumers and transfers it to the members of the cartel.

¹⁴ One can imagine the story in the *Wall Street Journal*. “The FTC announced today that it will not challenge a proposed joint venture of the only 5 producers of type-ZZ insulin. A study by the Commission’s Bureau of Economics found that the joint venture will enable the producers to reduce their manufacturing costs by 1%. The Economics study also found that by selling type-ZZ insulin through the joint venture, costs will be reduced by an additional 1%. The study further found that the producers plan to triple the price of type-ZZ insulin. However, in the opinion of the Commission’s economists, this price increase will not reduce the usage of type-ZZ insulin at all because users would die quickly without the drug. Therefore, the Commission concluded, society as a whole will be better off by permitting the joint venture. The stockholders of the drug companies in the venture will gain more than vaccine customers will lose. In the Commission’s view, Section 5 of the FTC Act should not be used to prevent such efficient joint ventures despite these price increases.”

C. Predatory Pricing

The Supreme Court's opinion in *Brooke Group* is more consistent with the true consumer welfare standard than the aggregate welfare standard. Under the test embraced by the Court, predatory pricing consists of (1) pricing below some appropriate measure of cost, and (2) a probability of recoupment. Recoupment can only occur if, following the period of below cost pricing, prices are increased sufficiently above the competitive level for long enough that the losses incurred during the period of below cost prices are recouped, and then some.

Under the aggregate economic welfare standard, pricing below marginal cost would be condemned without more because it is inefficient – regardless of the possibilities for recoupment. In explaining why a finding of below-cost pricing is not sufficient for liability without more, the Court focused on the impact on consumers, not efficiency, which is what led it to embrace a recoupment requirement:

Without [recoupment], predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its costs, unsuccessful predation is in general a boon to consumers.¹⁵

Hence, according to the Court, conduct that increases consumer surplus is not a violation of the antitrust laws, even if it diminishes producer surplus. However, the converse is not true. Conduct that results in long-term consumer harm owing to the exercise of market power – i.e. recoupment – constitutes a violation regardless of the gains realized by the producer. This result illustrates the Court's use of a true consumer welfare standard.

¹⁵ *Brooke Group Ltd. V. Brown and Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993).

D. Concerted Monopsony Conduct

The famous *Kartell*¹⁶ opinion written by Judge (now Justice) Breyer provides an analysis of a buyer-side “cartel” comprised of final consumers and their agent that also is consistent with the true consumer welfare standard, not the aggregate economic welfare standard.¹⁷ Buyer-side cartels are inefficient and reduce aggregate economic welfare because they reduce output below the competitive level. Thus, monopsony by a buyer cartel of intermediate re-sellers would reduce both true consumer welfare and aggregate welfare. However, a buyer-side cartel comprised of *final consumers* raises true consumer welfare (i.e., consumer surplus) because their gains accruing from the lower price outweigh their losses from the associated output reduction, even as the conduct reduces total welfare (i.e., total surplus).¹⁸

Judge Breyer’s opinion treats Blue Cross as a single buyer assumed to have legitimate monopsony power in the purchase of medical services. Blue Cross also had potential market power in the sale of insurance in Massachusetts. However, Judge Breyer viewed Blue Cross essentially as an *agent* for the customers it insured, rather than as an intermediary firm that purchased inputs and sold output as a monopolistic re-seller.

¹⁶ *Kartell v. Blue Shield of Massachusetts, Inc.*, 749 F.2d 922 (1st Cir. 1984).

¹⁷ This discussion of *Kartell* draws from Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 *Antitrust Law Journal* 669 (2004).

¹⁸ In contrast, a buyer-side cartel of intermediate firms reduces both consumer and aggregate welfare because the cartel restricts input purchases, which leads to less output downstream and higher prices paid for the product by the final consumers over time. For example, consider a cartel of tobacco companies that reduces the wholesale price its members pay to tobacco farmers for a number of years. The reduced supply of tobacco over time that would result from this cartel will increase the retail price of tobacco products sold to consumers by these firms, even if the firms do not collude in the retail market. Both the tobacco farmers and consumers of tobacco products would be harmed.

The court apparently assumed that Blue Cross would pass on its lower input costs to its customers in the form of lower insurance premiums.¹⁹

This interpretation implies that Judge Breyer and the court were concerned with consumer welfare, not efficiency or aggregate economic welfare. In permitting Blue Cross to achieve and exercise monopsony power by aggregating the underlying consumer demands for medical care – i.e., permitting Blue Cross to act as the agent for final consumers - the *Kartell* court implicitly opted for the true consumer welfare standard. Blue Cross's assumed monopsony conduct on behalf of its subscribers would lead to higher welfare for its subscribers despite lower efficiency and aggregate economic welfare. Thus, this result represents a clear (if only implicit) judicial preference for the true consumer welfare standard rather than the aggregate economic welfare standard.

