The Wrath of Khan:

An analysis of Lina Khan's treatment of vertical integration

By Tom Spencer, Young Voices[1]

Table of Contents:

[1] I'd like to thank Sam Bowman, Caleb Franz and Katie McAuliffe for helpful feedback and comments made throughout the writing of this paper. I'd also like to thank Young Voices for their support that made it possible.

Executive Summary

Antitrust legislation is vague by design, relying on uncertain phrases such as “unfair” and “competitive”. This has allowed enforcement to bend as economic understanding develops. The effects of this are obvious in the 20th century; during periods where the economic consensus emphasized the need for intervention the Courts tended to be interventionist, and during periods where economists emphasized the need for freedom, so did the Courts.

In recent years we have seen the growth of a movement strongly against the Chicagoan turn that embraced freedom. These advocates argue that an economy dominated by several powerful companies yields long-run harm in that it discourages innovation, harms workers, the environment and encourages monopolization.

This movement has been led by Lina Khan, current Chair of the Federal Trade Commission. Given the importance of her position it is essential that her arguments are properly understood, so that defenders of antitrust orthodoxy can better evaluate her policies. Lina Khan fits solidly within the structuralist school of thought that dominated antitrust in the middle of the 20th century. From this observation, I show that Khan’s ideas fail in the following ways:

1. Khan understates the efficiency benefits of vertical integration
2. The precedents Khan cites are misleading and fail to account for pro-integration judgements that followed the passing of the Sherman Act
3. Khan fails to provide a convincing argument about why consumers should accept higher prices
4. Khan ignores the strong association between innovation and vertical integration.

Introduction

The ideological battle between Chicagoan and Structuralist antitrust scholars has driven substantial legal change in the treatment of vertical integration.[2] Whilst exceptions do exist,[3] the bulk of the literature directly preceding the emergence of the Chicago School of Economics was fiercely suspicious of vertical integration.[4] This changed due to the development of a new school of antitrust analysis led by figures like Robert Bork[5], Ward S. Bowman Jr[6] and Richard Posner[7] leading to a more liberal treatment of vertical integration. To Chair of the Federal Trade Commission (FTC), Lina Khan this was a mistake. Khan argues that an excessively narrow judicial interpretation of anti-competitiveness has resulted in an overconcentration across the economy presenting economic harm.[8] Given the popular influence of her ideas, as well as the immense importance of her position, it is essential that her thought is well understood and scrutinized to ensure that antitrust continues to work in the publics best interests.

The following shall explicate the ideas of Lina Khan regarding vertical integration, in doing so critically analyzing her views considering the relevant economic literature. Part 2 shall provide a history of how the legal treatment of vertical integration has changed. This shall be followed in Part 3 by an examination into Lina Khan's academic material on vertical integration to provide a detailed summary of what she sees to be the errors of its treatment under orthodox antitrust analysis, as well as her views on how to address them. Part 4 will examine the theoretical and empirical economic literature on vertical integration and use this to assess the accuracy of Khan's claims. Finally, Part 5 will conclude drawing all the previous sections together to analyze the risks presented at the FTC due to Khan's leadership, and restating the problems that her policies will result in.

[2] Herbert Hovenkamp and Fiona Morton, "Framing the Chicago School of Antitrust Analysis" (2020) 168 University of Pennsylvania Law Review 1843.
[3] Ronald Coase, "The Nature of the Firm" (1937) 4 Economica 386.
[4] Joe Bain, "Industrial Organization" (1959 Wiley); Carl Kaysen & Donald Turner, "Antitrust Policy: An Economic and Legal Analysis" (1959 HUP).
[5] Robert Bork, "Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception" (1954) 22 University of Chicago Law Review 157.
[6] Ward Bowman Jr, "Tying Arrangements and the Leverage Problem" (1957) 67 Yale Law Journal 19.
[7] Richard Posner, "Antitrust Law: An Economic Perspective" (University of Chicago Press 1976).
[8] Lina Khan, "The Separation of Platform and Commerce" (2019) 119 Columbia Law Review 973.

