

Reconsidering the Public Benefit Test in Merger Analysis: The Role of 'Pass Through'

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There appears to be a general economic and judicial consensus that 'total welfare' (that is, the sum of producer and consumer surplus) should be the basis for merger decisions under the authorisation process. This is borne out in both cases - one on each side of the Tasman - considering the proposed Qantas/Air NZ alliance. For instance, the "Tribunal, consistently with its previous determinations, adopted a test of assessing the benefits to the public said to be generated from the Alliance by considering the benefits which flowed not only to ultimate consumers but also to the parties and their shareholders."¹ Similarly the NZ High Court conducted an exercise of weighing carefully the monetary estimate of public benefits flowing from the alliance with monetary estimates of any reduction in efficiency (allocative, productive and dynamic) resulting from a substantial lessening of competition.²

It is not the purpose of this paper to comment specifically on these cases and the unusual circumstance of two courts applying essentially the same law on the same facts and coming to completely different conclusions. It is their framework for decision-making that interests me here. The Australian Competition Tribunal endorsed the Total Welfare Standard (or TWS) despite continued applications from the Australian Competition and Consumer Commission (ACCC) that it adopt a Consumer Welfare Standard (or CWS)

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¹ Qantas Airways Ltd [2004] ACompT 9, para.8.

² Air New Zealand and Anor v. Commerce Commission and Ors, HC AK CIV 2003 404 6590 [17 September 2004].

instead. The CWS would place all weight on consumer surplus and none on producer surplus in a merger authorisation.³

This is part of a long-standing debate regarding 'pass through': the notion that private benefits to a merger are only relevant if they are passed through to consumers. A requirement of pass through is consistent with a CWS in that mergers with productive efficiency benefits are only permitted if those benefits are (a) sufficient to overcome any competitive detriment and (b) are actually used to mitigate that competitive detriment. Detractors of a pass through requirement point out, however, that if maximising total welfare is the goal of competition policy then only (a) should be required of mergers and that (b) is distributional: involving a value judgment that the welfare of consumers is more important than the welfare of producers (or their owners). In a public benefits test all individuals would be regarded as part of the public.⁴ This is consistent with a TWS.

The Tribunal has long endorsed this wider view of public. In its *QCMA* decision,⁵ the Trade Practices Tribunal considered the public as a broader set than just consumers. They said:

This we see as anything of value to the community generally, any contribution to the aims pursued by the society including as one of the principal elements (in the context of Trade Practices Legislation) the achievement of the economic goals of efficiency and progress. If this concept is adopted, it is clear that it could be possible to argue in some cases that a benefit to the members or employees of the corporations involved serve some acknowledged end of public policy even though no immediate or direct benefit to others was demonstrable.⁶

This statement clearly rejects a requirement of pass-through. However, even in *Qantas*, the Tribunal, in affirming the TWS, found it difficult to let go and included an important caveat:

... that the weight that should be accorded to benefits achieved by producers might depend on whether and to

³ Except in "exceptional circumstances" that they argued were not present in the *Qantas* case.

⁴ Robert R. Officer and Philip L. Williams, "The Public Benefit Test in an Authorisation Decision," *The Law and the Market*, M. Richardson and P.L. Williams (eds.), Federation Press: Melbourne, 1995, pp.157-165.

⁵ *Re Queensland Co-Operative Milling Association Ltd, Defiance Holdings Ltd* (1976) ATPR 40-012; 25 FLR 169.

⁶ *ibid.*, ATPR 17,242; FLR 182-3.

what extent any cost savings or other benefits were passed on to consumers.⁷

Thus, some weight would continue to be placed on pass through. The Tribunal, however, offered no reason for this caveat.

In light of this, this paper revisits the general acceptance of a TWS. In so doing, I will address several key themes. First, I will describe the TWS and CWS and note that in both Qantas/Air NZ cases, the TWS was not strictly applied. Moreover, in the Tribunal, an explicit and important departure from TWS was advocated; although ultimately not applied as no substantial lessening of competition was seen as likely to occur. Second, I will consider the rationale for the TWS. However, there I will note that it is not, in fact, endorsed by economic thinking. Economists instead favour the Pareto criterion that does not place arbitrary weights on individuals' welfare.

