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ABSTRACT:
Title: MR. MAGOO VISITS WAL-MART: FINDING THE RIGHT LENS FOR ANTITRUST

Author: Albert A. Foer, President, The American Antitrust Institute

Wal-Mart, the largest of power buyers, represents a paradox. From one perspective it is exactly the type of company we want our economy to produce. On the other hand, from several different perspectives, it represents a danger to be condemned. What can we say about the Wal-Mart phenomenon from the perspective of antitrust? This paper sifts through the criticisms and holds them up against the standard of antitrust, with particular attention to predation, monopsony, great bargaining power that is less than monopsonistic, and price discrimination. Special attention is given to the so-called waterbed effect. The paper asks whether antitrust, which developed when manufacturers were king, is up to the challenge of the power buyer in an increasingly retailer-driven marketplace. An appendix provides a set of questions that need to be answered.

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Keywords: power buyer, monopsony, price discrimination, waterbed effect, bargaining power, retailing, goals, choice.

Author Contact: bfoer@antitrustinstitute.org

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Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust

Albert A. Foer[1]

> *What you see depends on the state of your vision as much as on what is actually "out there." Perhaps because my uncorrected eyesight has always been so poor, one of my childhood heroes was the nearsighted Mr. Magoo, a cartoonish paragon of outspoken self-certainty whose impaired vision assured that he got nearly everything wrong. If Mr. Magoo visited a Wal-Mart, I wonder, would he conclude that he had just met the consumer's best friend? Or would he be a bit frightened by the implications of his experience? The answer would depend on what corrective lenses he might be wearing.*

In this paper, we visit the emerging antitrust issue of buyer power, taking Wal-Mart as the leading but far from the only example of a company whose scale and strategy give it the ability to exercise unprecedented influence over a supply chain that it entirely dominates. Antitrust grew up in an age characterized by consolidating manufacturers and horizontal cartels. During the last thirty years or so, while service industries such as the retail trades came to equal and perhaps displace manufacturing as the driving force in the American economy, U.S. antitrust theory and practice became more and more enamored of anti-cartel enforcement, reducing its concern about single-firm conduct and ignoring almost completely the power-related problems that arise in vertical relationships.[2] Rather than disappearing, these problems have in fact grown dramatically. The question is whether antitrust policy and priorities can be –or should be—reshaped in order to take

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[1] President, American Antitrust Institute, www.antitrustinstitute.org. Foer holds a J.D. from the University of Chicago, an M.A. in political science from Washington University, and an A.B. from Brandeis University. He was a retail chain store executive for thirteen years and is a former Acting Deputy Director of the FTC's Bureau of Competition. The author extends special thanks to Peter Carstensen, Paul Dobson, Gregory Gundlach, John Kirkwood, Robert Lande, and Robert Steiner (who disagrees with the discussion of the waterbed effect) for their comments on an earlier draft.

[2] "For the past generation, informed primarily by economics and under the influence of the Chicago school of antitrust, U.S. antitrust policy has downplayed the competitive significance of vertical distribution relationships. Instead, antitrust policy and enforcement has favored a 'single-stage' approach through which horizontal economic relationships are viewed as the primary determinant of the final prices paid by consumers." Gregory T. Gundlach and Albert A. Foer, "Combining horizontal and vertical analysis in antitrust: the American Antitrust Institute's roundtable on the implications of the work of Robert L. Steiner, 49 The Antitrust Bulletin 821 (winter 2004). And see the articles in that volume that develop new insights into interactions between horizontal competition and vertical distribution relationships.

into account the rise of Wal-Mart and its smaller colleagues who occupy the category of power buyers.

We begin by sifting through the various criticisms made of Wal-Mart to see which, if any, can be considered to involve antitrust. Three areas receive the most attention: predatory pricing; the so-called waterbed effect; and price discrimination. We examine the goals of antitrust to determine whether they are sufficiently flexible to encompass appropriate limitations on Wal-Mart and other power buyers. Our objective is to identify the right questions to be asking. We do not yet have sufficient information to answer all of our questions. In an appendix, therefore, we specifically raise an agenda of questions whose empirically-based answers will help us reach conclusions.

The Paradox of Wal-Mart

For those attempting to apply antitrust analysis to the Wal-Mart phenomenon, the choice of lens is critically important. Wal-Mart represents a paradox arguably unlike anything previously seen in the domestic economy.[3] On the one hand, Wal-Mart is exactly the type of company that American capitalism is supposed to both generate and venerate. It has grown large in the U.S., not by merger or acquisition,[4] but through internal growth, which is to say, because consumers have voted for it with their feet and wallets. It has been innovative, particularly in its tight control over supply lines, its unparalleled use of data, and its ability to cut costs.[5] It has saved consumers –especially lower- income consumers-- a ton of money. Together with its competitive impact on other retailers and suppliers, Wal-Mart has played a leadership role in keeping national economic productivity high[6] and inflation low.[7]

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[3] The last retailer to garner such extreme power was the A&P food chain, against whom the Robinson-Patman Act was passed. "Relative to Wal-Mart today, the A&P a half century ago was a far less awesome force," says Barry C. Lynn in "Breaking the Chain, The Antitrust Case Against Wal-Mart," Harper's Magazine 34 (July 2006).

[4] An exception: Wal-Mart was permitted to acquire the leading chain of food stores in Puerto Rico in a deal that was criticized by the American Antitrust Institute and is dissected in Warren S. Grimes, "Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller," 72 Antitrust L.J. 563, 583-588 (2005). Those interested in merger policy toward power buyers should see John J. Curtin, Jr., Daniel L. Goldberg, and Daniel S. Savrin, "The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a 'Gatekeeper' Analysis of Retailer Market Power under the U.S. Antitrust Laws," 40 Boston College L. Rev. 537 (1999).

[5] On Wal-Mart's innovative mastery of logistics and how this contributed to its tight control over its suppliers, see Barry C. Lynn, *End of the Line* (Doubleday, 2005) 104-108. "Wal-Mart was the leader in the use of information technology in retailing and pioneered a number of IT applications. These applications include use of computers to tract inventory in distribution centers(1969), scanning using standard barcodes (1980), radio frequency (RF) guns to track merchandise (late 1980's), and complicated electronic data and satellite communications systems to manage logistics and keep the right items in the stores and in stock (late 1980s, early 1990s)." William W. Lewis, *The Power of Productivity* 94 (Chicago 2004).

[6] "The annual growth in U.S. retailing labor productivity jumped from 2% during the period 1987-1995 to 6.3% during 1995-1999, explaining nearly one-quarter of the economy-wide acceleration in productivity.

At the same time, Wal-Mart stands accused of destroying entire downtowns, of harming the environment, of abusing workers, of violating immigration laws, of endangering national security, and of bullying suppliers.[8] The question posed in this paper is, first, is there anything about Wal-Mart's behavior that raises the probability of antitrust violations? If no, does the Wal-Mart phenomenon require us to reconsider what we want from antitrust?

Sources of Buyer Power

Paul Dobson, a British economist who has closely monitored the growth of power buyers in the U.K., observes that there are three primary sources of power for large retailers, which may be found in their roles as (a) customers, (b) competitors, and (c) suppliers for producers.[9] First, retailers buy their products for resale to ultimate consumers. A large retailer might well account for between 10 and 30 percent of a supplier's total sales. "The scale of these sales and the fact that there are few, if any, alternative means of picking up lost sales from elsewhere means that a supplier cannot afford to be delisted, while the retailer, in contrast, may not suffer it it can readily acquire alternative products from other suppliers."[10]

Second, retailers act as competitors when they sell proprietary (also known as "own label," "private label," or "store brand") products in competition with producer branded goods. As Dobson says,

> The threat to a branded goods supplier is twofold: the retailer can, if it so chooses, undermine the supplier's branded products, e.g., by placing them in less well-located shelf positions, raising their retail prices, or even substituting them for its own-label products (which can be given the appearance of offering better value to consumers). This can afford the retailer a large and credible bargaining lever over the branded goods supplier while allowing it to promote its own franchise with

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'Almost half [of the retail productivity growth] is due to Wal-Mart, alone.'" Robert L. Steiner, "The Evolution and Applications of Dual-Stage Thinking," 49 The Antitrust Bulletin 877, 884 (winter 2004).