E. Harm to Competitors

The antitrust analysis of competitor harm from merger and exclusionary conduct also is more consistent with the consumer welfare standard. Numerous courts have said that it is not enough for the plaintiff simply to prove injury to competitors.²⁰ The plaintiff must also show injury to competition, which generally is interpreted as referring to consumer harm. Under the aggregate economic welfare standard, substantial harm to competitors could lead to liability. Competitor injury would be a cognizable harm, independent of the harm to consumers. Indeed, under the aggregate welfare standard, harm to competitors would be given the same weight as benefits to consumers and the

¹⁹ The regulatory structure imposed on Blue Cross in Massachusetts could have prevented consumer harm from the monopsony conduct. Peter J. Hammer & William M. Sage, *Monopsony as an Agency and Regulatory Problem in Health Care*, 71 Antitrust L.J. 949 (2004).

²⁰ According to Kirkwood, *supra* note __ at 31, there were 133 decisions that reiterated this proposition in the 1998-2002 time period.

defendant— all three would be assessed. This is because when economists add consumer and producer surplus, they implicitly assume that a dollar has the same social weight when given to producers (either the defendant or its competitors) as when the dollar is given to consumers and, therefore, that a pure transfer of a dollar from one to the other has no welfare consequences. As a result, harm to competitors actually could be used to trump consumer benefits.²¹

For example, consider the following hypothetical merger that leads to competitor harm. Suppose that in the pre-merger market for a differentiated product, there is a low cost dominant firm with a 90% market share and two high cost competitors, each with a 5% market share. Suppose that the two small firms propose to merge. Suppose that the uncontested facts are that the merger will significantly reduce the merging firms' costs, cause prices to fall by 10%, and permit the merging firms to increase their combined market share from 10% to 30%. This merger would be a boon to consumers. However, it could reduce aggregate welfare because it would lead to higher overall production costs as the lower cost dominant firm loses sales to its higher cost competitor. Under the aggregate welfare standard, the merger could be condemned on those grounds, despite the benefits to consumers.²²

²¹ As noted earlier, if the harms to the competitors are offset by gains to the defendant firm, then those offsetting effects would wash out. However, this may not be the case if the firms' costs differ or their total output is not constant.

²² To illustrate this analysis, suppose that the pre-merger price were \$100, the dominant firm's production cost is \$10 per unit and the merging firms' costs each are \$60 per unit. Suppose that the products are differentiated so that the merging firms could survive in the market despite its higher costs. Suppose further that the merger reduces the costs of the merging firms to \$50 and they increase their output from 10 units to 30 units, while the dominant firm's output falls from 90 units to 70 units. (This assumes for simplicity that the total quantity demanded is fixed at 100 units, though this assumption could easily be relaxed.) On these facts, consumers gain \$1000 (i.e., \$10 x 100 units) in consumer surplus. However, with perfectly inelastic demand, this is a pure transfer from the firms to consumers and so this impact is given no weight in the aggregate welfare standard. The aggregate cost of production is increased. This represents the balance between two opposing effects. On the one hand, the merging firms' costs of producing the 10

Antitrust liability under the Sherman Act places no weight on competitor injury unless it is a building block to showing or inferring consumer injury.²³ For example, in the *Brunswick* case, the Court denied standing to a competitor that complained about the injury it suffered from a merger that resulted in increased competition and lower profits.²⁴ The Court observed that the claimed damages were designed to award the plaintiffs “the profits they would have realized had competition been reduced.” The Court pointed out that it would be “inimical to the purposes” of the antitrust laws to award such damages. Antitrust laws were enacted for “the protection of competition, not competitors.”²⁵ The cognizable harm that flows from a horizontal merger would be higher prices, something that would have benefited a rival.

This point obviously does not apply simply to mergers. Suppose that a high cost entrant were to enter a market served by low cost monopolist. Suppose that the entry would cause prices to fall but would raise total production costs by diverting production to the less efficient entrant. Suppose that the monopolist engages in some type of exclusionary conduct to keep the entrant out of the market (e.g., naked exclusionary agreements with key input suppliers to withhold inputs that the entrant needs; fraud on the patent office; deceptive advertising; sham litigation; etc.) Under the true consumer welfare standard, this conduct would be illegal if it prevented prices from falling. But under the aggregate welfare standard, it could be defended on the grounds that it prevents

units they previously produced falls by \$10 per unit for a total efficiency gain of \$100. On the other hand, an additional 20 units will be produced by the high-cost merged firm rather than the low-cost dominant firm, which entails an efficiency loss of \$ 800 (i.e., \$40 cost difference x 20 units). Thus, aggregate welfare falls in total by \$700 (i.e., \$800 - \$100). Under the aggregate welfare standard, this merger thus would be prohibited under the antitrust laws, despite the consumer benefits.

²³ The Robinson-Patman Act is different..