Finally, I will reconsider the public benefit test not be means of a standard that merger policy should adhere to as a *matter of principle* but as a standard that it should adhere to as a *matter of process*: in order to ultimately achieve desirable outcomes. In this respect, I will demonstrate that there is a difference between accepting maximising total welfare as the goal of competition policy and applying a TWS to evaluate merger authorisation. Instead, I will argue for an augmented form of CWS as the appropriate standard by which mergers should be judged both by the ACCC and by the Courts. Put simply, *placing weight on pass through* is appropriate in order to actually ensure that mergers that take place maximise total welfare.⁸

Welfare Tests and Merger Analysis

To begin, it is useful to review the various welfare tests as they apply in merger analysis. A merger may have three broad classes of potential effects:

1. Potential consumer detriment due to a lessening of competition (C)
2. Net increase in profits for *all* suppliers (Π)
3. Net benefits to others outside of the market (B)

⁷ Op.cit., para. 8.

⁸ As such this paper resolves "[t]he puzzle as to why the Commission feels it can persist in its disregard for well-established principles of economics – when they have been consistently enunciated by the Tribunal." (Officer and Williams, op.cit., p.165) Put simply, by doing so, the Commission is not in fact disregarding those principles.

Each of these – C, Π and B – represent changes in the surplus accruing to various parties. So:

- Under a **consumer welfare standard** (CWS), a merger is only approved if C is not too large (i.e., $C < 0$).
- Under a **total welfare standard** (TWS), a merger is only approved if $C < \Pi + B$.

In this analysis, C represents the loss to consumer surplus as a result of any lessening of competition as a result of the merger. I note that this is not equivalent to the deadweight loss that might be caused or changed by a merger but includes also the higher prices consumers may have to pay.

Note that in separating out Π and B, I have disaggregated the usual notion of a public benefit; into profits and other. So in the Qantas case, items such as cost savings, engineering and maintenance work, improved scheduling, new flights and online benefits would be considered part of Π . The benefits to tourism from potential increased demand would be allocated between Π and B. This is because the former sets of benefits are almost purely private – benefiting the shareholders of the allied parties while the latter potential has an external effect on others in the tourism industry. As such, those benefits are closer to the meaning of ‘public’ as it would be defined by economists.⁹

Note also that Π includes the change in profits to all firms in an industry. A merger will generally have an impact on other firms in an industry. An anti-competitive one will benefit them while a pro-competitive one may harm them. A total welfare calculation will include these. While it can be a complicated task working these net effects out, below I will argue the case for neglecting Π altogether in merger analysis; which has the additional benefit of removing this practical complexity.

The Williamson Example

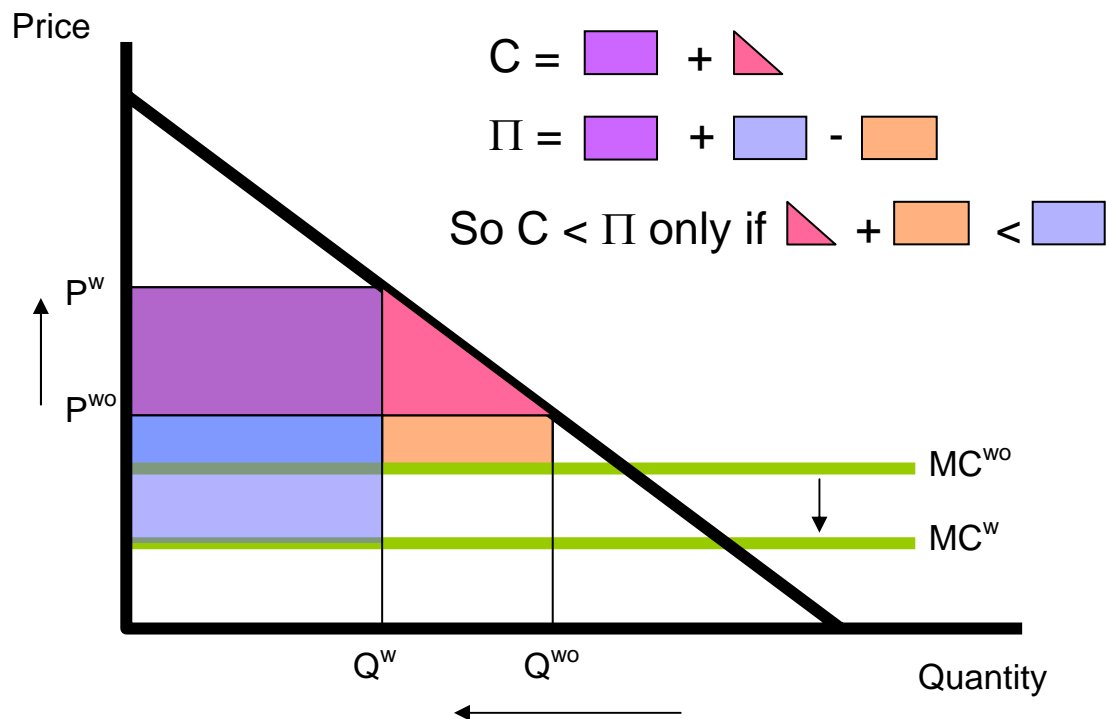
With these in mind it is useful at this point to review the classic analysis of Oliver Williamson of a merger to monopoly.¹⁰ Williamson considers a case where two firms in an industry merge to become a monopolist. However, the merger

