[Loyola Consumer Law Review](http://lawecommons.luc.edu/lclr)

Volume 22 | Issue 3 Article 3

2010

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

Steven C. Salop
Prof. of Economics & Law, Georgetown University Law Center

QUESTION: WHAT IS THE REAL AND PROPER ANTITRUST WELFARE STANDARD?

ANSWER: THE *TRUE* CONSUMER WELFARE STANDARD

*Steven C. Salop**

I. Introduction

There has been long-standing antitrust controversy regarding the economic welfare standard for antitrust.[1] 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 Robert Bork's usage of the term "consumer welfare" in referring to aggregate welfare.[2]

The aggregate economic welfare standard would condemn conduct only if it decreases the sum of the welfare of consumers (i.e., buyers) *plus producers* (i.e., sellers plus competitors); and *without regard to any wealth transfers*. Thus, efficiencies such as cost savings can trump demonstrable consumer injury. In contrast, the true consumer welfare standard would condemn conduct if it reduces the welfare of buyers, irrespective of its impact on sellers.[3] Efficiency benefits count under the true

---

* Professor of Economics and Law, Georgetown University Law Center. This is a slightly revised version of testimony to the Antitrust Modernization Commission (Nov. 8, 2005). 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.

[1] This issue of the proper economic welfare standard may be different from the legal standard used to achieve maximization of the economic welfare standard. *See, e.g.*, the recent symposium in 73 Antitrust L.J 2 (2006) on two legal standards for Section 2.

[2] Robert H. Bork, THE ANTITRUST PARADOX 372-74 (1978).

[3] Most analysis of competing welfare goals takes place in a simple

consumer welfare standard, but only if there is evidence that enough of the efficiency benefits pass through to consumers so that consumers (i.e., the buyers) would directly benefit on balance from the conduct.

For example, consider a merger that not only permits the merged firm to reduce costs significantly, but also endows the selling firm and its rivals with the incentive and ability to raise its price above the pre-merger level. As a result, that merger would violate the true consumer welfare standard because consumers are harmed. Even though there are efficiency benefits, consumers are harmed because the cost savings are not large enough to force firms to reduce prices, relative to the pre-merger outcome. Simply stated, it cannot be assumed that *all* cost savings will lead to consumer benefits. Only if the cost savings are so large as to cause prices to fall, would the merger pass muster under the consumer welfare standard.

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 total aggregate harm to consumers.[4] For example, if a merger to monopoly raises prices and reduces the welfare of customers by $100 but simultaneously increases the profits of the monopolist by $110 because it now enjoys higher prices and slightly lower costs, that conduct would be blessed by the aggregate economic welfare standard but 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*

---

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 those instances, the analysis of welfare standards generally involves a partial equilibrium analysis that treats the purchasers as the "consumers" and the sellers as the "producers." Antitrust sometimes goes beyond the immediate level and evaluates the welfare of final consumers, as in the case of manufacturers' vertical distribution restraints. However, 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] The consumer harm would be borne by consumers who are still willing to buy the product at the higher prices (perhaps merely because there are no perfect substitutes), plus the consumers who substitute to other products that they preferred less at competitive prices. 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).

the conduct also likely harms consumers. 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 firm, and competitors all contribute equally to *aggregate* welfare.[5] This is another key difference between the two standards, and it is one that is generally overlooked by adherents to the Chicago school of economics.

This short article will discuss the differences between the two welfare standards from both a positive (i.e., descriptive) and a normative viewpoint. The positive analysis briefly reviews the evidence which concludes that the standard legislated by Congress in adopting the Sherman Act - the standard currently used by antitrust agencies and our judicial system - is the true consumer welfare standard. The normative analysis then briefly explains why the true consumer welfare standard is the better standard for achieving the goals of antitrust legislation.

II. Positive Analysis

Professor Robert Lande provides evidence that Congress focused on true consumer welfare, not aggregate welfare or efficiency, in adopting antitrust safeguards. Professor Lande analyzed the legislative history of the Sherman Act, including Senator John Sherman's (the legislation's namesake) characterization of monopoly overcharges as "extorted wealth."[6] Most commentators agree,[7] including even Judge Frank

---

[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 cost structures.

[6] Robert H. Lande, *Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust*, 58 ANTITRUST L.J. 631, n. 27 (1989). *See generally* 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). *See also* Philip Areeda, Introduction to Antitrust Economics, 52 Antitrust L.J. 523, 536 (1983):"'Consumer welfare' embraces what individual consumers are entitled to expect from a competitive economy. If the efficiency extremists insist that only their definition of consumer welfare is recognized by economists, we would answer that ours is clearly recognized by the statutes. The legislative history of the Sherman Act is not clear on much but it is clear on this."