²⁴ *Brunswick Corporation v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977)

²⁵ *Id.*

a decrease in efficiency that more than offsets any decrease in the deadweight loss in consumer surplus. Under the aggregate welfare standard, the consumer benefits simply accruing from paying a lower price on volume that would have been purchased at a higher price do not count as a social benefit because they are just a transfer of wealth from the monopolist to consumers.

Similarly, business torts that have no impact on prices or quantities but harm one competitor at the expense of another competitor would be actionable under the aggregate welfare standard. The victim would simply need to show that its injury is larger than the gain to the other firm. In fact, if there were a consumer gain from the conduct, that gain would not be sufficient to save the conduct if the victim suffered more than the gains to the other producer and consumers.²⁶

These examples illustrate the fact that aggregate economic welfare standard is inconsistent with the view that antitrust laws should be for the protection of consumers,

²⁶ This can be illustrated with a numerical example. Suppose that a dominant firm engages in conduct that raises its profits by \$100, increases the welfare of purchasers by \$170 and reduces the profits of competitors by \$720. That conduct would be permitted by the true consumer welfare standard because consumers are benefited. However, it would be condemned by the aggregate welfare standard because total welfare falls by \$450 (i.e., $\$100 + \$170 - \$720$). To illustrate how these numbers might arise in market situation, suppose that the dominant firm invests in a better mousetrap. Suppose that 90% of its lifetime sales are to customers diverted away from its rivals, customers who are attracted to the higher quality (say, at the same price). The aggregate welfare benefits of this innovation over its lifetime could be less than the profits of the innovator plus the gains to consumers. That net benefit would need to be reduced by the reduction in the profits of the competitors who lose out. It could easily be true that this adjustment would mean that the remaining net aggregate benefits of the innovation fall short of the cost. Suppose that the better mousetrap costs \$1,000 for design and fixed costs over its lifetime. The innovator earns \$11 profit on each of 100 units sold over the lifetime of the design, producing an operating profit equal to \$1,100. After subtracting the design and fixed costs, the dominant firm's net profits rise by \$100. Suppose that the new mousetrap increases consumer welfare by \$1 per unit for consumers who switch to the better mousetrap and gives new users consumer surplus of \$8 per unit. In this case, the 90 consumers that switch from the old mousetrap to the new one get aggregate benefits of \$90 and the 10 new customers get aggregate benefits of \$80 (i.e., 10 times \$8), for a lifetime total of \$170 (i.e., $\$90 + \80). Suppose that the displaced competitors lose the profits of, say, \$8 per unit they were making on the 90 units they had been making but that are now diverted over the lifetime of the design. This leads to a reduction in their lifetime profits of \$720. Thus, the net benefit of the innovation is negative, $-\$450$ (i.e. $\$100 + \$170 - \$720$). Thus, this better mousetrap would not pass muster once the competitor losses are taken into account. This is a common result in oligopolies. See A. Michael Spence, *Product Selection, Fixed Costs and Monopolistic Competition*, 43 REV. ECON. STUDIES 217 (1976).

not competitors. The aggregate economic welfare standard places the same welfare weight on competitor injury as it places on consumer gains. This is not the current law.

Treating competitor harm as sufficient for antitrust liability would represent a major change to modern antitrust doctrine. It does not appear to be favored even by proponents of the aggregate welfare standard. Moreover, as discussed below in the normative analysis, the overarching policy goals of antitrust law would not be served by this standard.

F. Potential Confusion By Judge Bork and Others

This analysis of competitor harm also suggests that there is confusion over the meaning of the aggregate welfare standard. It is unfathomable that Judge Bork would have wanted to count their lost profits, since doing so would incorporate protection of competitors (even less efficient competitors) explicitly into the overarching welfare goal of antitrust. Counting any harm to these rivals as sufficient for antitrust liability would be in total conflict with Judge Bork's view that antitrust should focus on the injury to competition, not injury to competitors.

The Supreme Court has stated that antitrust is a "consumer welfare prescription" and cited Judge Bork's book in doing so.²⁷ In light of the general difficulty that courts have with economic terms, let alone diagrams such as the Williamson Diagram reproduced in the book, it is not clear that the Court understood that Judge Bork was re-defining the term "consumer welfare" to mean something very different.²⁸ For example, Judge Wald explained the context in which the Court used the phrase as follows.