⁹ See, for example, the definition of ‘public good’ in Joshua Gans, Stephen King and Gregory Mankiw, *Principles of Microeconomics*, 3rd Asia Pacific Edition, Thomson: Melbourne, 2005.

¹⁰ Oliver Williamson, “Economies as an Anti-trust Defense,” *American Economic Review*, 58 (1), 1968, pp.18-34. See also the discussion by Joseph Farrell and Carl Shapiro, “Scale Economies and Synergies in Horizontal Merger Analysis,” *Antitrust Law Journal*, 68, 2001, pp.685-710.

brings about synergies that reduce marginal costs.¹¹ Figure 1 describes the outcome. Assuming there are no 'pure' public benefits, note that to satisfy the CWS, marginal costs with the merger would have to fall by a substantial amount so that despite an increase in market power, consumers face lower prices. The figure depicts the case where those cost reductions are insufficient to bring about that outcome so that $C > 0$. Note that, in this case, the TWS nets out the higher prices paid by consumers as these accrue to the merged firm. This leaves an increase in deadweight loss to be compared against the net producer surplus (i.e., profit increase netting out the higher price) that itself depends largely on the magnitude of any cost reduction. So if those cost reductions or efficiencies are sufficiently high, the TWS will be satisfied.

Figure 1: TWS and the Williamson Example



The Qantas Test

As noted earlier, the Tribunal in the Qantas case reaffirmed its use of the TWS but included an important caveat:

... that the weight that should be accorded to benefits achieved by producers might depend on whether and to

¹¹ There is a real issue as to whether a horizontal merger can really bring about synergies that cannot be achieved in the absence of a merger. See Farrell and Shapiro, *op.cit.*

what extent any cost savings or other benefits were passed on to consumers.¹²

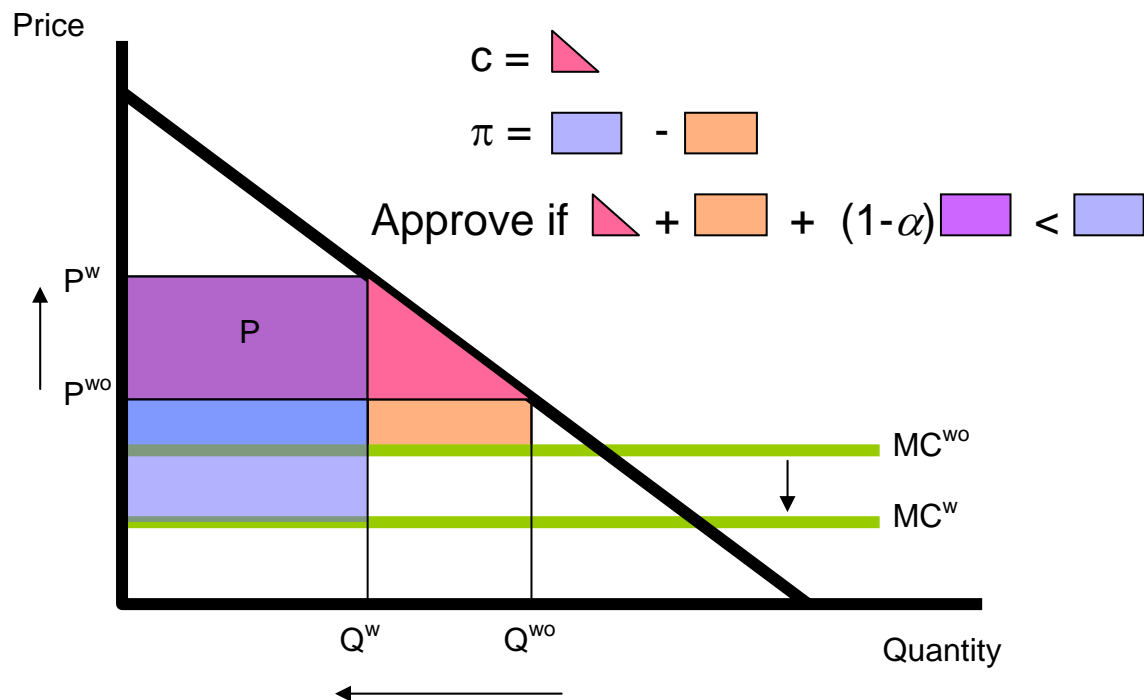
I interpret this to mean that the Tribunal is discounting, to some extent, the increased payment accruing to the merged firms. This caveat is potentially a considerable strengthening of the threshold for an approved merger relative to the TWS. In fact, in many respects it lies between the TWS and CWS.