Where we are and how we got here

Vertical integration occurs "when a firm does something for itself that it could otherwise procure on the market." [9] There are principally two types of vertical integration: downstream and upstream. The former refers to moving towards the consumer (I.e., a butcher buying a restaurant); whereas the latter refers to moving towards the supply (I.e., a butcher buying a farm). Legally, there are three ways that this could be done. Firstly, a firm could start doing something for itself, rather than purchasing that thing on the market or selling to an intermediary retailed (I.e., the butcher begins farming his own cattle). Secondly, a firm may acquire a different firm in a vertically relevant market (I.e., the butcher buys a restaurant to sell his meat in). Finally, through a relational contract between two vertically related firms that maintain separate legal ownership (I.e., the butchers' restaurant contracts to join a franchise).

American jurisprudence over which vertical integrations should be permitted has changed dramatically over time. This instability is because this area of law is particularly vulnerable to judicial activism.

The key pieces of legislation defining how vertical integration must be considered are the Sherman Act, the Clayton Act and the Federal Trade Commission Act.[10] This means that vertical integration would be prohibited where it would "substantially lessen competition"[11], constitute a "restraint of trade"[12] or would be an "unfair method of competition".[13] All these requirements, particularly those in the Sherman and Clayton Acts, are largely economic, thus lending themselves to legal analysis that would bend as economic understanding advances. For this reason, American jurisprudence over which vertical integrations should be permitted has changed dramatically over time. Indeed, this instability has been strengthened by the fact that this area of law has been particularly vulnerable to judicial activism. As Herbert Hovenkamp explains, "few *areas of economic law have experienced more fumbling, experimentation, and interest-group activity than the law of vertical integration*".[14]

Even so, at the passing of these pieces of legislation there were very few worries about any anti-competitive elements of vertical integration. The key insight was that of Adam Smith; namely, that the division of labor is limited by the size of the

[9] Martin Ricketts, "The Economics of Business Enterprise: An Introduction to Economic Organization and the Theory of the Firm" (4th edn, Elgar, 2019).
[10] Robert Cole, "General Discussion of Vertical Integration" in Robert Cole (eds), Vertical Integration in marketing (Urbana 1952).
[11] Clayton Act 1914, ch 323.
[12] Sherman Act 1890, ch 647.
[13] Federal Trade Commission Act 1914, ch 311.
[14] Herbert Hovenkamp, "The Law of Vertical Integration 1880-1960" (2010) 95 Iowa Law Review 863.

market.[15] This was taken to mean that there are economies of scale from specialization. Accordingly, larger markets tend towards disintegration.[16] For example, a small, isolated village will force all farmers to become butchers as well, however, in a larger market specialization will occur allowing for both specialist butchers and specialist farmers. For this reason, public and legal attention was more focused on horizontal harms. This is most clearly seen during the 'breaking up' of Standard Oil in 1911. The court paid considerable attention to the supposed horizontal harm that arose from Standard Oil's alleged monopoly, but its extreme vertical integration did not receive any substantial analysis.[17] This was used as precedent to justify two decades of lenient treatment of vertical integration by the courts.[18]

[L]arger markets tend towards disintergration. For example, a small isolated village will force all farmers to become butchers as well, however, in a larger market specialization will occur allowing for both specialist butchers and specialist farmers.

However, during the Great Depression this attitude changed thanks to the emergence of the Harvard school of industrial organization. These scholars were extremely fearful of what is known as foreclosure.[19] This occurs when a firm uses one line of business to disadvantage rivals in another line of business.[20] For this reason, Bain was skeptical of the Smithian argument that vertical integration would decrease as markets became more concentrated. Most controversially to modern observers was Bain's argument that vertical integration in manufacturing was motivated by a desire to avoid paying monopoly prices to suppliers "who *would otherwise be in highly concentrated markets*."[21] This is because most scholars now see such avoidances as a positive welfare-gain of vertical integration.[22] The work of Bain, as well as that of Henry Simons[23], Edward

[15] Adam Smith, "An inquiry into the nature and causes of the Wealth of Nations" (first published 1776, OUP 1976).
[16] George Stigler, "The Division of Labour is Limited by the Extent of the Market" (1951) 59 Journal of Political Economy 185.
[17] United States v Standard Oil Co of NJ , 221 U.S. 1, 76–77 (1911).
[18] George Ellery Hale, "Trust Dissolution: "Atomizing" Business Units of Monopolistic Size" (1940) 40 Columbia Law Review 615.
[19] Bain (n 4) at 358.
[20] Friedrich Kessler and Richard H. Stern, "Competition, Contract and Vertical Integration" (1959) 69 Yale Law Journal 16.
[21] Hovenkamp (n 14); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process" (1978) 21 Journal of Law and Economics. 297.
[22] Joseph Spengler, "Vertical Integration and Antitrust Policy" (1950) 1 The Journal of Political Economy 347.
[23] Henry Simons, "A positive programme for laissez-faire" (University of Chicago Press 1934).