[7] Wal-Mart's position is presented in S. Robson Walton, "Wal-Mart, Supplier-Partners, and the Buyer Power Issue," 72 Antitrust L.J. 509 (2005). Positive achievements of Wal-Mart may be found in chapter two of Charles Fishman, *The Wal-Mart Effect* (Penguin Press, 2006). [Also Richard Vedder's paper at _U. Conn. L. Rev. (2007)] Paul A. London, in chapter six of *The Competition Solution, The Bipartisan Secret behind American Prosperity* (AEI, 2005) credits Wal-Mart and other aggressive new retailers with remaking the playing field by building the new mass-marketing category of retailers that brought lower prices to consumers.

[8] See generally Anthony Bianco, *The Bully of Bentonville* (Doubleday, 2006)

[9] Paul Dobson, "British Grocery Trade Lessons," 72 Antitrust L.J. 529, 536 et seq. (2005)

[10] Dobson, 72 Antitrust L.J. 537.

consumers, using own-branded goods to reinforce the retailer's brand image in consumers' minds as the "consumers' champion.[11]

Finally, retailers are "suppliers that 'sell' shelf space, either directly through listing or slotting fees or indirectly through requiring lower prices from producers as a condition of stocking, and advertising space, such as through promotional support payments."[12]

These three roles yield the retailer a substantial bargaining advantage over the supplier that is obvious if one asks: who has more to lose if one party backs away from the relationship? Procter & Gamble is Wal-Mart's largest supplier, accounting for only 2 percent of Wal-Mart's sales, while Wal-Mart accounts for 18 percent of Procter's revenues.[13] Think in terms of relative switchability: the retailer can more easily switch to a new supplier than the supplier (with sunk costs and limited options) can switch to an equivalent retailer. Fishman refers to supplying Wal-Mart as an addiction. Once hooked, few suppliers, apparently, have successfully freed themselves.[14]

Monopoly, Monopsony, and Bargaining Power

The large retailer's ability to play these three roles also accounts for a difference between the selling side and the buying side of an industry, which antitrust needs to take into account. On the selling side, the ability to exercise market power may require sixty percent or more of the market. On the buying side, it is considerably less, perhaps as little as 8 percent,[15] although the empirical data on this question is no more than sketchy. This

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[11] Dobson, 72 Antitrust L.J. 538. Having a proprietary brand also may give the retailer an intelligence leg up on understanding the supplier's cost structure. Economist Robert L. Steiner informed the author that according to Private Label Magazine, in its annual "Top 50" Report, private label accounted for 30 percent of Wal-Mart's sales in 2005. Also, "A recent study by the Hartman Group found that half of all the private label sales in the U.S. are Wal-Mart's private labels. This has been a boon for many private label suppliers and has probably counteracted to some degree the tendency for increased concentration at the manufacturing level in some industries." E-mail to author, October 4, 2006.

[12] Dobson, 72 Antitrust L.J. 536.

[13]Bianco, 183.

[14] An exception is the Snapper lawn mower company, whose exit from Wal-Mart is described in Fishman, 111 et seq. Selling an upscale branded product through Wal-Mart was damaging Snapper's appeal to its independent dealers, which accounted for the largest and most profitable part of its business. Snapper was strong enough to give up 20 percent of its business and eventually earned this business back through the dealers.

[15] Dobson supports a U.K. Competition Commission argument that retail buyer power can be very significant (to the extent of distorting competition) even if the retailer controls as little as 8 percent of the total market. Dobson, 72 Antitrust L.J. 529, 535 (2005). And see *Toys R Us v. FTC*, 221 F.3rd 928 (7th Circ.)2000) where a buyer's 20% market share was enough to "call the shots" that led to the FTC's complaint, as described by Warren S. Grimes, "Buyer Power and Retail Gatekeeper Power, 72 Antitrust L.J. 563, 582 (2005). Kirkwood provides evidence for concluding that buyers without dominant market

is a terrifically important point, for if market power were to be accepted as beginning at a much lower level on the buyer side than on the seller side, antitrust theories could be crafted to deal with the kind of marketplace abuses that Wal-Mart and perhaps other big box power buyers may engage in.

Monopoly is the term applied when a seller controls a very high portion of the market, such that it can set its own prices to maximize profitability rather than take the prices established by a competitive interplay of supply and demand.[16] Normally, a monopolist need not own one hundred percent of a market; typically, something like sixty percent is sufficient. It is often said that monopsony is the buyer side equivalent of monopoly, and that it should be viewed as the mirror image of monopoly. The antitrust laws have from time to time recognized monopsony, but in an economy where concentration was most typically found at the manufacturing level rather than the retail level, antitrust clearly paid far more attention to monopoly than to monopsony.[17] As one of the most fragmented of industries, retailing was rarely the locus of monopsony power.

Channels of distribution have not remained in place, however. Today, with the emergence of big box retailers and the consolidation of chains at both the retailing and supplying levels into a much smaller number of mega-chains, the relative bargaining strength of manufacturers and retailers has been reversed. Even so, no retailer has or is likely to attain anything near sixty percent of a national market. So, if monopsony is truly and fully a mirror image of monopoly, there are no national monopsonistic retailers in the U.S.

A major economic critique applied to monopoly is that it causes a reduction of output below the level of a competitive market, depriving society of goods and services that would have been produced competitively. This is a "dead weight loss" that harms the whole society and is one reason antitrust opposes monopoly. Switching over from monopoly to consideration of monopsony, a comparable loss of productivity might occur in, for example, an agricultural industry, where if there were only one buyer of a certain commodity and it reduced the price it was willing to pay, farmers would reduce the amount of the commodity that they would produce and prices to ultimate consumers would consequently rise because their demand would outstrip the available supply.[18]

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positions had been able to obtain non-cost-justified concessions from their input suppliers. John B. Kirkwood, "Buyer Power and Exclusionary Conduct," 72 Antitrust L.J. 625, 642-44 (2005).

[16] See chapter 4 of Dennis W. Carlton and Jeffrey M. Perloff, *Modern Industrial Organization* (Pearson 2005) for a contemporary economic textbook treatment of monopolies and monopsonies; and Roger G. Noll, "'Buyer Power' and Economic Policy," 72 Antitrust L. J. 589 (2005).

[17]The standard work on monopsony is Roger D. Blair & Jeffrey L. Harrison, *Monopsony, Antitrust Law and Economics* (Princeton 1993).

[18] Peter Carstensen has pointed out to me that in some circumstances, e.g. the dairy industry, a monopsonist may be able to drive down the price of suppliers in one region, reducing output there, but might purchase additional supplies from other markets at higher prices, such that prices to consumers will not go up but the monopsonist's profits will increase. Moreover, "a monopsonist can in some circumstances avoid the reduced production from reduced prices by making an all or nothing offer. The monopsonist tells

Why would farmers reduce their output in response to a monopsonist's reduction of price? Because in agriculture, the least productive land is farmed last and each additional unit of output costs more than the average. In order to continue to farm profitably in the face of a lower price, farmers would stop producing the part of the crop that was most expensive to produce. Thus, crops that would have been sold at a competitive price are not produced at a monopsonistic price despite the presence of ultimate consumers who would be willing to pay the competitive price.

