Abstract: How far should an industry be allowed to consolidate, when both competition and innovation are strategic and forward-looking? We propose a stochastically alternating-move game of dynamic oligopoly with endogenous mergers, and extend Rust"s (1987) method to estimate it using data from the hard disk drive industry, in which a dozen global players consolidated into only three in the last 20 years. We simulate welfare outcomes under alternative antitrust regimes which allow more or less mergers. The results highlight a dynamic welfare trade-off between ex-post pro-competitive effects of blocking mergers and ex-ante value-destruction side effects. We find the optimal policy is to stop mergers when five or less firms exist. This threshold may be relaxed in a declining industry but only slightly.