Chamberlin[24] and John R Commons[25] before him, directly led to a new judicial understanding of when vertical integration would be anticompetitive.

After the appointment of Thurman Arnold as Assistant Attorney General responsible for Antitrust in 1938 the ideological ideas from Harvard came into Government. This can best be seen through the cases that dominated the era. As the most prominent one of the time, United States v Yellow Cab Co[26] deserves careful consideration. Here, the Supreme Court held that the Checker Cab Manufacturing Co's acquisition of several cab companies constituted a violation of the Sherman Act. The ratio of the decision was that Checker's actions constituted foreclosure since a consequence of them was that they would exclude large parts of the market through which cabs can be sold in interstate commerce.

After the appointment of Thurman Arnold as Assistant Attorney General responsible for Antitrust in 1938 the ideological ideas from Harvard came into Government.

This is particularly extreme when you consider that the only reason the monopoly power existed in the actions of Cities like Chicago to create a taxi monopoly[27]; Checker simply acquired an already existing monopoly that the cities had created. For example, New York City lacked these same policies and so just 15% of cabs would be excluded from using other companies there if Checker were to force this. Yet, there was no evidence that Checker even planned on mandating their taxis to exclusively use their cars in the first place.[28] It is therefore difficult to understand why this was held to be a violation given there was no evidence of harm ever taking place, or even being planned to take place and the monopoly power only existed due to State action to create that monopoly. However, such decisions were rampant in the era.[29] This development peaked in the 1968 Merger Guidelines. These concluded that ""*integration accomplished by a large vertical merger will usually raise entry barriers or disadvantage competitors to an extent not accounted for by, and wholly disproportionate to, such economies as may result from the merger*".[30]

This extreme anti-vertical integration attitude prompted a considerable amount of scholarship moving the Overton window towards acceptance of free markets. We can see this best in the writing of Robert Bork who directly challenged the notion of leverage and foreclosure as likely harms resulting from a vertical merger.[31] Bork

[24] Edward Chamberlin, "The Theory of Monopolistic Competition" (HUP 1933).
[25] John R Commons, "Legal Foundations of Capitalism" (Macmillan 1924).
[26] 332 U.S. 218 (1947).
[27] Edmund Kitch, "The Yellow Cab Antitrust Case" (1972) 15 The Journal of Law and Economics 2.
[28] 4 Brief for Appellee, at 16, United States v. Yellow Cab Co., 338 U.S. 338 (1949).
[29] See for example United States v. Philadelphia National Bank, 374 U.S. 321 (1963).
[30] U.S. Dep't of Justice, Merger Guidelines (1968), available at https://www.justice.gov/archives/atr/1968-merger-guidelines
[31] Robert Bork, "The Antitrust Paradox: A Policy at War with itself" (Basic Books 1978).

never did Chicago trounce its ideological opponents as plainly and lastingly as it did in the field of its early conquests—antitrust

argued that the "sole *merit*" of foreclosure theories "is *that it establishes a new high in preposterousness*".[32] There were three key arguments made in defense of vertical integration by Chicagoans at this time: I) firms cannot extract additional profits from branching out from a dominant position, since increasing the price of one would offset the profits of the other[33]; II) a firm can only foreclose rivals insofar as it generates cost savings which benefits the consumer[34]; III) vertical mergers generate significant efficiency-gains due to the elimination of double marginalization.[35]

These ideas manifested themselves in the Reagan Administration. This was highlighted in the 1982 merger guidelines that were considerably more deferential to vertical integration than their 1968 equivalent. The key difference was a change in presumption; now it was believed that vertical mergers would only pose antitrust problems if the acquired firm is operating in a concentrated market.[36] As a result, not a single vertical merger was challenged during the 1980s.[37] The impacts of this change were put best by Daniel Crane, *"of all of Chicago's law and economics conquests, antitrust was the most complete and resounding victory... never did Chicago trounce its ideological opponents as plainly and lastingly as it did in the field of its early conquests—antitrust."*[38]

The effects of this 'trouncing' maintain to this day. As Hovenkamp has explained most forms of vertical integration are understood to be "*economically beneficial and competitively benign*".[39] This represents a move from *per se* illegality to effective *per se* legality;[40] exactly what Bork advocated.[41] Although the legal basis for stopping vertical integration under the Clayton, Sherman and Federal Trade Commission Acts remain the same, the courts have continued to take the view that most integration will not satisfy the requirements of these acts to require state intervention.