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

Easterbrook:

> 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 dominant theme is the protection of consumers from overcharges.[8]

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

A.Merger Guidelines and Merger Law

The Merger Guidelines promulgated by the FTC and DOJ explicitly suggest that mergers, which raise prices generally, 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 these cost-savings are passed-through effectively, thereby not raising prices. Several judicial opinions also explicitly use a test that focuses on the price impact

---

thesis).

[8] Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L.J. 1696, 1702-03 (1986).

[9] *See also* John Kirkwood, *Consumers, Economics and Antitrust*, 21 RES. IN L. & ECON. 1 (2004). Kirkwood's survey results underestimate how widespread the usage of the true consumer welfare standard is because he did not count courts' findings that higher prices and reduced output are *sufficient* for antitrust liability as evidence supporting the courts' use of the true consumer welfare standard.

[10] *Fed. Trade Comm. and Dep't. of Justice, Horizontal Merger Guidelines* § 4 (rev. ed. 1997), *available at* http://www.justice.gov/atr/public/guidelines/horiz_book/4.html (last visited Feb. 8, 2010). 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 37. The 1997 version of the Guidelines also include a footnote that the agency in its prosecutorial discretion may, in rare cases, consider "inextricably linked" efficiencies outside the relevant market, but only when these benefits "are great and the likely anticompetitive effect in the relevant market(s) is small." *Id.* at 36. Of course, even in this situation, consumers in other markets must gain a larger benefit than the harm to consumers in the target market.

of the merger.[11]

B.Horizontal Restraints

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 coupled with reduced output is generally 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. Further analysis is required. The relevant inquiry under the aggregate welfare standard would also have to consider whether the conduct sufficiently reduces costs to offset the deadweight losses of the output restrictions.

For example, suppose that a group of sellers jointly undertakes conduct that reduces their fixed costs by $1 while simultaneously (and inextricably) raising their prices by $10. Suppose, further, that their output remains constant 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, and therefore *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]

---

[11] *See, e.g.,* FTC v. Univ. 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) (holding 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).

[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 Okla., 468 U.S. 85, 107-08 (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 dead weight 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

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 high 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 because it is deemed inefficient, regardless of the possibilities for recoupment. In contrast, 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:

> 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

---

five 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 study further found that the producers plan to increase the price of type-ZZ insulin by 300%. However, in the opinion of the Commission's economists, this price increase will not reduce the overall usage of type-ZZ insulin significantly. 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 large price increases."

[15] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993).

violation regardless of the gains realized by the producer. This result also illustrates the Court's (*preferred*) use of a true consumer welfare standard.

D. Concerted Monopsony Conduct

The famous *Kartell*[16] opinion written by Judge (now Justice) Stephen Breyer provides an analysis of a buyer-side "cartel" (comprised of final consumers and their "agent" insurance provider, Blue Cross) that also is consistent with the true consumer welfare standard, not the aggregate economic welfare standard.[17] Buyer-side cartels generally are inefficient and reduce aggregate economic welfare because they reduce output below the competitive level. Thus, concerted monopsony conduct 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* generally would raise true consumer welfare (i.e., consumer surplus) because gains accrued from the lower prices would outweigh the losses from the associated output reduction, even though the conduct inherently reduces total welfare (i.e., total surplus).[18]

Judge Breyer's opinion regards 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 treated Blue Cross essentially as an *agent* for the customers it insured, rather than as an intermediary firm that purchased inputs and sold outputs as a monopolistic re-seller. The court apparently assumed (perhaps wrongfully) that Blue Cross would pass on its lower input costs to its customers in

---

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

[17] *See also* Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669 (2004).

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

the form of lower insurance premiums.[19]

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 thus lead to higher welfare for its subscribers despite reduced efficiency and lower 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 mergers and exclusionary conduct also is 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 defendant; as a result, all three effects would be quantitatively assessed and balanced. When economists add consumer and producer surplus, they implicitly are assuming that a dollar has the same social weight when given to producers (either the defendant or its competitors) as when given to consumers. That is why a monetary wealth transfer from one to the other has no welfare consequences. As a result, harm to competitors actually could be used to trump consumer benefits.[21]

---

[19] The regulatory structure imposed on Blue Cross in Massachusetts in principle could have prevented any consumer harm through price regulation of Blue Cross. 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 9, at 31, there were 133 judicial decisions that reiterated this proposition between 1998 and 2002.

