SPECIAL SECTION

# The War on Middlemen

## Introduction

BY IKE BRANNON

The spate of inflation following the 2020–2021 pandemic led politicians to search for a villain to blame other than their own spending programs or an ill-timed monetary expansion. We've been told that much of the blame should fall on "greedy" corporations, which supposedly used the post-pandemic environment to raise prices as well as reduce the size of their offerings, or what President Joe Biden referred to as "shrinkflation."

The Biden administration also apportioned a modicum of blame for inflation—and a host of other societal ills—on "middlemen," the entities that facilitate transactions between producers and consumers. The administration has pursued a variety of lawsuits against what it perceives to be powerful middlemen who have exploited their position to make money without providing value to the market in proportion to their income. Congress has also introduced legislation attempting to rein in the group.

***Intermediation*** / Ascribing various economic ills to middlemen is not new. For instance, Lenin's writings before the Russian Revolution often denounced the evils of middlemen, and the Russian Revolution made the "bourgeois proletariat" enemies of the state. But the breadth of the current attacks on their role in the US economy has been almost unprecedented in a market economy.

However, such rhetoric is best construed as little more than agitprop: Market intermediaries that have success in today's economy generally do so because they offer services valued by both buyers and sellers. They often streamline transactions or, in many cases, facilitate competition among sellers. They may help buyers get lower prices while promoting other cost-saving services in combination with linking buyers and sellers. What's more, blaming them for the inflationary spike that's now receding is simply nonsensical, and no scholar has provided any serious explanation otherwise.

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In the following special section, three scholars weigh in on the value provided by middlemen in the US and global economy. Alex Reinauer discusses the lawsuits the US Department of Justice and Federal Trade Commission have initiated against Apple and Amazon that allege their platforms—the Apple App Store and Amazon's Marketplace—charge sellers too much for access. Ron Bird explains how credit card companies have greatly facilitated a payments revolution across the globe, making it easier for us to buy goods and services anywhere in the world. Finally, Anthony Lo Sasso discusses how the Biden administration and a bipartisan group of legislators have demonized pharmacy benefit managers, which manage the drug formularies for insurers, and attribute high drug prices to their machinations rather than the high cost of drug development and testing. *R*

## Targeting Digital Platforms

BY ALEX R. REINAUR

President Biden's antitrust regulators have filed a pair of lawsuits targeting tech platforms, claiming they abuse their position as intermediaries between consumers and third parties. The Justice Department (DOJ) sued Apple in March 2024 for allegedly monopolizing the smartphone market, and the Federal Trade Commission (FTC) sued Amazon in September 2023, claiming the company used anticompetitive and unfair practices to maintain its monopoly in the online retail market.

Both FTC Chair Lina Khan and Assistant Attorney General Jonathan Kanter, head of DOJ's Antitrust Division, have sounded alarms over what they see as nefarious middlemen in the American economy, particularly in digital markets. In her 2021 "Vision and Priorities" memorandum to the FTC, Khan wrote, "Research

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documents how gatekeepers and dominant middlemen across the economy have been able to use their critical market position to hike fees, dictate terms, and protect and extend their market power" (Khan 2021). More recently, Kanter delivered a keynote speech for the Open Markets Institute where he described platforms as powerful intermediaries and middlemen that "have the ability to extract more than their fair share from both sides of the market" (Kanter 2024).

The success or failure of a platform hinges on the value it delivers to its users, and it would be fair to say that both Apple and Amazon have had plenty of success. When it comes to the agencies' respective antitrust suits, courts will ultimately have to weigh alleged anticompetitive conduct against the procompetitive effects of the platforms' business models.

***Apple*** / The DOJ accuses Apple of monopolizing the smartphone market by exerting its control over app distribution and access to application programming interfaces on the iPhone to suppress technologies that would increase competition among smartphones. The allegedly suppressed technologies include "super apps" (all-in-one applications), cloud streaming apps, messaging apps, smartwatches, and digital wallets. The DOJ argues that by suppressing these technologies, Apple has increased consumers' reliance on Apple's iOS ecosystem, thereby making it difficult for users to switch to a competing smartphone.

Central to the DOJ's claims is Apple's position as an intermediary between third-party creators and consumers, describing the tech company as a "middleman" and "toll booth operator." The petition also asserts that Apple's "leverage over third parties reinforced its tight control over how third parties innovate and monetize on and off the smartphone in ways that were anticompetitive and exclusionary."