---

[32] Ibid, at 231.
[33] Ibid, at 229.
[34] Ibid, at 236.
[35] Ibid, at 219.
[36] Oliver Williamson, "Vertical Merger Guidelines: Interpreting the 1982 Reforms" (1983) 71 California Law Review 2.
[37] Steven Salop, "Invigorating Vertical Merger Enforcement" (2018) 127 Yale Law Journal 1962.
[38] Daniel Crane, "Chicago, Post-Chicago and Neo-Chicago" (2009) 76 University of Chicago Law Review 1911.
[39] Herbert Hovenkamp, "Robert Bork and Vertical Integration: Leverage, Foreclosure and Efficiency" (2014) 79 Antitrust Law Journal 983.
[40] Daniel Sokol, "The Transformation on Vertical Restraints: Per Se Illegality, the Rule of Reason, and Per Se Legality" (2014) 79 Antitrust Law Journal 1003; Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 907 (2007).
[41] Robert Bork, "The Rule of Reason and the Per Se Concept: Price Fixing and Market Division Part II" (1966) 75 Yale Law Journal 373.

This can be seen most clearly in two areas: maximum resale price mechanism (RPM) and territorial restrictions. Previously the former, the act of "*raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce*" was prohibited.[42] However, citing the work of Bork, the Supreme Court overruled this precedent in 1997 arguing that these practices had no *per se* anti-consumer effect.[43] Today, maximum RPM is *per se* legal as a result of this judgment. The latter, territorial restrictions were declared *per se* unlawful in United States v Arnold, Schwinn and Co[44] on the basis that they impeded the viability of small businesses, a decision described by Robert Bork as "*not only wrong, but its rationale verged on mere wittiness"*.[45] Again, relying heavily on the work of Bork, citing him on five occasions, the Supreme Court overruled this restriction; they recognized correctly that territorial restrictions enhanced inter-brand competition from manufacturer efficiencies created by vertical restraints.[46] Like maximum RPM, territorial restrictions have become *per se* legal.[47]

[V]ertical mergers combine complementary economic functions and eliminate contracting frictions, they have the potential to create cognizable efficiencies that benefit competition and consumers

Whilst some restrictions on vertical integration do exist, the actions of competition authorities since the Reagan era have signalled a significant relaxation in the rules. Indeed, in the most recent Guidelines from the Department of Justice (DoJ) and FTC show this same willingness to support businesses right to vertically integrate. This is shown best in the following quote, "*Because vertical mergers combine complementary economic functions and eliminate contracting frictions, they have the potential to create cognizable efficiencies that benefit competition and consumers . . . The Agencies do not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is unlikely to be anticompetitive in any relevant market*".[48]

---

[42] United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211, 213 (1951); Albrecht v Heraldo Co., 390 U.S. 145 (1968).
[43] State Oil Co v Khan., 522 U.S. 3 (1997).
[44] 388 U.S. 365 (1967).
[45] Robert Bork, "Vertical Restraints: Schwinn Overruled" (1977) 1977 The Supreme Court Review 171, 172.
[46] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).
[47] Douglas Ginsburg, " Vertical Restraints: De Facto Legality Under the Rule of Reason" (1992) 60 Antitrust Law Journal 67, 71.
[48] U.S. Dep't of Justice & Fed. Trade Comm'n, Draft Vertical Merger Guidelines, Jan. 10, 2020, https://www.ftc.gov/news-events/press-releases/2020/01/ftc-doj-announce-draft-vertical-mergerguidelines-public-comment.