²⁷ *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979); ROBERT H. BORK, *THE ANTITRUST PARADOX* 66 (1978)

²⁸ Judge Bork's and others' use of this terminology is inherently confusing. To illustrate, consider the confusion that the use of the term "consumers" might engender when "consumers" sometimes is taken to

There, the Court was asked to decide whether consumers who purchase goods for their own use have standing to sue under section 4 of the Clayton Act. It is thus hardly surprising that the Court answered the question by saying that the floor debates suggest that Congress designed the Sherman Act as a "consumer welfare prescription." Moreover, even if one thinks that the Court intended to exclude all other considerations, the phrase "consumer welfare" surely includes far more than simple economic efficiency.²⁹

Judge Bork's possible motivation for creating confusion also is unclear. Some have suggested that he was intending to deceive uninformed readers who would not understand the Williamson diagram in his book or the distinction.³⁰ However, in light of the fact that the aggregate welfare standard is inconsistent with Judge Bork's position that harm to competitors should not form the basis for a finding of antitrust liability, perhaps even he did not fully understand the implications of his proposal.

III. NORMATIVE ANALYSIS

The analysis in the previous section was descriptive. It focused on what courts and agencies do today. That analysis supported the view that current practice utilizes the true consumer welfare standard, not the aggregate economic welfare standard. Similarly, one might argue that the legislative history, including the characterization of monopoly overcharges as "extorted wealth," demonstrates that Congress has already put the

mean "consumers plus shareholders of all the firms" in the explanation of the aggregate welfare standard: "As long as a business arrangement does not shrink the size of the consumer's share more than it increases total wealth, consumers as a whole are better off." Charles F. Rule and David L. Meyer, *An Antitrust Enforcement Policy to Maximize the Economic Wealth of All Consumers*, 33 *Antitrust Bulletin* 677, 686 (1988).

²⁹ *Rothery Storage & Van Co. v Atlas Van Lines, Inc.*, 792 F.2d 210, 231 (n.3) (citations omitted).

³⁰ For example, see Lande, *supra* note __ at 638 ("Bork's brilliant but deceptive choice of the term 'consumer welfare' as his talisman, instead of a more honest term like 'total welfare,' 'total utility,' or just plain 'total economic efficiency.'"). See also Herbert Hovenkamp, *ECONOMICS AND FEDERAL ANTITRUST LAW* 49 (1985) ("more than a little chicanery in such terminology").

normative issue to rest. Congress arguably carried out the normative analysis and made the normative decision during that legislative process.

However, this conclusion would not settle the normative issue with respect to the future. A critic could argue that current usage is misguided and that antitrust law instead should adopt the aggregate welfare standard. Congress could choose to revisit the issue and amend the legislation. Therefore, additional policy analysis to determine the better standard remains useful.

A. Economics and Antitrust Policy

It is sometimes suggested that *economics* favors the aggregate welfare standard. As with many issues, economic analysis is more complicated and involves trade offs. On the one hand, economic efficiency is a desirable economic goal because it does not waste resources. The economic efficiency goal is reflected in the aggregate welfare standard, which is concerned with total wealth. On the other hand, much economic analysis is premised on a different efficiency notion that flows from the concept of Pareto Optimality and that I will refer to as “Pareto efficiency.” Pareto efficiency is a desirable goal because it ensures that changes in economic outcomes caused by the conduct of firms does not reduce the welfare of some members of society as it raises the welfare of others. The Pareto efficiency goal is reflected in the concern with distributional effects between buyers and sellers captured by the true consumer welfare standard. That standard ensures that consumers as a group are not harmed by conduct that benefits the defendant firms.

Both Pareto efficiency and maximum aggregate welfare could be achieved if redistribution of wealth were costless and if it were carried out as a matter of course.

Society could achieve efficiency and then ensure that everyone would share in the efficiency benefits by redistributing some the gains to those who otherwise would be harmed by the conduct. However, when redistribution is costly and is not carried out, then there is a potential conflict between these two goals. Thus, it is not true that *economics* can be said to support the aggregate welfare standard.

1. Competition and Dynamic Cost Pass-Through

Even without redistribution, proponents of the aggregate welfare standard might argue that there is no conflict between efficiency and Pareto efficiency because efficiencies are always passed-through fully to consumers. According to this view, adopting a standard that sacrifices wealth to improve short run consumer welfare would be myopic. This is because, it is argued, markets are dynamic and the cost savings of today will lead to increased consumer wealth tomorrow. The cost savings will increase innovation competition that leads to diffusion of the cost savings to rivals. As a consequence, diffusion will cause price competition to intensify over time, causing prices to fall and consumer welfare to increase in the long run.