[21] As noted earlier, if the harm(s) to the competitors are offset by gains to the defendant firm, then those offsetting effects would effectively wash out. This may not be the case, however, if the firms' costs differ or their total output is not constant.

i. Application to Merger Law

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. Now suppose that the two small firms propose to merge. Assume that the undisputed facts are that the merger will reduce the merging firms' costs, but to a level that remains significantly above the costs of the dominant firm. Suppose that the merger also causes prices to fall by 10%, and permits the merging firms to increase their combined market share from 10% to 20%. This merger apparently would be a benefit to consumers. However, it also could simultaneously reduce aggregate welfare because it would lead to higher overall production costs as a result of the lower cost dominant firm losing sales to its higher cost competitor. Under the aggregate welfare standard, the merger in principle could be condemned on those grounds – even despite the benefits to consumers.[22]

---

[22] To illustrate this analysis, suppose that the pre-merger price is $100, the dominant firm's production cost is $10 per unit and the merging firms' costs each are $60 per unit and price is $75. Suppose that the products are differentiated such that the merging firms could survive in the market despite these higher production 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 and all prices fall by $5. (This assumes initially – for simplicity – that the total quantity demanded is fixed at 100 units, though this assumption could easily be relaxed.) Based upon these facts, consumers gain $500 (i.e., $5 x 100 units) in consumer surplus. However, with perfectly inelastic market 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 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). Even if output rose somewhat, aggregate welfare could still fall. For example, suppose that output increased by 5% to 105. The impact of a $5 price decrease and 5 unit output increase would create a positive welfare benefit trapezoid; the consumer surplus triangle at the top would involve in an increase of approximately $12.5 (i.e., (5*5/2), while the producer surplus rectangle would involve an increase in the $120-425 range, depending on the fraction of the increased output produced by the dominant firm (whose unit cost is $10 and post-merger price is $95) and the merging firm

Antitrust liability under the Sherman Act places no weight on competitor injury unless it is a building block to showing or inferring consumer harm.[23] For example, in the *Brunswick* case, the Court denied standing to a competitor that complained about an injury 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."

ii. Application to Exclusionary Conduct

This point obviously does not apply simply to mergers. Suppose that a high-cost competitor were to enter a market served by a low-cost monopolist. Assume that this entry would cause prices to fall but would raise total production costs by diverting production to the less efficient entrant. Suppose that the monopolist therefore 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; or so on). 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 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 that accrue from paying a lower price per volume that would have been purchased even at a higher price do not count as a social benefit. Why? Simply because it is merely a transfer of wealth from the monopolist to consumers.

Similarly, business torts and claims of unfair competition that have no impact on prices or quantities yet harm one competitor at the expense of another ought to be actionable antitrust concerns under the aggregate welfare standard. The

---

(whose unit cost is \$40 and post-merger price is \$70). Under the aggregate welfare standard, this merger thus would be prohibited under the antitrust laws, regardless of the underlying true consumer benefits.

[23] The Robinson-Patman Act is different.

[24] Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977).

victim-competitor 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.[25]

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, 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

---

[25] 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 under 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 a market situation, suppose that the dominant firm invests in a better mousetrap. Assume 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. This 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 life time. 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. Now 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 x $8), for a life time 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 aggregate welfare effect of the innovation is negative, -$450 (i.e. $100 + $170 - $720), so this better mousetrap would not pass muster once the competitor losses are taken into account. This result, namely that entry can lower aggregate welfare, is common in imperfectly competitive markets. *See* A. Michael Spence, *Product Selection, Fixed Costs and Monopolistic Competition*, 43 REV. ECON. STUDIES 217 (1976).

doctrine. It would seem more consistent with the approach taken in a centrally planned economy like Soviet Russia than in a modern market economy like ours. Such a change does not even appear to be favored by proponents of the aggregate welfare standard like Judge Bork. 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 lost competitor 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.[26]

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 terminology, let alone diagrams such as the Williamson Diagram reproduced in the book, it is unclear if the Court even understood that Judge Bork was effectively 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 dictated below.

> There, the Court was asked to decide whether individual consumers who purchase goods have standing to sue under section 4 of the Clayton Act. It is thus hardly surprising that the Court answered this question by saying that the Congressional

---

[26] Robert H. Bork, THE ANTITRUST PARADOX 66 (1978).

[27] Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979); Bork, *supra* note 26.