Khan's revolution

Despite her young age, Lina Khan has managed to grow to become one of the most influential people in antitrust. Her paper, Amazon's Antitrust Paradox, that she published whilst still a student was described by the New York Times as "*reframing decades of monopoly law*".[49] Her work, as I will describe, rails against the orthodox understanding of competition as it has existed since the 1980s. Although this has attracted significant criticism from the giants of the profession,[50] the fact that her work has now been recognized politically through her appointment to the Chairpersonship of the FTC implies that it is a necessity that her ideas are properly respected and evaluated. The following section shall aim to explicate her ideas laid out in her academic research without judgment as fairly as possible. I shall then weigh up her ideas in section 3 in light of the relevant economic literature.

The fact that her work has now been recognized politically through her appointment to the Chairpersonship of the FTC implies that it is a necessity that her ideas are properly respected and evaluated

Oligopoly is where Khan directs most of her attacks. She argues that a market dominated by a small number of very large firms is less likely to be competitive than a market with less market concentration. She provides three reasons to justify this claim: I) oligopolies enable dominant firms to coordinate, often tacitly, with much greater ease to maintain their dominance; II) oligopolies can use their existing dominance to block new entrants; III) oligopolies have greater bargaining power enabling them to hike prices and lessen quality of a service without losing profits.[51] Although contemporary antitrust does account for price and quality, it often ignores other damages that come from oligopoly like harm to "*workers, producers, entrepreneurs, and citizens*".[52]

In contrast, Khan emphasizes that a return to structuralism would address these issues. Whilst in the short-run it may be the case that consumer welfare is maximized by an assessment of prices and output, Khan would argue that examining the "*health of the market as a whole*" is a better metric for conducting antitrust.[53] The emergence of network industries, in particular Amazon, has presented problems with markets that the current approach is incapable of solving.

[49] David Streitfeld, "Amazon's Antitrust Antagonist has a Breakthrough Idea" New York Times (New York, September 7 2018) < https://www.nytimes.com/2018/09/07/technology/monopoly-antitrust-lina-khan-amazon.html>

[50] Herbert Hovenkamp, "Whatever did happen to the antitrust movement" (2018) 94 Notre Dame Law Review 583; Joshua Wright, Elyse Dorse, Jonathan Klick and Jan M. Rybnicek, "Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust" (2018) 51 Arizona State Law Journal 293.

[51] Lina Khan, "Amazon's Antitrust Paradox" (2017) 126 Yale Law Journal 710, 718.

[52] Ibid, at 737.

[53] Ibid, at 716.

This is because dominant digital platforms integrate across business lines to an extent where they operate both as the platform and market for their own goods. Khan writes, *"this structure places dominant platforms in direct competition with some of the businesses that depend on them, creating a conflict of interest that platforms can exploit to further entrench their dominance, thwart competition, and stifle innovation".*[54]

Where dominant network firms vertically integrate, they often become the infrastructure by which their competitors compete, creating what Khan would see as an unfair benefit to the detriment of the competitiveness of the market

Khan's analysis of Amazon's vertical integration into the delivery market through the creation of the Fulfillment-by-Amazon (FBA) service is particularly useful in the effort to understand their views. A consequence of Amazon's dominance of E-commerce is the considerable bargaining power it has accrued with delivery companies. As an example, in 2015 UPS derived $1,000,000,000 in value from Amazon alone.[55] This has allowed Amazon to receive considerable discounts estimated at 70% of regular delivery prices.[56] Lina Khan argues that Amazon have used the weakness of UPS that they have created to fill to create FBA, a logistics and delivery company for independent retailers. As well as offering cheaper prices than their competition, FBA has added perks in that they will store your products in their warehouses, package and post them, as well as allowing the retailers' consumers to benefit from Amazon Prime perks from the service. A big reason why Amazon were able to do this is because they were able to leverage their dominance to expand vertically. Indeed, even though they were taking trade away from the established logistics firms like UPS they continued to use them to deliver a huge amount of the goods sold using FBA. To Khan, antitrust law does not do enough to prohibit these practices.[57] Where dominant network firms vertically integrate, they often become the infrastructure by which their competitors compete, creating what Khan would see as an unfair benefit to the detriment of the competitiveness of the market.