But compare the agricultural monopsonist to Wal-Mart. Wal-Mart is not interested in reducing sales volume to raise prices. When Wal-Mart batters its supplier into reducing Wal-Mart's cost of goods, and the benefit of lower costs is passed on to consumers in the form of lower prices, more goods are produced, not fewer. Whereas a farmer faces an upward sloping marginal cost curve, this situation may not be replicated in certain industries, for certain buyers and for certain suppliers. For example, a power buyer may be able to find a supplier that can maintain or increase output by passing costs off onto society (externalities) or by increasing its (the supplier's) economies of scale or moving down the experience curve through a new relationship that involves producing additional output for a single retailer.[19] Hence, in the short run, at least, there is no reduction of output to Wal-Mart when it bullies a supplier to reduce its price to Wal-Mart. Again, if monopsony is truly a mirror image of monopoly, there are probably no monopsonistic retailers.

But this is only part of the picture. Here we need to make a distinction that is gradually coming to be recognized, between the neoclassic concept of monopsony and the emerging concept of massive bargaining power. Monopsony power is exerted through the reduction in the quantity purchased. John Kirkwood defines *bargaining power* as "the power to obtain a concession from another party by threatening to impose a cost, or withdraw a benefit, if the party does not grant the concession."[20] Sometimes the same concept is reached through the term "countervailing power." Buyer power thus includes both monopsony and its kissing cousin, bargaining power. The one is well-recognized but hard to find in the real world; the other is not yet well-credentialled but is the crux of whatever contemporary problem exists with power buying retailers.

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the producer that it will buy X quantity and pay Y price. The monopsonist pays the marginal cost to the producer, appropriates all the rents, and gets the same production that in a competitive market would have come at a competitive price. Essentially, the producer faces a choice of marginal survival by producing at the level the buyer demands or it must exit entirely from the market. Hence, it is denied the choice of reducing output as price declines." E-mail to author.

[19] Albert A. Foer, "Introduction to Symposium on Buyer Power and Antitrust," 72 Antitrust L.J.505, 506.

[20] John B. Kirkwood, "Buyer Power and Exclusionary Conduct: Should Brooke Group Set the Standards for Buyer-Induced Price Discrimination and Predatory Bidding?" 72 Antitrust L.J. 625, 637 (2005). Also see Zhiqi Chen, "Buyer Power: Economic Theory and Antitrust Policy," forthcoming in 22 Research in Law and Economics (2007).

A Very Brief Introduction to Antitrust

Before honing in on the relationship between antitrust and Wal-Mart, we should very briefly outline what antitrust covers. We can then hold up the antitrust standard against the various criticisms to identify the potential antitrust problem areas.

The purpose of the antitrust laws is today generally said to be the promotion of consumer welfare, by maintaining competitive markets. Exactly what this means is subject to some debate.[21] At the least, it seeks to provide consumers with competitively set prices, a reasonable range of choice in goods and services, and an innovative, growing economy.

Antitrust consists of three principal laws. The Sherman Act of 1890[22] outlaws unreasonable restraints of trade and monopolization (but not monopoly in itself). The Clayton Act of 1914[23] specifies certain anticompetitive activities that are unlawful, creates a merger control regime, and (by virtue of amendments known as the Robinson-Patman Act) outlaws certain types of price discrimination. The Federal Trade Commission Act of 1914[24] creates an administrative agency that enforces the federal law against unfair methods of competition, which is generally identical with the Sherman and Clayton laws enforced by the Department of Justice. Private parties are encouraged to enforce the antitrust laws through litigation, by the awarding of treble damages and attorneys fees to those who vindicate the public interest in competition. Most states also have their own antitrust laws similar to the federal laws. [25]

Criticisms of Wal-Mart

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21 See AAI Working Paper No. 05-09: Albert A. Foer, The Goals of Antitrust: Thoughts on Consumer Welfare in the U.S., **http://www.antitrustinstitute.org/recent2/441.cfm**, to be published in Philip Marsden (ed.), *Transatlantic Antitrust Handbook* (forthcoming). It is important to note that there is no significant school of antitrust thought today that would label itself "protectionist," i.e., supportive of the right to exist for inefficient competitors without regard to a negative effect on consumers.

22 15 U.S.C. sec. 1 et seq.

23 15 U.S.C. sec. 12 et. seq.

24 15 U.S.C. sec. 41 et seq.

25 Among the resources for an introduction to the antitrust laws are Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* (West Group, 2004); Herbert Hovenkamp, *The Antitrust Enterprise, Principles and Execution* (Harvard, 2005); and John H. Shenefield and Irwin M. Stelzer, *The Antitrust Laws, A Primer* (AEI Press, 2001) Several primers may be found at http://www.antitrustinstitute.org/links/primers.cfm.

Many of the criticisms of Wal-Mart fall under the category of unfairly gaining competitive advantage by externalizing costs that are generally borne by rivals. For example, if other retailers abide by environmental standards but Wal-Mart evades them, Wal-Mart may gain a competitive advantage.[26] If it pays less in wages and benefits than do other employers or creates substandard labor conditions, it may gain a competitive advantage.[27] If it avoids dealing with labor unions while competitors are unionized, this may produce a competitive advantage. If Wal-Mart violates immigration laws by employing illegals, it may gain a competitive advantage.[28] Cumulatively, the advantage may amount to an important contributor to Wal-Mart's success as a competitor. The advantage comes from achieving lower costs, which are passed on in the form of lower prices, leading to a gain in market share for Wal-Mart.

To the extent that Wal-Mart accrues competitive advantage in this way by violating a law, there is something wrong and it needs to be rectified. However, the rectification should come in the form of better law enforcement or the tightening of legislative or regulatory loopholes. These are problems that have an important competitive aspect, but they are not the kinds of problems that have been susceptible to antitrust enforcement. I am not aware of anyone in the antitrust community today who argues that antitrust should be re-shaped in order to target these practices, which are more appropriately addressed by specific labor, immigration, and environmental laws. Later in this paper, however, I will discuss the possibility of taking external costs foregone into account when analyzing charges of price predation.

It is also alleged that Wal-Mart gains a competitive advantage by purchasing goods manufactured in low-wage markets such as China and that this undermines domestic labor unions, forces suppliers to move their assets overseas, and facilitates lower prices than can be charged profitably by rivals who source domestically. In effect, it is Wal-Mart's very low prices that are responsible for the replacement of American workers by lower-wage foreign workers. This argument, of course, can be applied to any retailer who purchases from lower-cost markets (not that long ago, these markets were in the American South) and is really an argument against free trade and globalization rather than Wal-Mart. Antitrust, to the contrary, generally supports trade with minimal

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[26] Many of the criticisms are those that are made against any large user of land. Others involve ripple effects of Wal-Mart's large scale, low cost operations, such as its effect on salmon farming in Chile. Often the criticism reflects dismay that Wal-Mart has not chosen to use its clout in more pro-environmental ways. E.g., "Wal-Mart buys so much salmon that if it imposed and enforced a set of standards on how salmon was to be raised, and how salmon workers were to be treated, salmon farming and processing companies would need to comply, either to keep Wal-Mart's business or to stay competitive." Charles Fishman, *The Wal-Mart Effect* 180-81. Also see Al Norman, *Slam-Dunking Wal-Mart! How You Can Stop Superstore Sprawl in Your Hometown* (Raphel Marketing, 1999) at 17 et seq. It is reported that Wal-Mart "appears to have emerged an intriguing shade of green as a result of extensive discussions over the past year with left-leaning environmental groups." Anthony Bianco, *The Bully of Bentonville*, 287.