However, there are several procompetitive justifications for Apple's terms. Apple's closed ecosystem has become a selling point because it promotes fully integrated products and seamless user experience. Apple also promotes the security and privacy benefits of its closed ecosystem. The DOJ characterizes these as merely cover for anticompetitive conduct. However, payment functions are complicated and Apple has a strong justification for wanting to provide secure financial transactions. "When there is demand for trust in the process—especially in financial transactions—you want to integrate everything," argues American Enterprise Institute scholar Will Rinehart (Rinehart 2024).

***Amazon*** / Like the DOJ's case against Apple, the FTC accuses Amazon of exploiting its position as an intermediary. The complaint focuses on two contractual arrangements with third parties that use Amazon to sell their goods.

First, Amazon requires sellers to use its storage, packaging, and delivery services to qualify for the platform's "Prime" label and its associated two-day shipping guarantee. The FTC alleges that this requirement allows Amazon to impose excessive fees on third-party sellers while also restricting their ability to explore alternative fulfillment methods.

But Amazon has a clear reputational interest in ensuring that its Prime orders are delivered in a safe and timely manner, according to Bilal Sayyed, former director of the FTC's Office of Policy Planning. "This idea that parties should be able to take advantage of the platform and the Amazon brand, but then give the merchandise to a third party that may … not meet the same delivery fulfillment and delivery standards, really strikes me as a very dangerous ground for the agency to hang a case on," Sayyed has observed (ITIF 2023). Amazon's two-day shipping with Prime is overwhelmingly popular with consumers, and a court will likely view the practice as procompetitive.

Second, Amazon limits the reach of third-party sellers' products if those items are found to be priced lower on other websites. These price parity provisions, or "most-favored-nation" clauses, do help Amazon ensure that products sold on its platform are set at the most competitive price, which benefits its customers. The FTC asserts that these arrangements could discourage third parties from lowering prices on other platforms for fear of losing visibility on Amazon's platform.

However, price parity provisions encourage platforms to invest in search functionality by preventing "showrooming," where consumers might discover products on Amazon but make their purchases elsewhere. Farronato et al. 2023 discuss this scenario, arguing that if showrooming becomes prevalent, "Amazon would not get compensated for the search and recommendation services it provides, which may lead to underinvestment in those services."

***Conclusion*** / It remains unclear if the antitrust suits against Apple and Amazon will reach a resolution anytime soon. Apple has filed a motion to dismiss the DOJ's suit, and the FTC's suit against Amazon is scheduled to go to trial in October 2026. Both cases raise the possibility of structural relief, for which the FTC has explicitly requested and the DOJ maintains as a possibility. That could mean breaking up or the unbundling of certain services. Should antitrust regulators succeed in their efforts, consumers might be deprived of products and services they currently value. *R*

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# Payment Cards: Beyond Marginal Cost

**BY RONALD BIRD**

Payment card companies are middlemen that facilitate transactions between merchants and consumers. Credit and debit cards have become ubiquitous in recent years, with the pandemic greatly increasing their usage. Nearly all retailers conduct most of their transactions via payment cards.

Their ubiquity has been accompanied by complaints from some merchants that the amount they are charged for the service—typically 2–3 percent of the transaction—is excessive. Merchant trade associations and consumer advocates have reinforced this notion with assertions that the payment card networks collude to set excessive fees and stifle competition, charging well above the marginal cost of processing the transaction. However, these assertions ignore that creating a payment network is a costly and complicated endeavor that entails billions of dollars of investments and that the market, with four major competitors—MasterCard, Visa, American Express, and Discover—is more competitive than they allege.

Politicians responded to the anti-payment-card outrage with legislation to have the government cap card fees. In 2010, the Durbin Amendment imposed a ceiling on debit card transaction fees, along with requirements for debit card issuers to offer alternative transaction networks for merchants to choose when presented with Visa- or Mastercard-branded debit cards. The legislation resulted in millions of households losing access to debit cards while doubling the rate of debit card fraud at the same time that credit card fraud declined (Bird 2024).

The proposed Credit Card Competition Act would extend to the most commonly held bank-issued credit cards a fraud-promoting requirement that has been found to be disastrous in the debit card market: Covered banks that issue credit cards to their customers would be required to allow merchants to funnel transaction processing through cut-rate alternatives to the Visa and Mastercard networks, and the act limits the ability of card-issuer banks to require these alternative processors to provide adequate anti-fraud protection.