Most relevant for the purposes of this essay are the proposals Khan offers to deal with these alleged harms. Chiefly she discusses two solutions: firstly, governing through competition; and secondly, governing through regulation. The former involves preventing these 'monopolies' from arising, whilst the latter stresses that we should regulate them in a way that forces them to act in the public interest.[58] Although Khan also suggests reforms to predatory pricing law as being beneficial

[54] Khan (n 8), at 977.
[55] Laura Stevens and Greg Bensinger, "Amazon seeks to ease ties with UPS" (Wall Street Journal, December 22nd 2015).
[56] Stephanie Clifford and Claire Cain Miller, "Wal-Mart says 'Try this on': Free Shipping" (New York Times, November 11th 2010).
[57] Khan (n 51), at 780.
[58] Ibid, at 790.

when explaining how one can clamp down on monopolies through competition, it is her suggested reforms to vertical integration that are more relevant to this essay.

Her favored way of dealing with this is to introduce further scrutiny to mergers that would allow the cross-leveraging of data.[59] Currently only mergers above a certain monetary threshold require agency review,[60] yet this is, in Khan's opinion, a poor proxy for harm. She suggests an automatic review of all deals involving the exchange of certain forms of data. This would work best for Khan if combined with a prophylactic ban on vertical integration for firms with a certain level of dominance, a policy similar to the separations regime recommended by fellow structuralist Tim Wu.[61] This would mean that, for example, Google would not be able to own both a search engine and a Maps service; or Amazon would not be able to run Amazon Basics. The inspiration for this comes from banking law.[62] Here, there has been a long-standing principle of separating platforms and commerce,[63] done under the argument that this prevents an excessive concentration of financial power under singular entities.[64] To Khan digital platforms now hold comparatively massive amounts of market power to financial firms, and thus similar regulation is not necessary.

This would mean that, for example, Google would not be able to own both a search engine and a Maps service; or Amazon would not be able to run Amazon Basics

The second way Khan suggests that we can regulate 'dominant platforms' is by accepting their monopolized status and regulating them in a way that supports the public interest. Historically many services have been accepted as public utilities, accepted as monopolies, and had their powers limited.[65] The most obvious example is railroads. By 1900 six railway firms had captured 90% of the market for coal resulting in high uniformed prices amongst the oligopolists.[66] In response, states decided to impose rules providing things like maximum rates of storage of grain for railway companies to ensure they would not extract an excessive amount of consumer welfare.[67] Khan applies this to today's issues by suggesting that legislation should be imposed to require that platforms do not discriminate in price

[59] Ibid, at 792.
[60] See Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 81 Fed. Reg. 4,299 (Jan. 26, 2016).
[61] Tim Wu, "The Master Switch: The Rise and Fall of Information Empires" (Atlantic Books 2010).
[62] Bank Holding Company Act S. Rep. No. 91-1084, at 2 (1970).
[63] Bernard Shull, "The Separation of Banking and Commerce: Origin, Development, and Implications for Antitrust" (1983) 28 Antitrust Bulletin 255, 259.
[64] Saule Omarova, "The Merchants of Wall Street: Banking, Commerce, and Commodities", 98 Minnesota Law Review 265, 268, 275.
[65] William Boyd, "Public Utility and the Low Carbon Future" (2014) 61 UCLA Law Review 1614, 1643.
[66] Khan (n 8), at 797.
[67] Munn v Illinois 94 U.S. 113 (1877).

or service.[68] She explains that, "[*T]his approach would permit the company to maintain its involvement across multiple lines of business and permit it to enjoy the benefits of scale while mitigating the concern that Amazon could unfairly advantage its own business or unfairly discriminate among platform users to gain leverage or market power*".[69] However, Khan admits that difficulties do exist with this approach in that it would require a price ceiling on the amount that Amazon can charge, which is often very difficult for regulators.[70]

The Economics of Hipsterism

The policy Khan is most unabashed about is separating platform and commerce. Building upon her arguments in Amazon's Antitrust Paradox, she is much clearer in Separations of Platforms and Commerce about the intellectual history behind separations and why they are advantageous in limiting the harm that arises from oligopoly in platforms. Reading the two papers together one can understand that she considers this the optimal solution, whilst other suggestions like regulating as public utilities are merely good solutions that would also work. Khan even suggests this could be done without Congressional approval through the FTCs Section 5 powers[71], as confirmed in National Petroleum Refiners Association v Federal Trade Commission.[72] I have restrained from making judgements on the efficacy of these views in order to present a fair picture of Khan's key policies that she would like to implement on vertical integration. The following shall make that judgement.