[27] [See papers by Richard Michael Fischl, Erin Johansson, and John Stout at _U.Conn. L. Rev. _ (2007)]

[28] [See papers by Gilberto M. Garcia, Maurice Hew, Jr., M. Isabel Medina, and Michael Wishnie at _U.Conn.L.Rev. __(2007)]

distortions as part of its dedication to the ideal of flexibly operating markets with no artificial barriers. If the loss of manufacturing and manufacturing jobs to lower-cost countries is a problem, it can be addressed through treaties, trade laws, adjustment allowances, and retraining. I don't sense any interest within the antitrust community for policies that would be considered protectionist.[29]

A relatively new concern being raised about Wal-Mart relates to national security. As the exemplar of just-in-time delivery from the lowest-priced sources around the world, Wal-Mart reflects a national love affair with efficiency. But it is a special kind of efficiency that is targeted at the lowest prices in the near-term. Barry C. Lynn has described how recent changes in supply chains, including the creation of tightly knit global systems of which Wal-Mart is a prime example, have tended to make the nation vulnerable to potentially devastating breakdowns.[30] The chains have become so long, with so little redundancy, that when critical links are broken (e.g., by an earthquake near the site of the only manufacturer of a critical input), entire industries may be forced to close down. This concern, if correct, should be of more than academic interest to antitrust enforcers, because it suggests a limitation on the efficiency arguments that direct so much of current antitrust thinking. However, the fragility of supply lines and the implications for national security are not themselves matters within antitrust's purview, nor am I aware of any sentiment within the antitrust community to change this.[31]

The transformation of supply lines that Lynn describes can be seen as part of a movement toward tighter and relatively more closed systems which is rapidly changing the way business is done. It should lead antitrust experts to question whether the tools that were developed during a long era of more independent companies acting competitively rather than as integrated segments of large networks, are still adequate.[32] The new systems typically include a dominant firm which depends on "partners" that are

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[29] For more on the relationship between trade and antitrust, see the articles generated at an American Antitrust Institute symposium and published in 47 New York Law School Law Review (2003).

[30] "Our corporations have built the most efficient system of production the world has ever seen, perfectly calibrated to a world in which nothing bad ever happens. But that is not the world we live in. Not only is human civilization riven routinely by earthquakes and hurricanes, but so too is it shattered by wars and acts of terror and simple human error. Which means it is only a matter of time until we experience our next industrial crash, perhaps one much worse than any we have yet known." Barry C. Lynn, *End of the Line*, 3 (Doubleday, 2005).

[31] Consider the FTC's problem when it approved, on what appear to be weak conditions, the recent joint venture of Boeing and Lockheed Martin to build expendable rocket launch vehicles, a joint venture that was acknowledged to be anticompetitive, but was justified on national security grounds. See http://www.ftc.gov/opa/2006/10/ula.htm.

[32] The American Antitrust Institute has initiated a project on systems competition. See http://www.antitrustinstitute.org/recent2/508.cfm.

clearly subordinate. In the case of Wal-Mart's system, one of the keys to the dominant firm's influence is its buying power.[33]

What about the destruction of local retailers? When Wal-Mart comes to town, usually to the outskirts, shopping traffic rapidly moves toward its "every day low prices" and many if not most of the local retailers suffer dramatically, often ending in bankruptcy.[34] Those who survive tend to focus their business on niche products whose volume is insufficient to attract Wal-Mart's attention. In general, the law considers that there is nothing wrong with a competitor drawing away customers by setting lower prices than the other established purveyors. There is one major exception: predatory pricing.[35]

Pricing Strategies

The illegal act of predatory pricing is defined as setting one's prices below an appropriate measure of cost, with the ability to later raise prices sufficiently to recapture the investment made in below-cost pricing.[36] In other words, if Wal-Mart were to set its prices so low that it knew it would lose money on each sale, with the intent of driving local retailers out of business, and then raising prices once the competition was eliminated, this would likely violate Section 2 of the Sherman Act.

But there does not seem to be any evidence that this kind of predatory pricing is a strategy that has been adopted by Wal-Mart. Charles Fishman in his excellent book The Wal-Mart Effect says,

> Whether the local merchants, or Wal-Mart's big-box colleagues, find a way to compete in a particular town, or go out of business, Wal-Mart does not exploit its customers in victory. Wal-Mart is brutally competitive, but it is not technically predatory. It's not "low prices until the competitors are strangled"—it's "*always* low prices." [37]

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[33] For one treatment of the new systems phenomenon, see Marco Iansiti and Roy Levien, *The Keystone Advantage* (Harvard Business School Press, 2004), and also see my critique, at http://www.antitrustinstitute.org/recent2/356.cfm.

[34] See chapter six of Anthony Bianco, *The Bully of Bentonville*.

[35] The Robinson-Patman Act might also be considered a basis for dealing with anticompetitive effects caused by low pricing.

[36] See *Brooke Group Ltd. V. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1993) and *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

[37] Fishman, 226. This is not to suggest that Wal-Mart cannot drive out competitors by above-cost pricing, utilizing the cost advantages it has obtained as a power buyer and cost externalizer. Apparently it does this very effectively. Under current law, above-cost low pricing by itself is properly encouraged. However, it is the strategy that conjoins buyer power with very low pricing that raises the issues we are most concerned about in this paper.

The power of the Wal-Mart strategy is that the Waltons really have been committed to every day low prices. But strategies can change. Wal-Mart has grown at its staggering rate by passing on much of its cost advantage to consumers and using its capital to open huge new stores. Noting that Wal-Mart's domestic growth is slowing down as the best market locations have become saturated and that the stock market in recent years has not viewed Wal-Mart as an especially strong investment vehicle, we should ask: will there come a time when most rival retailers have been vanquished and the only way to show profit growth is by raising prices? Will Wal-Mart embark on a strategy, for example, of "price flexing" such that it would charge lower prices in stores that face competition than in stores which command a very large market share?[38] An effective price flexing strategy may even include some below-cost pricing, most likely aimed at a selected number of "known value" products that help determine where a consumer will shop. Will we look back ten years from now and realize that Wal-Mart was engaged in slow motion predatory pricing, where the recoupment of the investment in low prices comes many years after market entry?[39]

Recall the two elements of illegal price predation. First, will Wal-Mart set its prices below its costs? If it has not done this in the past, as Fishman concluded, is there any reason to anticipate that it will do so in the future, with ever-increasing attention focusing on all of its business practices? This would seem not to make sense if it enters a strategic phase dedicated to expanding profit margins.

Second, if Wal-Mart were to raise prices above current levels, this might require jettisoning its historic low-price strategy. Perhaps it would go the way of Macy's and other large retailers of listing substantially higher prices but offering selected goods at "discount" from time to time.[40] Could Wal-Mart maintain its high volume of business if its everyday prices were not recognizably below the level of its remaining competitors? And a related question: if Wal-Mart raised its prices noticeably, would new retailers be

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[38] The U.K.'s Competition Commission is engaged in a major investigation of the grocery industry. In its Report on Supermarkets, in 2000, it found that the practice of local price flexing operated against the public interest. Wal-Mart appears in the U.K. through a company named Asda. In a submission to the Competition Commission dated 10 August 2006, Asda wrote that it "considers that local price flexing and pricing below cost on individual product lines are consistent with the operation of a highly competitive grocery market. However, in respect of both practices, Asda urges the CC to look at all forms of pricing tools—including the use of vouchers." At 5.1. On the relationship between price flexing and persistent below-cost discriminatory pricing, see Paul Dobson, "Micro-Marketing and Discriminatory Practices" in *U.K. Grocery Retailing* (November 2006).

[39] The return on recoupment must be considered in light of present value. Thus, a recoupment that occurs far into the future would need to be very large indeed.

[40] When I was a retailer, I hated this predominant "hi-low" practice, which many of us referred to as the "phony discount" run by "mark it up, mark it down" retailers. But once other retailers adopted this strategy, sale-oriented consumer behavior made it nearly impossible for most retailers to follow an "everyday low price" strategy. One of Wal-Mart's most commendable achievements was its ability to flourish without adopting a phony discount policy.

induced to enter the market? The retail business has generally been one of easy entry.[41] The question is whether fear of Wal-Mart's ability to slash prices and advertise heavily would keep new retailers from entering. Thus it would seem that a Wal-Mart strategy of price flexing would be most likely, in which prices are nowhere or only selectively and periodically set below costs, but the magnitude of the markup will depend on the intensity of localized competition. Such a strategy would not likely be stopped under current interpretations of the antitrust laws, but could be quite effective in deterring entry.