To see this, let P be the additional payments made by consumers as a result of the merger. In the context of Figure 1, $P = (P^w - P^{wo})Q^w$. Define the net surpluses as: $c = C - P$ and $\pi = \Pi - P$. Then,

- Under the **Qantas test**, a merger is only approved if $c < \pi - (1 - \alpha)P$ or $c < \Pi - \alpha P$.

Here α is a number between 0 and 1 as defined by the Court. It represents the discount applied to payments, P , received by the merging firms. If $\alpha = 1$, then there is not discount and the test is the same as the TWS. If $\alpha = 0$, then payments to the firm are completely discounted and the threshold test becomes approve if $C < \pi$.

Figure 2: The Qantas Test



¹² *Op.cit.*, para. 8.

Evaluating the Total Welfare Standard

Here I now review the justifications and problems associated with the TWS. It is often said that this standard is advocated by economists. Indeed, as I point out below, this is not strictly true.

Justifying the TWS

The first justification for the TWS – a justification that does receive support from economists – is that “shareholders are people too.” This case is put very strongly by Officer and Williams¹³ who note that companies are made up of diverse groups including workers and shareholders. The latter may be dispersed throughout society at large representing individuals across the spectrum of wealth holdings. They go on:

... it is a mistake to believe that a general principle allocating resources or dollars away from companies to consumers increases the net welfare of society. The reverse also would be without foundation.¹⁴

They illustrate this with a simple but extreme example:

A good illustration of this concept is where a producer develops a patent that enables them to produce a product that is, say, 10 dollars better than competing products. If the producer sells the product at a 10-dollar higher price than the competition, then the full benefits of the patent have been captured by the producers and although consumers are no better off, they are no worse off, and therefore society or “the public” is better off by virtue that the producer is better off.¹⁵

This, however, is really more a critique of the CWS rather than an endorsement of the TWS. Put simply, the CWS only considers the welfare of consumers of the product of the market. However, the firms in the market are all owned – one way or another – by individual shareholders. Therefore, the CWS is a very narrow definition of consumer welfare: surely, shareholders have equivalent rights and the impact of the merger upon them should be taken into account.

The TWS does farther than this. It proposes to weight the net benefits received by shareholders by the *same amount* as the net costs to consumers. And Officer and Williams appear to endorse this: “a dollar is worth the same to the company as a dollar to its clients (consumers).” And this has guided quantitative assessments of public benefits. Officer and Williams continue in the spirit of their example:

¹³ Op.cit., pp.161-162.

¹⁴ Ibid., pp.161-162.

¹⁵ Ibid., p.162.

... let us consider the developer of the patent where it is believed there is a two-dollar detriment to consumers but there is a ten-dollar saving to the producer – a poorer quality product is produced. If none of the ten dollars saving from the producer was to pass to consumers, ie the poor quality product sold for the same price as the previously produced better quality product, and the two dollar detriment to consumers would be demonstrated, we have no doubt that the Trade Practices Commission, indeed, in all probability, the court, would find against the practice and prevent it being adopted.¹⁶

I am not so sure that is the case today. But, in any case, Officer and Williams would also appear to want the ACCC or the courts to permit this practice if the detriment to consumers was \$9 or \$9.99 or maybe even \$10. But I have my doubts as to whether a marginal increment to total welfare without any pass through would or should actually be approved.

Generally, economists are loathe to place weights on individual welfare and sum them up. First, consider the following example: do you think the theft of your wallet should be permissible if thief could demonstrate that the wallet and its contents were more valuable in their hands than in yours? The TWS would permit this. In effect, it implies that there are 'no lost wallets.' But this example should cause you to wonder whether there really is a one-to-one weighting of individuals.