It is true that efficiency improvements may diffuse to rivals to some extent through both imitation of the technological improvements and emulation of the innovative efforts. Such diffusion would increase competition over time to some extent, depending on the speed and completeness of the diffusion process. In fact, if diffusion of merger-specific cost decreases were instantaneously and totally diffused to every competitor, so that costs fell equally for all competitors, then maximization of static

aggregate welfare would roughly approximate maximization of long run consumer welfare.³¹

However, for two important practical reasons, this analysis does not support use of the aggregate welfare standard. First, the diffusion of innovations through imitation and emulation is neither instantaneous nor complete. Even in the best circumstances, there are substantial delays and innovations generally are only partially matched. Indeed, if a firm expected that its costly innovations would be matched instantly and completely, this competition might so reduce the expected profitability of the investments that the firm would not choose to undertake the investments. Second, rapid and complete diffusion that leads to increased price competition obviously is even less likely in markets in which there are barriers to entry. To take an extreme example, consider a merger to monopoly in a market with entry barriers. More generally, the existence of barriers to entry is necessary for there to be a finding of antitrust liability, which implies that diffusion would not be expected to occur precisely where it is most needed to prevent consumer harm. Moreover, there is no empirical evidence that shows that innovations are rapidly imitated or emulated in such markets. Thus, in these markets, society cannot count on the diffusion process to cause cost reductions to be rapidly passed-through to consumers in the form of lower prices and sufficiently higher product quality. As a result, analysis of innovation and dynamic markets does not justify adoption of the aggregate welfare standard.

2. The Costs of Wealth Redistribution

³¹ See Gary L. Roberts and Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, 19 World Competition 4 (1996).

Some proponents of the aggregate welfare standard might argue that society should be indifferent to income and wealth distribution. Other proponents argue that the wealth transfers from consumers to producers may be a social concern, but antitrust law nonetheless should ignore to them. They argue that tax policy implemented by the IRS is a better institution for dealing with such wealth transfers.³²

However, this argument is flawed for a number of reasons. First, to state the obvious, neutralizing the effects of anticompetitive conduct on profits and consumer wealth is not currently carried out by the IRS. Nor do welfare agencies at the federal or state level take this type of merger impact into account.³³

Second, neutralizing these effects would not be easy. It makes no sense to assume that the tax system is immune from significant transactions costs. Neutralization of wealth transfers would face the usual transactions cost inefficiencies inherent in all taxation. Moreover, there would be enormous transactions costs placed on the IRS if it tried to neutralize these transfers with special competition taxes and deductions on a case-by-case basis. The IRS would need to evaluate anticompetitive effects of conduct after the fact. This process obviously would involve very high costs and would be an extremely difficult task. In addition, the benefited firms or individuals would have the incentive to undertake costly (and inefficient) actions to reduce their tax liability. Because the transactions costs of neutralizing these wealth transfers are so high, it does not make economic sense to formulate an antitrust law under the opposite assumption.

³² For example, see Louis Kaplow & Steven Shavell, *FAIRNESS VERSUS EFFICIENCY* (2002).

³³ For some areas of the law (e.g., corporate law), it is argued the distributional gains and losses of the affected parties tend to wash out over the long run and so can be ignored. This outcome would not be achieved for antitrust law. Although the losses from anticompetitive conduct are broadly felt, there are systematic and more concentrated beneficiaries from anticompetitive conduct – dominant firms with durable monopoly power and firms in tight oligopolies protected by barriers to entry. Moreover, stock ownership in the U.S. economy is not distributed uniformly among its citizens.

3. *Restructuring Transactions to Prevent Consumer Harm*

There are a number of reasons to think that it is unlikely that in practice there would be substantial inefficiencies caused by use of the true consumer welfare standard. Firms would be able to restructure transactions to prevent coerced transfers without substantially reducing total wealth. This is because enforcement policy under the aggregate welfare standard in practice generally would not lead to firms to *maximize* aggregate welfare, but only would prevent them from reducing aggregate welfare below the pre-transaction level.

Wealth-creating activities can be and are combined with activities that transfer wealth from consumers at the same time that they reduce the degree of wealth-creation. Although the wealth-transfer and the wealth-creation effects are not inextricably linked in reality, they may appear to be so to imperfectly informed antitrust enforcers and courts. In addition, antitrust enforcers and courts may not even inquire into the relationship. They may treat careful comparisons to such “less restrictive alternatives” as beyond their purview.

For example, suppose that a group of firms faces a choice between the following two alternative joint ventures structures, both of which are feasible and profitable. One structure would reduce their costs by 10% (relative to no JV) and would involve ongoing intense competition among the participants, so that prices would *fall* by 5% (relative to no JV). Another structure would reduce their costs by 12% but would not involve so much competition, so that prices would *rise* by 5% (relative to no JV). The joint venture clearly would prefer the second structure because it would be more profitable. But consumers clearly would prefer the first structure.

If the true consumer welfare standard were the law, the second structure would not be permissible and the joint venture would be forced to adopt the first structure. This is because the second structure reduces consumer welfare, relative to no JV. The fact that the second structure permits the JV to reduce costs by 12% (as opposed to 10% in the first structure) would not be a permissible defense if the cost-savings do not lead to lower prices paid by consumers (or sufficient quality improvements).