[28] Judge Bork's use of this terminology is inherently confusing. To illustrate, consider the confusion that the use of the term "consumers" might engender when "consumers" is erroneously defined to 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 & David L. Meyer, *An Antitrust Enforcement Policy to Maximize the Economic Wealth of All Consumers*, 33 ANTITRUST BULL. 677, 686 (1988).

debates suggest that the Sherman Act was designed as a "consumer welfare prescription." Moreover, even if one thinks that the Court intended to exclude all other considerations, the phrase "consumer welfare" surely encompasses far more than simple economic efficiency.[29]

Judge Bork's possible motivation for creating such 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, let alone the distinction.[30] However, in light of the fact that the aggregate welfare standard is inconsistent with Judge Bork's own position that harm to competitors should not form the basis for punishable antitrust liability, perhaps even Judge Bork did not understand the actual broad 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 supports the view that current regulatory application prefers 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 normative issue to rest during its legislative process.

However, a critic still 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.

In this regard, I want to make three simple and basic points in this section. First, there is no reason to think that adopting the aggregate welfare standard would maximize long-run consumer welfare. Second, adopting the true consumer welfare standard does not involve or require using antitrust law to redistribute income and wealth. Third, adopting the aggregate

---

[29] Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 231 (D.C. Cir. 1986).

[30] *See, e.g.,* Lande, *supra* note 6, 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, ECON. AND FED. ANTITRUST L. 49 (1985) ("more than a little chicanery in such terminology").

welfare standard would lead to *inefficient* economic conduct which harms consumers.

A. Innovation, Imitation and Long-Run Consumer Welfare

One defense of the aggregate welfare standard is that a policy permitting any conduct that increases short-run aggregate welfare undoubtedly leads to the maximization of long-run consumer welfare. This is because, it is argued, markets are dynamic and the cost savings of today would lead to increased consumer wealth tomorrow. The cost savings would increase innovation competition that would lead to diffusion of the cost savings to rivals. As a consequence, diffusion would cause price competition to intensify over time, thus causing prices to fall and consumer welfare to increase in the long- run.

It is true that efficiency improvements may diffuse to rivals, at least 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, the exact extent being dependent upon 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 fall 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

[31] Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, (Nov. 2, 1995), *available at* http://www.ftc.gov/opp/global/saloptst.shtm (last visited Feb. 8, 2010) (Statement before the Federal Trade Commission Hearings on global and innovation-based competition. I also suggested that the enforcement agencies could (and perhaps should) take dynamic efficiency benefits flowing to consumers into account in merger enforcement, under a long-run consumer welfare standard. However, in light of the incomplete and delayed diffusion discussed in text the agencies certainly should not replace consumer welfare with either a short-run or long-run aggregate welfare standard. *See also* Gary L. Roberts & Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, 19 WORLD COMPETITION 4 (1996).

completely, this competition might therefore reduce the expected profitability of the investments that the firm *would not choose to undertake the investments*. Second, the rapid and complete diffusion that leads to such 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. Barriers to entry are a particularly relevant consideration because the existence of barriers to entry is a necessary condition for a finding of antitrust liability under the rule of reason in most antitrust cases. This implies, of course, that diffusion would fail 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 those markets where antitrust constraints are most needed and most often applied, society cannot rely 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.

B. Consumer Compensation and Efficiency

Some proponents of the aggregate welfare standard argue that society should be indifferent to income and wealth distribution.[32] Other proponents argue that the wealth transfers from consumers to producers may be a social concern, but antitrust law nonetheless should ignore them.[33] They argue that antitrust (or other legal regimes like tort law) should not be used as mechanisms for income redistribution. Instead, tax and transfer policy implemented by the IRS is a better institution for redistributing income and wealth.

However, this argument is flawed. First, the adoption of the consumer welfare standard does not mean that courts are using antitrust as a mechanism to redistribute wealth. Instead, it means that anticompetitive conduct is not permitted to redistribute wealth away from consumers. Antitrust law instead involves giving consumers a property right in the competitive

---

[32] *Treatment of Efficiencies in Merger Enforcement: Hearing Before the Antitrust Modernization Committee*, (Nov. 17, 2005) (statement of Charles F. Rule).

[33] *See, e.g.*, Louis Kaplow & Steven Shavell, FAIRNESS VERSUS WELFARE (2002).

outcome.[34]

Second, it likely is more efficient for antitrust law to prevent this redistribution away from consumers than to have the IRS attempt to neutralize it over time with tax and transfer policies. The redistribution away from consumers is automatically dealt with by adoption of the true consumer welfare standard.[35] That impact is not so difficult to gauge; and, the conduct of firms to prevent that redistribution also can be observed.