Second, is true total welfare really ever taken into account in practice? Most analyses include the merging firms and their customers. But in general the profits of competitors are ignored. Indeed, in my reading of the two Qantas/ Air NZ cases, it did not appear to be considered at all. Nor are the impacts on related markets that share resources with the market in question. For example, an anti-competitive merger in one market will cause a reduction of output there freeing up resources that flow to other markets. The resulting expansion of supply will involve benefits to producers and consumers in those other markets.¹⁷ But the issue of shared resources and their alternative deployment has, to my knowledge, never been given explicit weight by the ACCC or the Tribunal.

In many respects, from an economic perspective, the comparisons and judgments associated with such distributional statements are beyond anything that comes from a 'value free' application of economics. Thus, pointing out that the welfare of shareholders may be impacted upon by a merger is different from

¹⁶ Ibid., pp.162-163.

¹⁷ See Yoon-Ho Alex Lee and Donald J. Brown, "Competition, Consumer Welfare and the Social Cost of Monopoly," *Cowles Foundation Discussion Paper* No. 1528, 2005; for a recent discussion of these 'general equilibrium' issues.

saying what weight one class of individuals should receive relative to another. Put simply, economics is agnostic between putting no, part, equal or all weight on shareholders in the evaluation of mergers.

The more direct rationales for the TWS have been articulated recently by Michal Gal.¹⁸ I review those here because of their citation in Qantas but also because of their particular application to small market economies. First, Gal argues that in smaller economies, it is better to have more than less when it comes to mergers. She argues that mergers can assist in avoiding stagnation. In a sense, they shake up industry and he regards this as positive.¹⁹ Gal notes that TWS is a weaker requirement than CWS. As such, it will naturally encourage more mergers and, as this is good, so is the TWS.

Gal also argues that in small economies, international competitiveness is an important criterion. She argues that a TWS takes into account the benefits from improved international competitiveness. She provides a hypothetical example:

One interesting example involves rum producers from the Caribbean islands. The Caribbean domestic market for rum is very competitive. At the same time, high distribution and marketing costs in potential foreign markets create significant obstacles to the export of rum. A merger or a joint venture among rum producers that would enable them to realize scale economies in distribution and marketing abroad and to export rum would increase total welfare if the revenues from sales to other markets are significant. But unless domestic firms are prevented from charging different prices for their products abroad and in their home markets, consumers in the domestic markets will most likely be worse off, given probable cooperative conduct among rum producers, if the cost savings do not affect the production or distribution prices in the domestic market. In such situations the consumer welfare standard will clash with the goals of increasing total welfare as well as the international competitiveness of firms.²⁰

Interestingly, this example is not a very convincing rationale for the TWS. Gal assumes that international competitiveness is impossible to achieve without

¹⁸ See Michal S. Gal, *Competition Policy for Small Market Economies*, Harvard University Press: Cambridge (MA), 2003.

¹⁹ It is not at all clear what the theory or evidence really is in support of this proposition.

²⁰ Gal, *op.cit.*, p.203.

domestic cooperation – to the detriment of domestic consumers. In reality, export marketing joint ventures are commonplace throughout the world, while allowing producers to continue to compete domestically. Thus, while it may be the case, that total welfare with no cooperation is lower than with full cooperation, it is most likely that total welfare will be *maximised* for a hybrid arrangements and a confined sphere of cooperation. It is this outcome that would be most desired and a simple application of the TWS to a single proposal – full cooperation – does not necessarily yield this outcome.

To summarise, it is sometimes said that a CWS is not necessary to achieve distributional goals. This can be left to other government policy instruments such taxation and social security.²¹ While true, the same applies to the TWS. It is also not necessary to ensure shareholders get a better slice of the pie.

In this respect, the best justification for the TWS is that it maximises the size of the overall pie. It does that by permitting mergers only when there is more money or wealth created by them than not. This provides a foundation for the use of other policy instruments to redistribute wealth.²² However, this does *require that money is a practical means of redistributing that wealth*. The problem is that this requirement is not always met and without it there is no way of measuring or determining if the pie is bigger or not.

The Pareto Criterion

The welfare standard economists endorse is the Pareto criterion.²³

- Under the **Pareto criterion**, a merger should be approved if at least one person is made better off and no one worse off as a result of the merger.