However, suppose instead that the antitrust standard were aggregate economic welfare. Moreover, suppose that aggregate welfare is higher with the first structure. In this situation, there is a real question of whether the court would be willing or able to make the comparison to “less restrictive alternatives” if the proposed structure raises aggregate welfare. Many courts might conclude that this type of comparison to less restrictive alternatives is beyond the proper scope of antitrust enforcement. The court might conclude the second structure is permissible simply on the grounds that it does not reduce aggregate welfare, *relative to no JV*. If this were the case, then the second structure would be permitted despite the fact that both consumer and aggregate welfare are higher with the first structure. In this situation, adopting the true consumer welfare standard would not lead to a reduction in wealth. Instead, both consumer welfare and total wealth would be higher.³⁴

Permitting the comparison to less restrictive alternatives raises welfare. But, many commentators would argue that this more intrusive analysis should be foregone. They would argue that searching for the “first-best” structure is a “nirvana-complex” and beyond the capabilities of generalist courts. If that less intrusive approach is taken, then

³⁴ For a similar analysis, see Sven-Olof Fridolfsson, *A Consumer Surplus Defense in Merger Control* (Working Paper, February 2002)

the second structure would be permitted despite the fact that the first structure offers a higher level of aggregate welfare and the second structure reduces consumer welfare.³⁵

Even if the court were willing to compare the second structure to such less restrictive alternatives, the plaintiff would have to prove that the first structure is feasible, practical and generates sufficient profits for the venture to be willing to adopt that first structure if the second type were enjoined. It might be difficult in practice for the plaintiff adequately to demonstrate these facts. Determining these characteristics with sufficient confidence might be quite difficult unless the joint venture's own documents revealed the details. And, one might expect a well-counseled venture to avoid leaving such a paper trail. Of course, it would be far easier for a court to determine whether a particular JV structure raises or lowers consumer welfare.

Thus, in this type of situation, it would be more efficient to put the burden on the firms to choose a structure that does not harm consumers. The true consumer welfare standard would serve as a disincentive that redirects the firms to choose a structure that

³⁵ This same analysis could be illustrated in the context of a horizontal merger. Suppose that a supermarket chain acquires a significant rival that has 100 stores that overlap geographically. Suppose that there are cognizable efficiency benefits from the merger that are proportional to the number of stores acquired. However, suppose that the merger also raises market power risks that rise disproportionately with the number of stores acquired. To make this concrete, suppose that the acquisition of all 100 stores reduces both consumer welfare and aggregate welfare. Suppose that aggregate welfare would not be reduced if the firm were required to divest 5 stores and aggregate welfare would be maximized if the firm were required to divest 20 stores. Suppose that consumer welfare would not be reduced if the firm were required to divest at least 25 stores and consumer welfare would be maximized if the firm were required to divest 30 stores. Based on these numbers, if the court would require *maximization* of the relevant welfare standard, the required divestiture would be 20 stores under the aggregate welfare standard and 30 stores under the consumer welfare standard. However, if the court permitted any merger that did not reduce welfare, the required divestitures would be 5 stores under the aggregate welfare standard and 25 stores under the consumer welfare standard. In this example, the use of the more permissive version of the consumer welfare standard would end up leading to a higher level of aggregate welfare than would the more permissive version of the aggregate welfare standard. This is because the efficiencies are proportional to the number of stores.

avoids the coerced transfer and any need for neutralizing tax policy.³⁶ Even when a practical way of restructuring the venture is not apparent to the antitrust agencies, the firms will have better information about their real choices. In doing so, consumer welfare would rise and aggregate welfare often would be increased or hardly decreased.

Even if the venture cannot be restructured without a significant loss in efficiency, consumer harm often may be avoided by requiring the firms to make other commitments to offset the coerced wealth transfer. These commitments might involve divestitures that would increase competition in the relevant market or in an adjacent market that is patronized by the same customers. Or, the firms could make other long term contractual commitments to customers that are efficient. For example, suppose that defendant firm agreed to a remedy in which it licenses certain technology at a below-market royalty rate. Since the marginal cost of a license is zero, there would be no efficiency losses from such a remedy.

Fourth, several commentators have made the related point that enforcement standards should place more weight on consumer interests than producer interests (e.g., mandate the true consumer welfare standard), *even if aggregate welfare were taken to be the overarching goal of antitrust.*³⁷ The rationale for adopting a legal standard that

³⁶ Even with the true consumer welfare standard, in current practice, it is unlikely that the joint venture would be forced to choose the structure that *maximizes* the welfare of consumers. Unless forced by the antitrust authorities, the joint venture would have the incentive to choose the structure that maximizes the owners' profits, subject only to the constraint that consumer welfare does not decline. As discussed in the text, comparisons to "less restrictive alternatives" generally are quite limited, if carried out at all. See [U.S. Dep't of Justice & Federal Trade Comm'n.](#) Antitrust Guidelines for Collaborations Among Competitors (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>