***Why accept cards?*** / Merchants incur costs regardless of the medium of exchange. For instance, a business using cash must arrange for regular pickups from an agent—sometimes in an armored truck—and deal with the inevitable "shrinkage" that comes from careless or corrupt employees, not to mention an

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increased risk of armed robbery. Checks—still ubiquitous, albeit less common than in the past—present a risk of fraud as well.

Electronic payment card transactions are immediately transmitted to the merchant's bank, and merchants and their employees don't face any risk of robbery when all transactions are handled by payment cards. What's more, customers using a debit or credit card spend 12–28 percent more per transaction than cash customers.

Payment cards provide merchants with a bigger potential market for their goods or services because their customers are not constrained by the amount of money in their pocket or, with checks, the cash in their checking accounts. Cardholders with available credit line balances are more likely than other customers to purchase extra items that were not on their shopping list.

Before credit cards gave customers the ability to make large purchases easily, consumers had to obtain individual bank loans for major purchases. Many stores extended credit to their regular customers, which was laborious and costly, invariably entailing mailing monthly bills, dealing with non-paying customers, and effectively floating loans to most customers.

***Beyond marginal cost*** / Much like pharmaceutical companies that spend billions of dollars to formulate and test a new drug that patients' rights groups demand be sold at or near its marginal production cost, merchants who take umbrage at their fee because it's above the marginal cost of the transaction are ignoring the significant fixed costs of creating and maintaining the network of merchants that accept payment cards and consumers who use them. The payment card networks that exist today did not spring up spontaneously: Their creation required years of entrepreneurial labor, marketing costs, and endurance of recurring financial losses. Maintaining these networks requires continuing expenses of recruiting new merchant participants and new cardholders as businesses and the population grow and change. Transactions must be continually monitored to detect and prevent fraud and require investment to maintain the security and efficiency of the system. These costs are largely hidden from public view. Any assessment of whether these companies are earning economically excessive profit must first consider these legacy costs.

Merchants, consumer advocates, and regulators often allege that having just four major networks is a sign of imperfect competition and monopolistic fee-setting power. However, it would cost tens of billions of dollars to set up a new system, and it is hard to see how a new firm could earn back that investment in this market, as Discover, American Express, Visa, and Mastercard compete fiercely with one another. These payment card networks also face increasing competition from non-card payment systems, as well as the automated clearing house systems and emerging payment innovations. The largest retailers, Wal-Mart and Amazon, are investing heavily in researching how they could develop alternative payment structures that would bypass payment cards altogether.

Two generations ago, a vacation entailed bringing a large amount of cash and perhaps travelers' checks, and the loss of that money in any way would create a bona fide crisis. Today, people can travel virtually anywhere in the world without bringing any cash with them. This development constitutes an incredible improvement in consumer well-being. Contending that the government should cap the fees that payment card networks charge for this service—which are effectively set by what is a competitive market—makes little sense. *R*

*READING*


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# The Case of PBMs

**BY TONY LO SASSO**

Throughout history, the role of intermediaries in economic transactions has been a subject of criticism and suspicion. Even Plato expressed skepticism about middlemen, viewing them as profit-driven agents potentially undermining the common good and fostering inequality (*Republic* 371c–d).

Keeping up with this ancient—albeit misguided—tradition, the Biden administration has sought to demonize pharmacy benefit managers (PBMs), which are middlemen in the prescription drug market. A recent example of this effort is a July 2024 Federal Trade Commission (FTC) interim report.

PBMs are intermediaries in the healthcare pharmaceutical supply chain that manage prescription drug benefits on behalf of health insurers, Medicare Part D drug plans, large employers, and other payers. Their primary role involves negotiating with drug manufacturers to secure discounts and rebates, creating and maintaining drug formularies (that is, what drugs or similar drugs an insurer covers), and processing prescription drug claims. By leveraging their scale, PBMs aim to control drug spending, improve access to medications, and enhance overall patient outcomes.

Modern economic theory recognizes that intermediaries play a crucial role in enhancing market efficiency, reducing transaction costs, and facilitating the flow of goods and services. PBMs demonstrate the indispensable role of intermediaries in healthcare, balancing cost containment with access to essential medications. That is overlooked in the FTC's report, as noted in Commissioner Melissa Holyoak's dissenting statement.