Building upon her arguments in Amazon's Antitrust Paradox, she is much clearer in Separations of Platforms and Commerce about the intellectual history behind separations and why they are advantageous

The key factor Khan seems to understate is the benefits that vertical integration delivers. For example, at length she argues that Amazon have an incentive to discriminate against rivals to their products, such as Amazon Basics, without confronting the considerable literature that firms have an incentive to do exactly the opposite. Where firms discriminate against certain services, they create a disincentive for other producers to use their services, lowering the value of the platform.[73] Whilst it may be true that firms, by internalizing complementary

[68] Khan (n 51) at 798.
[69] Ibid, at 799.
[70] See Friedrich Hayek, "The Use of Knowledge in Society" 4 American Economic Review 519.
[71] Khan (n 8), at 1078.
[72] 482 F.2d 672, 674–78 (D.C. Cir. 1973).
[73] Jonathan Neuchterlein, "Antitrust Oversight of an Antitrust Dispute: An Institutional Perspective on the Net Neutrality Debate" (2009) 7 Journal of Telecommunications and High Technology Law 19, 40; Joseph

externalities, will favor their own affiliates[74], it does not follow that this means they have an incentive to do so in a way that harms consumers.[75]Moreover, structural separation would not do anything to eliminate this discrimination, even if the lack of consumer harm is something structuralists are fine with.[76] Indeed, it is widely known that Amazon Basics consistently offers a cheaper service without sacrificing quality than its competitors.[77] If it becomes the case that Amazon begins offering a service where manufacturers are better off selling elsewhere, then they will. And, if it becomes the case that Amazon offer a service that fails to meet the standards of another retailer, whether it be on or offline, then consumers will use that.

This is particularly concerning as it will help to maintain existing anti-competitive structures in some industries. Whilst Khan is concerned that Amazon entering new industries will necessarily kill off the competition this could not be further from the truth. Take the example of Amazon entering the film production market.[78] Under a separation's regime, this would be viewed as killing off the competition of the established studio market dominated by firms like Disney.[79] By entering this market, Amazon can decrease the concentration of the established oligopolies and offer more choice to consumers. Indeed, it seems unlikely that if it was not for the pressure from new entrants Netflix and Amazon Prime Video, then Disney would have never launched their own streaming service. A per se prohibition from vertical integration for dominant firms would have stopped this pro-competitive integration and damaged both market and consumer interests.[80]

Vertical integration can eliminate this need by allowing firms with market power to run with less costs and allow more profitable stages of production to cross-subsidize less profitable, but still necessary, stages

Moreover, there are significant efficiency gains that arise from engaging in vertical integration that Khan fails to recognize sufficiently. Where firms are not vertically integrated, then profits will be extracted at every stage of the supply chain. Vertical integration can eliminate this need by allowing firms with market power to run with less costs and allow more profitable stages of the supply chain to cross-subsidize

---

Farrell and Philip Weiser, ”Modularity, Vertical Integration, and Open Access Policies: Towards a Convergence of Antitrust and Regulation in the Internet Age” (2003) 17 Harvard Journal of Law and Technology 85, 87.

[74] Ibid, at 41.

[75] Francine Lafontaine and Margaret Slade, ”Vertical Integration and Firm Boundaries: The Evidence” (2007) 45 Journal of Economic Literature 629, 649.

[76] Duarte Brito, Pedro Pereira and Joao Vareda, ”Does Vertical Separation Necessarily Reduce Quality Discrimination and Increase Welfare” (2012) 12 The B.E. Journal of Economic Analysis and Policy 1.

[77] Lauren Cahn, ”This Is Why AmazonBasics Products Are So Cheap” (Yahoo, December 19 2018).

[78] Ben Fritz, ”Amazon Studios going into Comics” (Los Angeles Times, September 12 2012).

[79] Andrew Currah, ”Hollywood versus the Internet: the media and entertainment industries in a digital and networked economy” (2006) 6 Journal of Economic Geography 4.

