Price Discrimination & Competition: Implications for Antitrust

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Price Discrimination is a Loaded Phrase in Antitrust

- Price discrimination implies "bad" things will happen.
- Logic:
  - "Competitive" markets require P=MC.
  - Price discrimination implies P>MC
  - Hence, price discrimination implies that markets are not "competitive."

Price Discrimination v. Differential Pricing

- Price differences do not generally raise antitrust concerns
  - E.g., movie theaters
- Price differences do not necessarily imply price discrimination
  - E.g., revenue management (cruise lines)

Antitrust Scholars on Price Discrimination

"Persistent discrimination is very good evidence of monopoly because it is inconsistent with a competitive market; it implies that some consumers are paying more than the cost of serving them, a situation that would disappear with competition." (Posner, *Antitrust Law: An Economic Perspective*)

Economists on Price Discrimination, I

"...systematic discrimination may bolster the monopoly power of already powerful firms and facilitate adherence to collusive price structures." (Scherer and Ross, *Industrial Market Structure and Economic Performance*)

Most of What You Thought You Knew is Wrong

- All of these "insights" come from comparing monopoly to perfect competition
- What happens when you compare oligopoly with discrimination to oligopoly without discrimination?
- None of these insights survive

Why does Price Discrimination Intensify Competition?

Oligopolists would rather NOT Price Discriminate

- The ability to price discriminate puts them in Prisoners' Dilemma
  - Individual incentive to discriminate—it always raises profit
  - But if rivals discriminate, everyone is worse off.

So what does this mean for antitrust?

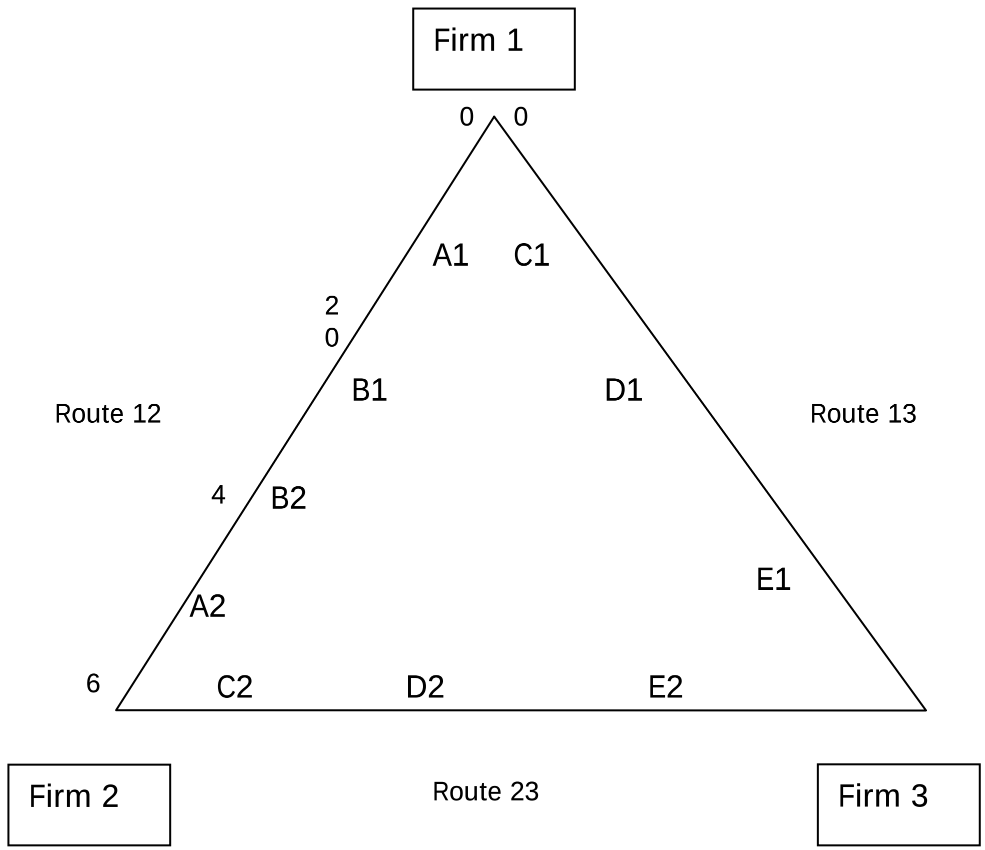
- Cannot appeal to discrimination without careful analysis of consequences.
  - Example: how does presence of discrimination affect merger analysis?
- We dispel four widely circulated Myths about the effects of price discrimination.

Price Discrimination Under Spatial Competition --- A Simple Example

- Three supermarkets located around a triangular city connected by three 6-mile roads.
- Consumers are distributed uniformly along the roads and each purchase one unit.
- Travel costs t=\$1 per mile.
- The marginal cost of the product is c=\$2.
- Consumer valuations are high enough relative to production and travel costs that the most distant consumers will buy to good.

Uniform Pricing vs. Price Discrimination

Location	Uniform Price*	Price Disc.*
A1	$9.00	$7.00
B1	$10.50	$5.50



When Does Price Discrimination Intensify Competition?

Customers do NOT agree on which brand is preferred

3-to-2 Merger with Uniform Pricing

If Firms 1 and 2 merge.

Prices rise via unilateral effects.

Merging firm raises price from $8 to $12.

Rival raises price from $8 to $10.

Some customers drive further to purchase products from further away

“cross-hauling”

$6.50

3-to-2 Merger with Price Discrimination

Competition on routes 13 and 23 doesn't change.

Thus, two-thirds of the customers are unaffected!

Competition on Route 12 is affected.

No inefficient "cross-hauling"

		Post-merger price*	
		$9	
		$10.50	
C1	$7	$7	0%
D1	$5.50	$5.50	0%
E1	$6.50	$6.50	0%
Average	$6.50	$7.50	16%

Comparing Merger Effects With vs. Without Price Discrimination

Location	% Price Change with Uniform Pricing	% Price Change with Price Discrimination
A1	44%	29%
B1	38%	91%
C1	44%	0%
D1	38%	0%
E1	21%	0%
Average	34%	16%

Conclusion: In this example, on average, price discrimination mitigates merger effects.

More Realistic Examples

The result mitigates merger effects in the ex does not hold in all environments. implications of price discrimination mergers are more complex.

Impact of Price Discrimination on Merger Effects

- Price discrimination causes market area of merging parties and competitors to widen.
- Impact
  - Mitigates merger effects if it brings non-merging firms into closer competition
  - Amplifies them, if it brings merging firms into closer competition.

Myths About Price Discrimination

Myth 1: Price discrimination does not arise in intensely competitive markets.

Myth 2: Price discrimination indicates the presence of significant market power.

Myth 3: Price discrimination almost always hurts some consumers

Myth 4: Imperfect Price discrimination is socially inefficient.

Myths dispelled, Price discrimination:

Can and does occur in markets with intense (but not perfect) competition...Myth 1

Is not a good indicator of significant market power...Myth 2

Can benefit all consumers...Myth 3

May improve efficiency...Myth 4

Conclusions

Does price discrimination make markets more competitive?