When thinking about whether its pricing policies are predatory, how should we measure Wal-Mart's costs? Shouldn't externalized costs normally borne by other retailers, but avoided by Wal-Mart, be included? Consider the related question of opportunity costs. Herbert Hovenkamp, a leading expostulator of the antitrust laws, is a supporter of the current views on the law of predatory pricing, but in his recent book, The Antitrust Enterprise,[42] he criticizes a court for ignoring a predatory pricing defendant's opportunity costs when determining whether pricing was below cost. The case involved American Airlines' strategy in its hub at the Dallas/Fort Worth airport, whereby when new competition entered, American cut its own prices to match the new entrant's prices, increased its own flights on the same routes, and when the newcomer exited, American raised its prices and reduced its number of flights—back to pre-entry levels. The court, dismissing the Justice Department's suit, ignored the value of the "best foregone alternative"—the opportunity costs—of American, which included the fact that American had to pull aircraft out of more profitable routes during the period of predation. Hovenkamp says that the government correctly treated American's "foregone or sacrificed" profits as costs.[43]

Can similar logic, i.e. that all costs should be considered, be applied in a predatory pricing case against Wal-Mart? It might be argued in distinction that when an opportunity cost is foregone, there is a sacrifice of profit by the actor; whereas when costs are avoided the sacrifice is pushed off onto someone else. (Recall General Patton's movie advice to his troops: approximately, "Don't die for your country. Let the other poor bastard die for his country.") In theory, this distinction as to who makes the sacrifice ought not affect the analysis of what costs should be taken into account when trying to provide a level playing field. A more important question, however, is whether the value of foregone externalized costs (think of it as an exercise in normalizing costs) can be calculated with enough precision to be administrable in a court setting. Presumably, it is only costs saved by violating the law that should be taken into account, and if such costs

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[41] This was truer when retailing could be characterized as a highly fragmented industry. As it becomes more concentrated, new entry may have to be accomplished at a much larger scale in order to be effective. For example, see the discussion of entry barriers in the Staples/Office Depot merger in Serdar Dalkir and Frederick R. Warren-Boulton, "Prices, Market Definition, and the Effects of Merger: Staples-Office Depot (1997), in John E. Kwoka, Jr. and Lawrence J. White (eds.), *The Antitrust Revolution* (NY 1999, 3rd ed.), at 154-56.

[42] Herbert Hovenkamp, *The Antitrust Enterprise, Principle and Execution* (Harvard Univ. Press, 2005).

[43] Id., at 165.

were not determined according to legal process, it is doubtful that an antitrust court should go into what would in effect be a criminal trial on a side issue to determine what externalized costs can be considered. Without prior convictions replete with cost data for the same period as the antitrust violations being alleged—that is, in most situations one could imagine—there is little hope that externalized costs will become significant in predatory pricing litigation.

The overall assessment is that Wal-Mart's marketing strategy in the future might lead to its testing out higher prices in order to raise profitability, but the current law of predatory pricing under Section 2 of the Sherman Act is unlikely to be violated even if there is evidence that Wal-Mart targets particular incumbent competitors or entrants and can be shown to price below costs until the targets have been controlled—because in the downstream market, Wal-Mart does not have sufficient market share to be considered a monopolist. It remains to examine Wal-Mart's role as a power buyer and how that may affect our evaluation of its downstream strategies.

Bullying Suppliers

If predatory pricing is not particularly an issue, are there other strategies that Wal-Mart might use to crush rival retailers?

To answer this, we need to proceed to the last and most relevant of the principal criticisms of Wal-Mart, that it bullies its suppliers. It is likely that Wal-Mart bullies its suppliers into price-discriminatory deals that have a negative impact on Wal-Mart's horizontal rivals. But is this actionable?

As a former retailer, I can attest that it is every retailer's sacred duty to attempt to bully one's suppliers, i.e., to drive the best possible bargain. But when a retailer is relatively small, its importance to a supplier is also relatively small and while it can bargain and even threaten, the supplier is not likely to strike a deal that is to not to the supplier's advantage.[44]

A power buyer like Wal-Mart, however, may control twenty or thirty percent or more of the national market.[45] Whether it offers shelf space for the supplier's product

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[44] My 22-store retail jewelry company (bigger than a mom-and-pop, but tiny compared to a national chain) often found that when we would push hard, the supplier would respond that he would sincerely like to accommodate our desire for an even lower price, but under the Robinson-Patman Act, he had to treat all retailers equally. Or, if he wanted our business badly enough, he would simply reduce the price and Robinson-Patman would go unmentioned.

[45] Lynn reports, "[T]hat one in every five retail sales in America is recorded at Wal-Mart's cash registers; that the firm's revenue nearly equals that of the next six retailers combined; that for many goods, Wal-Mart accounts for upward of 30 percent of U.S. sales, and plans to more than double its sales within the next five years." Barry C. Lynn, "Breaking the Chain, The Antitrust Case against Wal-Mart," Harper's Magazine 29, 30 (July, 2006).

may determine the supplier's very ability to remain in business. In theory, suppliers (especially large ones) are grown-ups who should be able to determine what is in their self-interest. They should be able to know up-front that dealing with Wal-Mart can be deadly and they should not commit to contractual terms that will hurt them. Do they, therefore, deserve any sort of antitrust protection from their own folly? Wal-Mart denies treating its suppliers badly and proclaims that they are true partners. It makes no sense, their Chairman says, to drive your partner so harshly that it doesn't want to do business with you – or cannot.[46]

Let me offer a *frog-ian* hypothesis that may justify antitrust intervention.[47] Apparently, when a supplier's relationship with Wal-Mart begins, there is some bargaining. The supplier is likely to be strongly attracted to the huge volumes that Wal-Mart is able to buy and sell, even if the profit margin is seen to be low. Wal-Mart puts its best foot forward. There is a meeting of the minds.

Producing at a scale large enough to satisfy Wal-Mart's demands is likely to require the supplier to expand capacity—a sunk cost. Possibly, the scaled-up production creates economies of scale for the supplier that make it possible to produce at a lower average per-unit cost, and therefore be more attractive to other customers.

The problem is that Wal-Mart apparently has an established strategy of demanding each year that the price be reduced by 5% or that the product be improved—meaning lower margins or more sunk costs for the supplier.[48] Sometimes there are efficiencies to be found or downward quality adjustments to be made, that will justify the price reduction. Sometimes it is necessary for the supplier to shift production to a lower-cost country such as China in order to produce at a price that accommodates Wal-Mart.

Like a frog in a pot of gradually heating water that is not at first hot enough to cause him to leap out, the supplier finds itself trapped in a rising temperature that eventually becomes deadly. To drop Wal-Mart as a customer becomes virtually unthinkable because the supplier's margins are already in trouble by this time and one cannot quickly replace a customer with 20-30 percent of the national market. Soon the supplier is in deep trouble (hot water, if you will), leading to a merger or bankruptcy.

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[46] Wal-Mart Chairman Rob Walton told the American Antitrust Institute's conference on buyer power, "Wal-Mart depends on maintaining a sustainable business relationship with each of our suppliers. It is important that Wal-Mart's suppliers remain profitable on their sales to Wal-Mart so they can continue to keep our shelves fully stocked with the assortment of products our customers demand…I am proud to say that Wal-Mart enjoys a reputation among our suppliers for fair dealing." R. Robson Walton, "Wal-Mart, Supplier-Partners, and the Buyer Power Issue," 72 Antitrust L.J. 509, 512 (2005).