³⁷ See David Besanko and Daniel F. Spulber, *Contested Mergers and Antitrust Policy*, 9 J. L. ECON. & ORG. 1 (1993); Sven-Olof Fridolfsson, *supra* note __; Joseph Farrell, Negotiation and Merger Remedies: Some Problems, in Francois Leveque and Howard Shelanski (eds.), *MERGER REMEDIES IN AMERICAN AND EUROPEAN COMPETITION LAW* 95 (2004). Damien J. Neven and Lars-Hendrik Röller, *Consumer Surplus vs. Welfare Standard in a Political Economy Model of Merger Control* (Working Paper, December 2003) have a similar analysis that focuses on lobbying by the parties and competitors.

differs from the overarching welfare goal relies on the fact that agencies and courts generally are not perfectly informed about the economic impact of the proposed conduct (e.g., merger or joint venture) and interact with the parties in a quasi-regulatory or judicial proceeding. In this situation, if the consumer welfare standard is mandated, a few mergers that increase aggregate welfare might be rejected. However, in many other cases, the parties would have the incentive to propose mergers that increase aggregate welfare, relative to what they would propose if the aggregate welfare standard were used instead. Thus, on average, use of the consumer welfare standard would lead to higher average level of aggregate welfare.

4. Harm to Competitors and the Complexity of the Aggregate Welfare Standard

Finally, there is also the key normative problem that the aggregate economic welfare standard explicitly counts harm to competitors as a cognizable harm and that harm could trump consumer benefits in a particular case. As discussed previously, Judge Bork championed the idea that antitrust should be indifferent to harm to competitors and rather should focus solely on harm to consumers (i.e., harm to competition). Judge Easterbrook similarly is very skeptical on normative grounds of permitting suits by competitors.³⁸ It is not clear why antitrust policy would be served by permitting competitor injury to be sufficient to find an antitrust violation in situations where customers are benefited by the conduct.

The need to measure and compare benefits and harms to competitors, the defendant firm and consumers also means that the aggregate welfare standard is more

See also Jonathan B. Baker, *Competition Policy as a Political Bargain*, __ Antitrust L.J. __ (2006) (forthcoming) for a political economy approach to this same issue.

³⁸ Frank H. Easterbrook, *The Limits of Antitrust*, 63 Texas L.R. 1 (1984).

complicated to implement than the true consumer welfare standard.³⁹ This comparison might be quite difficult in practice. In contrast, the true consumer welfare standard would only require that the impact on consumers be gauged.⁴⁰ Efficiency benefits and harms would be taken into the balance, but only by evaluating their net impact on consumers. This single-minded focus on consumers makes the true consumer welfare standard easier to implement, leads to fewer errors and comprises a more coherent set of rules.⁴¹ This is also a reason to favor the true consumer welfare standard.

B. Tort Law and Antitrust

Antitrust violations are sometimes seen as torts because they involve avoidable conduct by one party that harms other parties. The difference between the two antitrust welfare standards can be illustrated in the tort law context. As explained by Professor Lande at an ABA Panel on this issue in which Mr. Rule was a fellow panelist, the two standards analyze theft differently.

[A]ssume that I walked over to Mr. Rule and stole his wallet. Why would this be bad? The Chicagoist answer is that it would be inefficient for me to steal his wallet. I certainly agree that this would be inefficient, but inefficiency is not the reason we prohibit theft. We prohibit theft for a simpler, more fundamental reason. After we define a property right--in this case, after we determine that

³⁹ The analysis of the aggregate economic welfare standard would be even more complicated if some profits potentially are dissipated into inefficient conduct designed to erect barriers to entry, what is sometimes referred to as “rent-seeking.” For example, see Richard Posner, *The Social Costs of Monopoly and Regulation*, 83 *J. Political Economy* 807 (1975).

⁴⁰ This raises the question of how antitrust should deal with conduct that benefits some consumers and harms others. Antitrust law at least since *Philadelphia National Bank* has been reluctant to engage in explicit cross-market balancing. *U.S. v. Philadelphia National Bank*, 374 U.S. 321. One reason is that such balancing would, of course, increase the complexity of the analysis by encompassing other relevant markets. However, analysis of this issue is beyond the scope of this short article.

⁴¹ For example, in criticizing standards that incorporate non-economic concerns, Rule and Meyer argue that a standard is better if it is a “single, coherent, and objectively verifiable standard.” Rule and Meyer, *supra* note __ at 694. They prefer a standard that “focuses on a single economic goal.” *Id.* at 695. The true consumer welfare standard performs better than the aggregate welfare standard on these dimensions.

the wallet belongs to Mr. Rule--we attempt to prevent others from unfairly taking this property. Our goal is to prevent this transfer as an end in itself, not because it causes inefficiency.⁴²

Professor Lande further explains that the efficiency rationale for prohibiting theft would not involve a desire to stop this expropriation for its own sake. Instead, the rationale would focus solely on the impact on incentives.