[80] Nick Petit, ”Big Tech and the Digital Economy: The Moligopoly Scenario” (Oxford University Press 2020).

less profitable, but still necessary, stages.[81] This is especially important in the technology firms that Khan directs most of her criticism.[82] Given firms are more likely to own specialized assets in the new economy[83], then they are particularly vulnerable to hold-up problems. A classic example of this is that of a car manufacturer. If a manufacturer invests in new technology, an opportunistic specialized distributor who understands the significant sunk costs of these investors may choose to delay the agreement of a contract. This risk will have to be factored in prices resulting in higher prices for consumers.[84] The evidence even goes as far as to show that higher rates of mergers within an industry will result in higher innovation, largely thanks to the elimination of hold-up risks.[85] The interconnectedness of global supply chains is especially dispersed for technology firms, and so this risk is especially strong.[86] If we were to separate a firm like Amazon from their logistics operations, then these costs would arise resulting in higher prices and a greater hesitancy to invest in new technology. As Bork wrote, "*[f]ragmentation for its own sake confers no clear gain, and it makes economic processes more costly*".[87]

Khan's ideas would result in higher prices, less efficiency, less innovation and even less competition in some markets. Khan does recognise these weaknesses and discusses them at length; however, she does not adequately explain why it is worth taking these risks to achieve her end goal of separating platforms and commerce

The economic literature isn't divided; Khan's ideas would result in higher prices, less efficiency, less innovation and even less competition in some markets. Khan does recognize these weaknesses and discusses them at length; however, she does not adequately explain why it is worth taking these risks to achieve her end goal of separating platforms and commerce.[88] Rather she employs ad hominem attacks on several peer reviewed studies by accusing lawyers like Daniel Sokol of holding a bias since they happen to work for a Law firm who have Google as client.[89] As

[81] Oliver Williamson, "Transaction Costs Economics: The Governance of Contractual Relations", 22 Journal of Law and Economics" (1979) 233, 245-46.
[82] Robert Crandall, "The Remedy for the "Bottleneck Monopoly" in Telecom: Isolate It, Share It, or Ignore It?" (2005) 72 University of Chicago Law Review 3, 23.
[83] Benjamin Klein, Robert Crawford and Armen Alchian, "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process" 21 The Journal of Law and Economics 297.
[84] Coase (n 3).
[85] Peter Chao-Wen Chen, "Mergers, Aggregate Productivity and Markups" (PhD Thesis, University of Chicago 2019).
[86] Alan Meese, "Reframing Antitrust In Light of Scientific Revolution: Accounting for Transaction Costs in Rule of Reason Analysis" (2010) 62 Hastings Law Journal 457.
[87] Bork (n 31), at 55.
[88] Khan (n 8), at 1085-88.
[89] Ibid, at 1086.

someone aiming to derail orthodoxy it is her responsibility to show why members of the public should accept higher prices in order to break up the firms who provide us with fantastic services. Her ideas fail to stand up to just mild economic scrutiny, and thus must be rejected.

Conclusions

As Chair of the FTC, Lina Khan holds a remarkable amount of power over American industrial organization, particularly related to vertical integration. The decision to investigate or not to investigate a merger is one that could impose significant economic costs on firms providing disincentives for integration that could bring about enormous benefits to consumers. Whilst the courts will always be the final arbitrator of these decisions, the practices of the FTC inevitably impact company decision making, and thus impact consumers.

The ideas promulgated by Lina Khan are at odds with the economic consensus as it has existed in the last 50 years. Heterodoxy does bring benefits from time to time, but where that heterodoxy will bring about lesser investment, innovation, choice and higher prices to American consumers, then it must be avoided. When giants of antitrust like Herbert Hovenkamp describe her work as "*technically undisciplined, untestable, and even incoherent*"[90], it becomes clear just how damaging it is to have someone so radical in such an important position of power. America is lucky that unlike the European Union, the Courts will resist over-zealous competition regulators, because if not the harm that Lina Khan's FTC could do would be significant.

The plight of the structuralist, new-brandeisians or hipster school of thought is to answer Henry Manne's famous question, "*Why should the government, and sometimes incumbent management, be using the antitrust laws to block mergers that the market, by the existence of willing buyers and sellers, demonstrates to be desirable*".[91] Lina Khan has failed to do that, and until she does her efforts to reform vertical integration law must be resisted.

[90] Herbert Hovenkamp, "Whatever did happen to the antitrust movement" (2018) 94 Notre Dame Law Review 2; James Stewart, "Antitrust Suit is Simple Calculus" (New York Times, September 9th 2011).
[91] Henry Manne, "In Defense of the Corporate Coup" (Reason, 1984).