This criterion implies that policy makers should care about shareholders (as a broad group). It also implies that policy makers should care about the impacts of a merger on different merger classes. The key advantage of the Pareto criterion is that it defines a ‘no brainer’ in terms of merger analysis. Put simply, one does not need to make a value judgment to support mergers that do not harm. As soon as

²¹ Officer and Williams, op.cit., p.162.

²² A similar view is articulated with respect to microeconomic policy in general by Joshua Gans and Stephen King, *Finishing the Job*, Melbourne University Publishing: Melbourne, 2004.

²³ And legal scholars too: Robert Bork stated that “... the achievement of Pareto optimality was the sold objective of Congress (as long as 1890) when it enacted the nation’s antitrust statutes.” (Walter Adams et.al., “Pareto Optimality and Antitrust Policy: The Old Chicago and the New Learning,” *Southern Economic Journal*, 58 (1), 1991 p.5.

there are potential losers, values and the weighting of the welfare of losers relative to winners becomes necessary.

Herein lies the potential problem with the Pareto criterion: it is very strong. Even without a substantial lessening of competition (as usually defined), in Qantas, the Tribunal has demonstrated that some consumers might be harmed (e.g., time-sensitive fliers). The Tribunal found that the numbers of these consumers was not significant enough; however, the strict application of the Pareto criterion would have assessed this as sufficient to block the merger.

But on the same score, the Pareto criterion can be very weak. It does not define a full social ranking of alternatives and so is an imperfect guide for competition authorities. There can be many outcomes that are Pareto efficient but each involves a different distribution of benefits and costs across individuals. Thus, both having or not having a merger with distributional consequences can be Pareto efficient.

Kaldor-Hicks Compensation

The lack of a full ranking led Nicholas Kaldor and John Hicks to independently suggest that a compensation criteria for economic policy rankings.

- Under a **Kaldor-Hicks Compensation test**, a merger should be approved if those who gain from the merger could in theory compensate those who have been harmed and yet still remain better off as a result of the merger.

This augments the Pareto criterion to include a monetary (or other) transfer; that is, compensation. However, to be applicable a mechanism for achieving such compensation must exist.

One issue with the Kaldor-Hicks test is that it only requires the test to be satisfied in theory. Whether compensation actually takes place is not relevant and is a distributional matter. In this respect, it is not dissimilar from the TWS where the compensation mechanism is a monetary transfer and could in theory be made but the authorisation process does not require it. Of course, similarly, it is also applicable to mergers with undertakings that leave consumers no worse off.

Equivalent Criteria

This discussion suggests that there may be some equivalencies between the alternative welfare tests discussed thusfar. To see this, suppose that compensation of consumers by the merging firms can actually be achieved by a monetary transfer (as an undertaking). Then, any merger with a transfer undertaking that is rejected by the CWS will also be rejected by:

1. The Kaldor-Hicks compensation test: as, by definition, compensation is insufficient to make consumers at least as well off as before;
2. The TWS: as the monetary benefits to the merging parties are insufficient to overcome the monetary detriment to consumers;
3. The Qantas test: as it is a strong standard than the TWS.

Thus, if monetary compensation is possible, there exists a merger with an undertaking such that all of these tests will agree as to whether a merger should be rejected. More critically, if a TWS is supposedly a more permissive test of mergers (that is, would accept mergers the CWS rejects), when monetary compensation is possible that is no longer the case. Indeed, *using CWS is consistent with rejecting mergers that are harmful to total welfare.*

One might think that this suggests that we need not be concerned about which criteria is used if a merger with an undertaking is being proposed. However, in reality, that is not the case. What this says is that if the CWS is used and mergers with undertakings are possible, then the CWS will end up rejecting the same mergers as would the other tests applied to the merger with that undertaking.²⁴

If monetary compensation is not possible, however, this is not the case. However, as a matter of economics, in the absence of monetary compensation there is no economic basis for the TWS or other criteria. One cannot come up with a value free weighting of individual utilities to determine if the pie is larger with the merger than without it. Moreover, it is not obvious that the weighting should be one-to-one.

In reality, whether compensation is possible or not is not a 'given.' It depends on the imagination and willingness of parties to propose appropriate

²⁴ While the proposition relates to monetary compensation, when I consider undertakings below that 'compensate' consumers I am think of a broader class of mechanisms including behavioural undertakings (based on price or quantity) or structure undertakings (including divestitures).

undertakings that might mitigate any substantial lessening of competition. As I will argue below, how to foster appropriate merger proposals and undertakings is critical in determining the appropriate welfare standard.