Contrast that to a situation that would be faced by the IRS. Consider the example of mergers that are permitted because they are predicted to raise aggregate welfare, despite harm to consumers and competitors. At the end of each year, the IRS would need to evaluate the impact of the current and past mergers on prices and output in order to gauge the economic impact on consumers, the merging firm, and relevant competitors. Then, the IRS would need to design tax changes to compensate the losers (and tax the merging firm appropriately). The administrative costs obviously would be enormous, not to mention undoubtedly prohibitive. The IRS has no expertise in competition analysis and the necessary disaggregated analysis of antitrust impacts goes beyond anything that is done in antitrust cases, even where damages are calculated. In addition, taxation itself involves inherent inefficiencies. Therefore, it is not clear that the inefficiencies caused by use of the consumer welfare standard would exceed the tax inefficiencies.

C. Inefficiencies Created by the Aggregate Welfare Standard

The adoption of the aggregate welfare standard also would lead to inefficiencies because it would adversely affect competition.[36] Because efficiency is sometimes considered

---

[34] *See, e.g.*, Lande, *supra* note 6.

[35] If firms engage in anticompetitive conduct that leads to a different outcome and therefore harms consumers, they are required to alter their behavior to prevent the consumer harm. Alternatively, they are forced to compensate consumers by paying antitrust damages.

[36] Several recent papers take a somewhat related, and very interesting, approach to this issue. They compare the impact of the two welfare standards in the context of the interaction between merging firms and the antitrust enforcement agencies. For example, *see* David Besanko & Daniel F. Spulber, *Contested Mergers and Antitrust Policy*, 9 J. L. ECON. & ORG. 1 (1993); Sven-Olof Fridolfsson, *A Consumer Surplus Defense in Merger Control* (Res. Inst. of Industrial Econ., IFN Working Paper No. 686 2007); Joseph Farrell,

synonymous with aggregate welfare, this formulation may sound peculiar. However, it is relevant because the aggregate welfare standard likely would lead to certain inefficient conduct.

The adoption of an aggregate welfare standard likely would not require firms to engage in conduct that maximizes aggregate welfare. Instead, it would simply prohibit conduct that reduced aggregate welfare, relative to some type of status quo benchmark. Consider, for example, an efficient production joint venture among all the firms in the market to manufacture at lower cost an input used by the firms in their competing differentiated products. Suppose that the firms cooperate in production but continue to engage in price competition for the products they sell. As a result of that competition, suppose that prices paid by consumers would not rise above the pre-venture level. This production joint venture thus would pass muster under antitrust laws premised on the consumer welfare standard.

In contrast, suppose that antitrust adopted the aggregate welfare standard. In this scenario, suppose that the firms added joint pricing (i.e., joint marketing) to the activities of the joint venture and raised prices to consumers. Relative to competitive pricing, these higher prices would reduce aggregate welfare at the margin because the price increases would lead to a deadweight loss in consumer surplus. However, as long as the resulting price increase would not lead to a deadweight loss in efficiency that exceeded the cost savings from the joint production, the joint pricing would be permitted. This is because aggregate welfare would not fall *relative to the absence of any joint conduct*.[37]

A more refined antitrust analysis might permit the production joint venture but prohibit joint marketing, as did *NCAA* (albeit under the consumer welfare standard). However, joint marketing might pass muster under the aggregate welfare standard even if it led to significantly higher prices, if the cost-savings or quality improvements from joint pricing exceeded the

---

Negotiation and Merger Remedies: Some Problems (Competition Policy Center, UC Berkeley 2003), *available at* http://www.escholarship.org/uc/item/9p72k8fn; Damien J. Neven & Lars-Hendrik Röller, *Consumer Surplus vs. Welfare Standard in a Political Economy Model of Merger Control*, INT'L J. INDUSTRIAL ORG. (2005); Joseph Farrell & Michael L. Katz, *The Economics of Welfare Standards in Antitrust* , 2 COMPETITION POL'Y INT'L 2 (2006); Kenneth Heyer, *Welfare Standards and Merger Analysis: Why not the Best?*, 2 COMPETITION POL'Y INT'L 29 (2006).

[37] This is simply the standard formulation in the famous Williamson Diagram. Williamson, *supra* note 4.

deadweight losses (but not the consumer overcharge) resulting from the higher prices.

IV. Conclusions

This analysis leads to two simple 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, reduced to basics, the true consumer welfare standard is the better standard for antitrust law to mandate. Therefore, it would not make sense for the courts, agencies, or Congress to support policies to mandate the use of the aggregate welfare standard in antitrust law.