[47] The hypothesis rests heavily on the descriptions of Wal-Mart's behavior found in Fishman, *The Wal-Mart Effect*, and Bianco, *The Bully of Bentonville*.

[48] Fishman, 88.

Bullying is alleged to take a variety of forms, including not only the take-it-or-leave-us threat to reduce the price each year, but insistence that the supplier bear many of the costs of doing business that are usually borne by retailers.[49]

It is important to recognize that business decisions are not made with perfect information. Despite its data resources, Wal-Mart does not have the knowledge to be sure exactly how far it can push before killing off the supplier. And the supplier may not know exactly how far it can afford to be pushed-- or it may simply lack realistic alternatives. In after-the-fact litigation, it may take years to determine what was or was not below "an appropriate measure of cost." When a deal is on the table, there is little opportunity or ability to be sure about one's future costs, not to mention present ones. Which are fixed? Which are variable? How will they change over time in the presence of economies of scale and potentially changing input costs? The history of suppliers who were apparently healthy when they commenced doing business with Wal-Mart but ended up losing their independence or their corporate life suggests that Wal-Mart has not always been the very considerate and team-oriented partner that it self-portrays.[50]

The Waterbed Effect

The key to competition analysis of buyer power may be what is becoming known as "the waterbed effect."[51] Wal-Mart's suppliers are not generally subject to exclusive dealing provisions. They are not only free to sell to other retailers but they must do so, if they are to meet their own profitability objectives. Meeting a profitability objective, it goes without saying, is essential to a business that expects and desires to stay in business and to attract capital. If Wal-Mart is able to drive down the margin of profitability for the supplier when it sells to Wal-Mart, we hypothesize that it must necessarily attempt to increase the margin obtained on sales to Wal-Mart's horizontal competitors.[52] As profit

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[49] "Wal-Mart is, in fact, a genius at shifting work, and costs, that have traditionally been handled by retailers back to manufacturers." Fishman at 94.

[50] For example, consider the experiences of Vlasic, Huffy, Lovable, and Levi Strauss as related by Fishman, 79-109.

[51] See Paul W. Dobson, "Exploiting Buyer Power: Lessons from the British Grocery Trade," 72 Antitrust L.J. 529, 561: "At the retail level, the *virtuous* circle that the major retailers find themselves in is mirrored by a *vicious* circle that smaller retailers are caught in—smaller retailers face increased price differentials from what might amount to a 'waterbed' effect in which low purchase prices for the major retailers force suppliers to charge higher prices to smaller retailers in order to cover fixed costs." It is possible that the essence of the waterbed effect is that smaller retailers cover the producer's fixed costs while the power buyer pays the marginal costs.

[52] Wal-Mart (Asda) considers the "waterbed theory" to be "without theoretical foundation or empirical support." Asda Overview Submission to U.K. Competition Commission's Groceries Inquiry, 10 August 2006. A logical question might be how a supplier can raise prices to other purchasers, when its own market position has not been strengthened. The answer is that the supplier may lose customers, but if revenue is required to maintain a targeted profit level or even to cover fixed costs, the supplier has no effective choice.

margins tighten, the waterbed effect might be driven by the supplier's need to cover its fixed costs.[53]

The waterbed effect means that Wal-Mart's exercise of buyer power has a two-fold positive impact for Wal-Mart. First, Wal-Mart reduces its own cost of goods sold, which increases its margin and gives it the choice of taking additional profits or gaining market share through reducing its price to consumers. Second, the waterbed effect raises the costs of Wal-Mart's rivals, making them even less competitive with Wal-Mart. Logically, Wal-Mart will grow stronger and its rivals weaker. From Wal-Mart's perspective, this is part of a virtuous cycle. From the perspective of competing retailers, it is a vicious cycle. It may be that in the long run, as competing retailers sell less and less of the product (and Wal-Mart sells more), that there would be a net fall-off in overall production, but this is speculative and depends on assumptions about Wal-Mart raising its prices after it has captured a larger share of the overall market and new entrants being intimidated.

Because "monopsony" is a term that is so entangled with economists' elaborations on monopoly, which might lead to an unduly narrow interpretation, it may be useful to think instead of "Buyer Power" as part of a continuum reflecting the relationship between buyer and seller. At one end the seller has sufficient dominance to set price and drive a transaction, at the other end the buyer has such dominance, and in the middle there is rough parity. At the ends of the continuum are pure monopoly and pure monopsony. As bargaining power for one side increases, antitrust intervention becomes more justifiable. The part of the continuum that should be thought of as Buyer Power includes monopsony but also includes the part of the continuum in which the buyer has so much of an advantage that its actions cause disruptions in the competitive process. Robert Steiner characterizes the battle between seller and buyer over who will get how much of the consumer's dollar as "vertical competition" and he emphasizes that "horizontal and vertical relationships are closely intertwined."[54] Steiner also observes that

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[53] It might be argued that even though the supplier's margin and price are reduced, the quantity of goods sold goes way up when dealing with Wal-Mart and that this means that the gross margin dollars, which the supplier takes to the bank, will go up. Even if this were true, investors and banks generally pay more attention to measures like profit margins, return on assets, and their trends rather than absolute dollars of profit. Nevertheless, as Robert L. Steiner has pointed out to me, there may be some situations where Wal-Mart is in effect subsidizing smaller retailers. In an e-mail to the author, Steiner writes, "Say a manufacturer with fixed and variable costs receives a huge order from a very large customer and sells it at a thin markup but the total dollar revenues in excess of his variable costs are sufficiently large to cover his fixed costs for the year. That manufacturer is then clearly able to make a profit by filling smaller orders at the same price. Indeed, the smaller retailers would probably have had to pay a higher price--one that was calculated to help cover his overhead-- were it not for the big buyer's order. The fact that the smaller buyers have to pay a higher cost than the big retailer is therefore not due to any waterbed effect but is entirely explained by their lack of upstream bargaining leverage compared to the big buyer." I have my doubts how often these circumstances will hold, but the matter ought to be subjected to empirical study. To the extent that the supplier's per unit costs are reduced because of the increased output attributable to dealing with Wal-Mart, the potential loss of Wal-Mart's business becomes all the more catastrophic for the supplier to contemplate.

[54] Robert L. Steiner, "The Evolution and Applications of Dual-Stage Thinking," 49 Antitrust Bulletin 877, 897 (2004).

the exercise of monopsony power [i.e., bargaining clout] by large retailers typically "has forced down the factory prices of dominant manufacturers' brands to the benefit of consumers."[55]

Price Discrimination

So, shouldn't we applaud the lower prices for consumers, no matter how hard a Wal-Mart bullies a supplier? The answer may be found at the line that separates efficiency-driven reductions from muscle-driven reductions. This demarcation line, too, is slippery to ascertain, but it is the same line that animates the Robinson-Patman Act, the one law that was passed with the problem of buyer power in mind.

Under the terms and legislative intent of the Robinson-Patman Act, inducing price discrimination is illegal, unless it is cost-justified or needed in order to meet the competition. Applying the test to Wal-Mart, Wal-Mart should be entitled to seek a lower price than its competitors if it can show that there are things about selling to Wal-Mart (such as selling in full truckloads or eliminating an element of packaging) that reduce transaction costs or manufacturing costs by an amount approximately no less than the beneficial price differential given to Wal-Mart. If this results in Wal-Mart gaining a competitive advantage, no one is deemed to be injured (even though rivals are disadvantaged) and consumers may be winners.[56] On the other hand, if Wal-Mart obtains a price differential that is more than what cost reductions can justify, the presumption must be that it has used its muscle power to gain an unfair advantage. Unfortunately, the Robinson-Patman Act has not been interpreted in such a way as to make it a realistic threat to buyer-induced price discrimination. [57] The author is not aware of empirical data that would suggest whether Wal-Mart's low purchasing prices can be fully cost-justified all of the time, most of the time, or rarely.