The Allocation of Rights in the Merger Approval Process

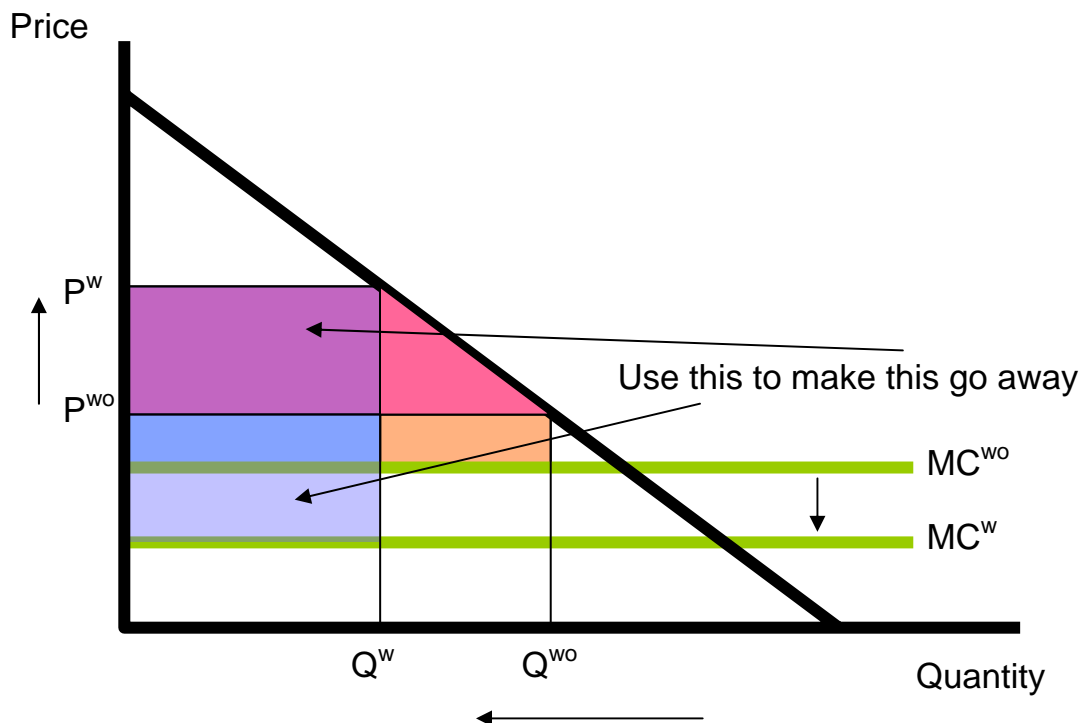
The issue of what welfare standard for merger control can be reframed as an issue of rights. Should consumers have a right to veto a merger proposal? If yes, then a CWS is appropriate. Alternatively, should firms have a right to a merger with significant private benefits? If yes, then a TWS may be appropriate. As matter of economics, absent other considerations, the allocation of such rights is usually just a question of distribution. And that, involves a value judgment.

But in merger control other considerations are not absent. In this case, one party has a significant decision right and a control over overall efficiency. Moreover, this right is asymmetric. Put simply, merging parties have a key right to (a) propose a merger or not; (b) which merger to propose and (c) whether to offer undertakings. In contrast, consumers and others have no so right. They cannot (a) propose a merger or divestiture; (b) picking merging or de-merging parties; or (c) propose undertakings. This asymmetry in decision-rights means that how those parties view their approval rights impacts upon what they propose.

To check this asymmetry, in my opinion, there are benefits in giving consumers a veto right. To see this, note that, under a TWS, approval rights are allocated to the merging parties. They will, therefore, propose a merger that maximises their joint profits and with an undertaking that ensures that total welfare is higher with than without the merger.

A CWS places a different set of constraints on the merging parties' decisions. They will still propose a merger that maximises their joint profits. However, under a CWS, they will do this with an undertaking that ensures that consumer welfare is higher than without the merger. Figure 3 illustrates what would be required.

Figure 3: CWS with Undertakings



What this means is that the CWS creates maximum incentives for firms to come up with undertakings and choose merger partners that protect consumers from the adverse consequences of such mergers. Put simply, the 'supply of merger proposals' comes from merging parties and it is potentially desirable to give them maximum incentives to protect consumer welfare. Indeed, in so doing, the mergers proposed may end up have a structure that reduces deadweight losses and, out of all possible market structures, maximises total welfare.²⁵

As a hypothetical example, consider a merger, 1, that involved a reduction in consumer welfare of C_1 with a total benefit to the firm of $\Pi_1 > C_1$. Suppose that there was an alternative merger, 2, with an undertaking which caused no consumer loss but a total benefit to the firm of $\Pi_2 < \Pi_1$. However, $\Pi_2 > \Pi_1 - C_1$. In this case, under a TWS, merger 1 would be proposed even though merger 2 would have maximised total welfare. In contrast, under a CWS, merger 2 would be proposed.