If I were to take Mr. Rule's property, his incentives to work hard could diminish, he might hire a guard for protection, or he might shoot me. Each of these reactions would constitute inefficiencies that could arise if we repealed the laws against theft.⁴³

There are two interpretations of this example that relate to the previous discussion. One interpretation would be that the proper standard is aggregate welfare and theft should only be illegal if it can be shown to cause these inefficiencies. The other interpretation would be that this example illustrates one of the rationales for the consumer welfare standard discussed above. A (per se) rule against theft is like the use of the consumer welfare standard chosen in order to give firms the right incentives to increase aggregate welfare (i.e., efficiency).

This example also illustrates how antitrust violations can be viewed as intentional torts, not mere negligence that leads to unintended accidents. Judge Richard Posner suggests that intentional torts involve a “coerced transfer of wealth to the defendant.”⁴⁴

Professor Lande’s analysis of the legislative history of the Sherman Act includes Senator

⁴² Robert H. Lande, *Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust*, 58 *Antitrust Law Journal* 631, 636-637 (1989). See also Richard Posner, *ECONOMIC ANALYSIS OF LAW* 208 (4th ed. 1992)

⁴³ Lande (1989), *supra* note __ at n.28 (citing R. POSNER, *ECONOMIC ANALYSIS OF LAW*, ch. 7 (3d ed. 1986).

⁴⁴ Richard Posner, *ECONOMIC ANALYSIS OF LAW* 208 (4th ed. 1992)

Sherman's characterization of monopoly overcharges as "extorted wealth."⁴⁵ For intentional torts, the conduct violates the law if the plaintiff is harmed at all. It is no defense to assault for the perpetrator to argue that he gained more satisfaction than the victim suffered.

In contrast, looked at through the tort lens, the aggregate economic welfare standard is a type of negligence standard. A negligence rule would find an antitrust defendant liable only if its profit gains were outweighed by harms to others (i.e., consumers and competitors). The negligence rule in torts is used for unintentional torts such as accidents.

The line between intentional and unintentional sometimes may be difficult to draw when particular conduct may not cause harm and the conduct is evaluated on an ex ante basis. However, anticompetitive conduct is usually viewed as intentional.⁴⁶ The characterization of anticompetitive conduct as an intentional tort also relates to analysis of the sources of the defendant's gains. For most anticompetitive conduct, the primary source of the defendant's profits is the wealth transfer from others, not an increase in aggregate welfare. This is illustrated most extremely for the case of a cartel in a market with perfectly inelastic demand. In that situation, the entire profits are comprised of the monopoly transfer less the cost of achieving and enforcing the cartel.

The fact that anticompetitive conduct involves coerced transfers that flow directly from avoidable conduct consciously undertaken by the defendant provides some support for viewing antitrust violations as intentional torts. Moreover, this characterization of the

⁴⁵ Lande (1989), supra note __ at n.27. More generally, see Lande (1982), supra note __.

⁴⁶ As Judge Hand famously said, "no monopolist monopolizes unconscious of what he is doing." *U.S. v. Aluminum Co. of America*, 148 F.2d 416, 432 (2d Cir. 1945)

conduct in turn supports adoption of the true consumer welfare standard. The defendant cannot justify intentionally tortious conduct on the grounds that his own gain exceeds the victim's loss as the defendant could under the aggregate welfare standard in antitrust. Such a negligence standard is not used for intentional torts. Instead, the tortfeasor's conduct would be enjoined or penalized even if he gets a benefit in excess of the harm to the victim. If the perpetrator wishes to get these benefits, he must compensate the victim in advance, so that the "transaction" would be made voluntarily by the "victim."⁴⁷

Intentional torts are associated with punitive damages. Thus, applying the intentional torts framework to antitrust also provides a rationale for applying a damages multiplier.⁴⁸ The punitive damages are needed to eliminate the incentive to harm consumers through an involuntary transfer.

IV. CONCLUSIONS

This analysis leads to several conclusions. First, the current antitrust welfare standard is the *true* consumer welfare standard. It is not the aggregate economic welfare standard that was confusingly mislabeled by Judge Bork as the consumer welfare standard. Second, the true consumer welfare standard is the better standard for antitrust law to mandate. It does not lead to significant, if any, reductions in aggregate wealth. It prevents coerced wealth transfers from consumers and any need to neutralize them with tax redistributions. It also is consistent with intentional torts law. Therefore, it would not make sense for the AMC to support policies to mandate the aggregate welfare standard.

⁴⁷ Id at 209.

⁴⁸ Detailed analysis of this issue is beyond the scope of this article. For one view, see Robert H. Lande, *Are Antitrust "Treble" Damages Really Single Damages?*, 54 Ohio State LJ 115 (1993); R. Lande, *Why Antitrust Damage Levels Should be Raised*, 16 Loy. Consumer L. Rev. 329 (2004)