Assuming the purchasing prices are not usually fully justified, the consequences of allowing muscle power to dictate Wal-Mart's discount would in theory include the

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[55] Id., 908.

[56] Meeting the competition does not seem to be a defense that is relevant to the Wal-Mart justification for inducing price discrimination.

[57] Section 2(f) of the Robinson-Patman Act,15 U.S.C. sec. 13, makes it "unlawful for any person…knowingly to induce or receive a discrimination in price which is prohibited by this section." This has been interpreted by the Supreme Court in *Great Atlantic & Pacific Tea Co. v. FTC*, 440 U.S. 69 (1979), to depend on the perspective of the seller. "Consequently, if the seller has a meeting competition or cost justification defense, which very well might be provided by the buyer's claims, the seller would not be viewed as violating the section. Since the seller has not violated section 2, the buyer has not 'induced' an illegal price and, therefore, is not in violation itself. In effect, a section of the Clayton Act that seems to have been aimed directly at the use of monopsony power hardly seems much of a threat to those possessing and exercising that power." Roger D. Blair and Jeffrey L. Harrison, *Monopsony, Antitrust Law and Economics* (Princeton, 1993) at 20.

waterbed effect that kills off competing retailers or leads them to merge, promotes consolidation at the supplier level, and stifles investment in innovation, all of which presumably lead in the long run to a reduced range of choices for consumers.[58] Consolidation at the supplier level is promoted because even very large suppliers are not able to bargain as equals with Wal-Mart—so the strongest try to bulk up to create countervailing power while the weaker see a bleak future and conclude they must exit the market for the maximum current value—by selling out before it is too late. It is widely believed that the Proctor & Gamble acquisition of Gillette was of this countervailing power nature.[59] Consolidation at the retail level is a strategic response aimed at achieving buyer power that more closely emulates Wal-Mart's. Interestingly, exit by merger is facilitated by our current merger control regime, which limits its concerns almost exclusively to short-term price increases. While the abuse of buyer power by a retailer is hardly ever of concern to our antitrust enforcers, the existence of buyer power downstream is sometimes seen as a defense for upstream mergers, on the theory that the Power Buyer will be able to keep the merged firm from raising prices.[60]

Power Buying and the Goals of Antitrust

Although a Wal-Mart may carry 120,000 items in a Supercenter and 60,000 in a typical store,[61] the variety of products within a particular category is necessarily limited. The strategy is to turn over a huge volume of the most popular items within a product line. This is why some niche retailers who focus on the slower-turning items that Wal-Mart won't likely stock may be able to survive. Consumers' range of choice might be protected if niche retailers can flourish and if e-commerce continues to expand consumer opportunities. In addition, however, manufacturers must have incentive to invest in the development and maintenance of products that Wal-Mart will not sell.[62]

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[58] Kirkwood notes five settings in which persistent, unjustified price discrimination induced by large buyers appear to pose a significant threat to consumer welfare: (1) disadvantaging of unfavored buyers, reducing their competitive vigor; (2) higher prices if the large buyer acquires market power as a seller; (3) higher prices if supplier has to raise prices to unfavored buyers; (4) possibility of the favored buyer becoming less efficient; and (5) reduction of profitability of suppliers, causing them to curtail investment in the industry. 72 Antitrust L.J. 625, 647-51. (2005).

[59] Fishman, 12.

[60] See Lawrence A. Sullivan and Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* (West Group 200) section 11.2h3.

[61] Fishman 15.

[62] Lynn reports that since 2004, Kraft, which had recently been celebrated as a leading company, announced plans to close 39 plants and eliminate one quarter of its products, a reduction in products that he attributes to the demands of Wal-Mart and other discounters to continue to lower Kraft's prices. Lynn, "Breaking the Chain," Harper's Magazine (July 2006), 29, 30. We do not know to what extent the quarter of Kraft's products that were eliminated have been replaced by near substitutes.

Is antitrust up to the challenge of Wal-Mart? Before anything else happens, the antitrust community has to determine that there *is in fact* a challenge. The Antitrust Modernization Commission chose not to address buyer power as a topic, even though if one were to think for a moment about the changes in the economy that might warrant modernization of antitrust, the shift from a manufacturing-based to a service-based economy would surely be near the top of the list.[63] Even worse, the AMC overwhelmingly voted (by straw vote in July, 2006) to recommend abolition of the Robinson-Patman Act. However poorly drafted the RPA, however poorly it has served consumer welfare, it surely deserved more debate, an empirical basis, and at least some discussion of its possible relevance to Wal-Mart and other power buyers. Hopefully, Congress will be more respectful of the issue.

Efforts to repeal the Robinson-Patman Act, should any ensue, need to take cognizance of the buyer power problem. Herbert Hovenkamp, who supports outright repeal, says, "The one situation where a manufacturer's price discrimination to resellers can be anticompetitive occurs when the low price is coerced by a powerful dealer."[64] Hovenkamp believes that "[A]ny legitimately anticompetitive price concessions compelled by powerful buyers could be dealt with under Section 1 or occasionally Section 2 of the Sherman Act."[65] We have already discussed some of the considerations that may make this crucial generalization tenuous.

It is difficult to see where Section 1 (agreements in unreasonable restraint of trade) would come into play in an analysis of Wal-Mart's relationship with suppliers. Vertical agreements, except for resale price maintenance which is not likely to be in question, are subject to rule of reason analysis, and an agreement between a powerful retailer and a supplier that might lead to lower prices for consumers is not likely to be viewed as an unreasonable restraint of trade.

Section 2 requires a defendant with monopoly power, practically defined as perhaps 60 percent of a relevant market. Robinson-Patman, which has no monopoly power prerequisite, seems to have more of an incipient anti-monopoly function. That is, suppose a power buyer has 20 percent of a relevant retail market, but that it is powerful enough to buy its inputs at close to their suppliers' average variable costs, while its smaller rivals must buy their inputs at approximately their suppliers' average total costs.

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[63] The American Antitrust Institute had strongly urged the Antitrust Modernization Commission to take up the issue of buyer power. http://www.antitrustinstitute.org/recent2/396.cfm.

[64] Herbert Hovenkamp, *The Antitrust Enterprise, Principle and Execution* (Harvard 2005) at 197. Also see Daniel S. Savrin, "The Robinson-Patman Act: A Failed Experiment in Curbing Buyer Power," 4 Robinson-Patman Act Newsletter of the ABA Antitrust Section, (winter 2006): "If buyer power genuinely presents an issue that warrants concern, as a matter of public policy, the analysis of the appropriate response ought to come in a context that is broader than a simple referendum on the Robinson-Patman Act. Rather, it should entail a careful factual and economic analysis of the current state and impact of buyer power on both supply and consumer markets, and the most effective and efficient means to check the improper or undue exercise of such power, without otherwise restraining competition and consumer welfare." At 4.

[65] Id., 197-98.

In other words, the smaller rivals must cover the suppliers' fixed costs, if the suppliers are to stay in business. Having raised its rivals' costs, at least relatively, through the exercise of buyer power, the power buyer's market share will almost inevitably grow, perhaps until it achieves monopoly status. If this type of induction of price discrimination could be successfully challenged under Robinson-Patman, the growth toward monopoly—more likely toward tight oligopoly-- could be slowed or stopped.