Application of the CWS as a standard improves the merger approval process. It is not a question of evaluating a world with or without a specific

²⁵ Bruce Lyons provides a formal treatment of this notion when firms choose who to merge with. See Bruce Lyons, "Could Politicians be more right than Economists? A Theory of Merger Standards," *mimeo.*, University of East Anglia, 2002.

merger. Instead, it is a question of using the process to bring forward proposals that minimise efficiency losses while protecting parties against adverse consequences flowing from a merger. Will this discourage mergers with significant efficiency benefits? It need not. With sufficient imagination and incentives, merging parties will be likely to come up with a means of reallocating sufficient levels of those benefits to consumers.

This is practically feasible. Indeed, the Australian system of undertakings supports such mechanisms. Anything contractible will do. It may be a divestiture, access regime, price undertaking, share transfer to consumers, or direct compensation. All these are contractually feasible. In addition, they have the advantage of relieving the Courts and regulator from making difficult quantitative and qualitative assessments of private firm benefits. A CWS provides an incentive for firms to offer compensation and so competition authorities need not directly intervene in the business and information of the merging parties.²⁶

The Pure Public Benefit Test

The analysis to date has ignored the impact of a merger on other potential beneficiaries who are neither suppliers nor buyers in the market in question. Those other beneficiaries, like consumers, have no right to offer undertakings and even if they would benefit from the merger, it is difficult to expect them to offer compensation unless they can form an agreement with the merging parties to do so. In my opinion, there is a case for suggesting that for pure public beneficiaries, independent compensation need not be required.

Examples of such pure public benefits include moves to ensure diversity, social goals, access to under-privileged groups, benefits to a key industry, innovations involving spillovers and perhaps international competitiveness. Such benefits do not include economies of scale and scope, plant rationalisation, synergies or the private benefits from increased innovation. These are not public benefits but private ones accruing to the merging parties. They would not be included.

Thus, what may be more appropriate is a pure public benefit test for mergers:

²⁶ For a related argument see Teresa Fels, Joshua Gans and Stephen King, "The Role of Undertakings in Regulatory Decision-Making," *Australian Economic Review*, 33 (1), March 2000, pp.3-16. See also, David Besanko and Daniel Spulber, "Contested Mergers and Equilibrium Antitrust Policy," *Journal of Law, Economics and Organization*, 9 (1), 1993, pp.1-29.

- Under a **pure public benefit test**, a merger should be approved if $C < B$.

To be sure, this exercise still involves a weighting of individuals – amongst consumers and also amongst beneficiaries – and this is a value judgment beyond an economist’s prerogative. In addition, a quantitative assessment of B can be difficult. However, once one accepts the need to make value judgments, as a matter of principle, there is no compulsion to undertake a quantitative monetary assessment of net benefits.²⁷

Conclusion

This paper argues that by placing weight on pass through, merging parties are more inclined to come up with merger proposals and associated undertakings that maximise total welfare (as well as protecting consumers). As such, the goals are not necessarily as conflicting as previously thought. The economic argument presented here vindicates notions that some weight should be placed on ‘pass through’ as a practical matter; as the Tribunal stated in Qantas. However, it does not tell us how much weight should be placed on it. The stronger argument for the CWS is based on a strict notion of consumer protection and Pareto optimality.

Nonetheless, it should be emphasised that to place no weight on pass through is not consistent with achieving total welfare maximisation. Put simply, a TWS exacerbates a bias already in the system: namely, that the merger parties propose mergers and undertakings. Thus, it is not true that “[t]here is no theory or evidence to suggest that consumers as a class are necessarily different from producers.”²⁸ They are different in that consumers cannot propose mergers or divestitures. Only producers can and for this reason, absent a differential weighting in the merger standard, the system is biased in their favour.

²⁷ The analysis here has focused on mergers (or joint ventures). However, a pure public benefit test has an equally strong rationale for other authorisations. I have not explored this in detail, however, and leave this for future work.

²⁸ Officer and Williams, *op.cit.*, p.161.