***Benefits*** / PBMs have several beneficial effects on the healthcare system, including:

- **Cost containment**: PBMs play a critical role in cost containment within the healthcare system by negotiating drug prices

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with manufacturers and leveraging their purchasing power. This allows them to secure substantial discounts and rebates that lower the overall cost of prescription medications. Nearly all these savings are passed on to insurers and consumers, resulting in reduced insurance premiums and out-of-pocket expenses. Additionally, PBMs implement cost-saving measures by encouraging the use of generic drugs and promoting cost-effective therapeutic alternatives. These strategies curb the rapid growth of pharmaceutical expenditures, making healthcare more affordable for a broader population.

Previous research I conducted with Ike Brannon elucidated one of the mechanisms by which PBMs can achieve savings (Brannon and Lo Sasso 2021). State Medicaid programs have two broad options for purchasing drugs for enrollees: direct management or employing managed care organizations and their PBMs. While states may appear to have significant bargaining power because of the size of their Medicaid programs, the ever-changing pharmaceutical market demands continuous attention, which PBMs are well-equipped to provide.

For instance, in recent years, Michigan centralized the purchasing of specialty pharmacy products while Illinois used PBMs. The introduction of curative hepatitis C therapies in the early 2010s illustrates the effects of this difference. Comparing data from the Centers for Medicare and Medicaid Services (CMS), we found that Illinois PBMs transitioned to cheaper generic alternatives by 2019, but Michigan did not. This nimble response by PBMs could have saved Michigan taxpayers up to $50 million annually, demonstrating the significant cost-saving potential of PBMs in adapting to market changes.

- **Market efficiency and transparency:** PBMs improve market efficiency by streamlining the pharmaceutical supply chain, reducing administrative burdens, and managing complex processes such as formulary development, drug utilization review, and claims processing. This centralization of tasks minimizes redundancies and errors, ensuring that medications are delivered promptly and accurately to patients. Also, PBMs provide valuable market information and analytics to insurers and healthcare providers, aiding in better decision making and resource allocation. By acting as intermediaries, PBMs enhance coordination among manufacturers, pharmacies, and payers, leading to a more efficient and responsive healthcare system.

- **Innovation and competition**: The presence of PBMs fosters innovation and competition within the pharmaceutical industry. By negotiating favorable terms and promoting the use of cost-effective medications, PBMs encourage drug manufacturers to develop innovative treatments that offer better value. This dynamic stimulates competition among manufacturers to produce high-quality, affordable drugs and adopt new, patient-centric payment and care models. The competitive environment nurtured by PBMs ultimately benefits consumers by expanding access to cutting-edge therapies and improving health outcomes.

- **Mail-order pharmacy programs:** PBMs support the provision of mail-order pharmacy services. They negotiate bulk purchasing agreements by leveraging their extensive networks and secure lower prices for medications. These benefits are then passed onto consumers through mail-order programs. These services allow patients to receive their prescriptions directly at their homes, reducing the need for frequent trips to retail pharmacies and ensuring a steady supply of necessary medications.

  Also, PBMs often implement automated refill programs and provide comprehensive medication management services through mail order, enhancing adherence to prescribed therapies and improving overall health outcomes, saving billions of dollars a year for both insurers and Medicare.

***Criticism of PBMs*** / It should be noted that some research has shown a positive correlation between drug list price, rebate amounts, and patient out-of-pocket costs in recent years—that is, insureds are not receiving the full rebates on their drugs' prices (see e.g., Mallatt et al. 2024). However, PBM critics attributing increased patient costs to PBMs "pocketing" rebates make a mistaken inference that overlooks key factors. First, drug companies, not PBMs, control drug list price. Second, a Government Accountability Office report found that 99 percent of rebates are returned to payers in the form of lower premiums (GAO 2019). Most importantly, it is the payer—not the PBM—that determines patient copayments and out-of-pocket costs. Given the long-term trend of rising healthcare costs, it is not surprising that payers may increase patient cost-sharing as a cost-control measure. Attributing this trend to PBMs, especially in light of experiences like Michigan and Illinois discussed above, is a questionable narrative.

***Conclusion*** / Despite the skepticism from politicians and independent pharmacists and pharmaceutical companies who resent having their prices pushed down, the role of PBMs in the healthcare system is essential. They have demonstrated their ability to contain costs, enhance market efficiency, and foster innovation and competition within the pharmaceutical industry. PBMs help manage an exceedingly complex prescription drug market to ensure better access to medications and significant savings for consumers and payers. R

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