The AMC in its very limited debate about the future of Robinson-Patman did not consider to what extent the Sherman Act can be used to deal with power buyers. In fact, after deciding that it would not recommend any legislative changes to Section 2 but hoped the law could be "clarified," the Modernization Commission punted the question of how to clarify Section 2 over to a joint project on Single Firm Conduct being conducted by the FTC and the Department of Justice.[66] Buyer Power was literally the first topic taken up by the joint hearings, but only insofar as it related to a case that was then headed to the Supreme Court, namely *Ross Simmons v. Weyerhaeuser*.[67]

This unusual case is all about a rather unique phenomenon: predatory overbidding. A jury found that a dominant firm in the lumber industry, Weyerhaeuser, intentionally bid too high for alderwood logs, driving smaller sawmills out of the market. The Ninth Circuit upheld a substantial verdict against Weyerhaeuser. The Government supported Weyerhaeuser before the Supreme Court in its amicus brief, seeking application of the same predatory pricing standards that apply to seller-side predatory pricing. The AAI and others argued that the situations are not parallel and premature application of a theoretical solution to a unique situation, where there is little prior experience, could set a bad precedent for all future situations involving buyer power.[68]

One of the interesting questions in *Weyerhaeuser* is whether the Sherman Act creates any obligations on the part of dominant buyers toward suppliers, assuming end-use consumers are not injured. In this case, it is arguable that consumers who buy lumber will not be affected, because even if Weyerhaeuser becomes the only buyer and the only seller of alderwood logs, it sells those logs into a competitive hardwood market that includes many other kinds of wood, and cannot price except in relation to the other woods. On the other hand, the kind of harm done by Weyerhaeuser's overbidding strategy is targeted at the upstream market. Are there no obligations of fair competition toward that market? If consumers are entitled to the benefits of a competitive market, where prices are set in a competitive marketplace, aren't suppliers equally entitled to the benefits of competition? If competition is supposed to result in the most efficient allocation of resources, doesn't upstream muscle power exercised by a power buyer

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[66] The website for the joint hearings is http://www.ftc.gov/os/sectiontwohearings/index.htm.

[67] No. 05-381, Supreme Court of the United States on writ of certiorari to the Ninth Circuit, was argued on November 28, 2006. The transcript may be found at http://www.supremecourtus.gov/oral_arguments/argument_transcripts/05-381.pdf.

[68] Brief of the American Antitrust Institute as Amicus Curiae in Support of the Respondent, http://www.antitrustinstitute.org/recent2/544.pdf. The case was argued on November 28, 2006.

generate misleading signals to the market and hence is it not inefficient? How the Supreme Court addresses the issues in *Weyerhaeuser* could be determinative for other situations involving buyer power.

Thus buyer power raises a question about the goals of antitrust. Is the only goal obtaining the lowest prices for end-use consumers in the near term? That is the current mantra, but it can be a nearsighted goal. Even if something called efficiency is the super-goal, there is a question of time frame, and the lens that only sees the near-term is missing the more important part of the picture. What consumers want from a market economy is choice and innovation as well as low prices and if all three goals cannot be achieved simultaneously, some sort of balance is needed.[69] Innovation requires a longer vision of a changing economy. If near term low prices means fragile supply lines, that may not be in the general interest. If near term low prices means the destruction of reasonably efficient upstream firms and high levels of concentration upstream, this can undermine opportunities for newcomers and incentives to invest in them. What seems like a high level of productivity today can morph into much lower productivity in the years ahead. On the other hand, rules that unduly restrict a power buyer from hard bargaining can be very costly to exactly those consumers whom antitrust is intended to protect.

Concluding Remarks

After discussing these matters with the Senate Judiciary Committee staff, I was asked what we should do. My answer was—and is-- that we are still trying to figure out the right questions to ask. This paper provides what are essentially hypotheses that might be tested in public hearings and through independent research. Ten key questions that have been intimated in the text are teased out in the appendix. With the AMC, FTC and Department of Justice seemingly not interested, it falls to Congress to hold hearings to obtain the facts on the Wal-Mart effect. Even very large companies are afraid to speak out against Wal-Mart because of its economic power.[70] Economic power usually translates into political power, so it will be a challenge to convince Congress to utilize its hearings and the subpoena power necessary to develop a full public record.

Whatever we may conclude after creating a full record that can be openly debated, the important thing is to not wander about like Mr. Magoo, certain in our mantras about consumer welfare and comfortable in our belief that the only significance of Wal-Mart is

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[69] Robert H. Lande and Neil Averitt, forthcoming [cite to be obtained] demonstrate that price and choice competition are not necessarily the same thing.

[70] See chapter six of Fishman, titled “What do we actually know about Wal-Mart?” Fishman notes, “The canon of Wal-Mart scholarship is so modest that in a couple of afternoons at the library, you can read every significant academic paper written about the company’s impact.” Page 140. Fishman, an experienced and award-winning journalist, found that “Wal-Mart had imposed a wall of silence around its operations, its relationships with its suppliers, even around the operations of its suppliers. The silence isn’t a matter of business etiquette or courtesy—it is policy, chillingly absolute.” Page 86.

that it illustrates the free market at its very apex, with antitrust able and at the ready if a problem happens to arise.

Would Mr. Magoo miss the lack of variety and choice of stores if the opposition is killed off? Or should he be quite happy just visiting one store for his entire shopping needs? Price is not everything, but it is important. Consumers also care about choice, quality, variety and innovation—and we owe it to ourselves to be sure we are not sacrificing long-term needs as we over-celebrate short-term discounts.

Appendix

Ten Questions that Should Be Pursued in Hearings on Wal-Mart and the Law of Power Buying

1. What is the evidence with respect to the alleged bullying of suppliers?

a. Has Wal-Mart frequently brought undue—coercive-- pressure on suppliers to reduce their prices?

b. What suppliers of Wal-Mart have been acquired, have merged, or have gone into bankruptcy? Were these considered strong companies prior to dealing with Wal-Mart?

c. Is the frog-in-the-pot model supported by evidence?

d. Why do suppliers not leave Wal-Mart if their profits are unduly squeezed during the relationship?

e. Most importantly, for antitrust purposes, how should the threshold of market power be determined on the buyer side? Should it be accepted as substantially lower than on the seller side?

2. What is the evidence with respect to the "waterbed effect" of Wal-Mart?

a. Do suppliers who provide low prices to Wal-Mart also raise prices to other customers in order to maintain a targeted profit margin?

b. If so, does this affect competition at the retail level?

c. Does the waterbed effect generate virtuous cycles (for Wal-Mart) and vicious cycles (for other retailers and suppliers)?

3. To what extent is consolidation at the supplier level an effect of the perceived need for countervailing power against Wal-Mart (and/or other Power Buyers)?

4. To what extent is consolidation at the retail level an effect of the perceived need to become a Power Buyer in order to compete against Wal-Mart (and/or other Power Buyers)?

5. In the evaluation of a proposed supplier merger, should the presence of a Power Buyer be considered a sufficient protection for consumers?

6. Why are there so few (if any) price discrimination cases under the Robinson-Patman Act against Wal-Mart?

a. Is it that harmful price discrimination does not occur?

b. Is it that it is too difficult to prove inducement of price discrimination?

c. Is it that the R-P defenses are too easy to assert and prove?

d. Is it the difficulty of drawing a line between cost-justified price breaks and the exercise of muscle power by a Power Buyer?

e. How could the statute be revised to deal with anticompetitive price discrimination induced by Power Buying?

7. What are the benefits to consumers of Power Buying and how can those benefits be maintained without allowing the waterbed effect to go unrestrained?

8. Is the short-run efficiency-based justification for not meddling with Power Buyers likely to lead to inefficiency in the longer run, by reducing the number of suppliers and the number of retailers to the point that new entry, investment in innovation, and consumer choice will suffer?

9. Is the law of price predation, which is tilted toward under-enforcement in order to avoid chilling aggressive price competition, unduly nearsighted?

a. Can foregone externalized costs be considered, in theory and in practice, when costs are calculated?

b. Should a strategy of price flexing by a Power Buyer who is not a monopolist, aiming lower or even below-cost prices at deterring new entrants, be subject to the antitrust laws?

10. If the Robinson-Patman Act is repealed, are Sections 1 or 2 of the Sherman Act adequate to reach competitive problems created by Power Buyers?