Effects-Based Analysis:
Mergers and Vertical Restraints

Acknowledgements

z   James Cooper, Dan O'Brien, Mike Vita, FTC

z   Tim Brennan, RFF and UMBC

z   Greg Werden, DOJ

z   Dan Hosken, Chris Taylor, Lou Silvia, FTC.

z

Outline

z I. Policy motivation: movement towards "effects-based" analysis

z II. How to determine Effects?

– Natural Experiments

– Theory-based inference

z III. Apply to Mergers and Vertical Practices

Movement towards Effects-Based Analysis of Mergers

z Mario Monti's antitrust legacy

- – Merger Guidelines; SIEC
- – Best Practices
- – Chief Economist

z Moving away from "Form" towards "Effect"

z How do we determine effects of mergers?

Movement Toward Effects-Based Analysis of Vertical Practices

z US 1977 Sylvania Decision.

z EC Article 81 Block Exemption Regulation.

z Movement away from "form" towards "effect"

z How do we determine effects of contracts between manufacturers and retailers (RPM, exclusivity, loyalty discounts, bundling, refusal to deal)?

How to Determine Effects?

- z "Effects" question compares two states of world,
  - – "with" vs. "without" merger
  - – "with" vs. "without" vertical restraint
- z But only one is observed
- z Two ways of drawing inference
  - – Natural experiments
  - – Theory-based inference

- *Control group*
- *Experimental group*

z *Control Group*

z Combination of marketing and refining assets of two major refiners in Midwest

z First of recent wave of oil mergers

– January 1998

z Not challenged by antitrust agencies

z Change in concentration from combination of assets *less* than subsequent mergers that were modified by FTC

z Examine pricing in a region with a large change in concentration

- Change in HHI of about 800, to 2260

z Isolated region

- uses Reformulated Gas
- Difficulty of arbitrage makes price effect possible

z Prices did *NOT* increase relative to other regions using similar type of gasoline

Theory-based Inference

z Posit pro- and anti-competitive theories

z Which one better explains the evidence?

z Questions for the parties

  – How well does theory explain observed competition?

z Example: Merger Simulation

  – Posit model

  – Estimate parameters

  – Simulate Merger Effects

Vertical Restraints: Natural Experiments

z Growing body of evidence on vertical

- Control Group (with restraint)

- Experimental group (without restraint)

z Find that vertical contracts and integration

- Reduce price

- Induce demand-increasing services

Representative Experiments

z   *Gasoline*: prices 2.7¢/gallon higher in states with vertical divorcement laws

   – Vita and Sacher (2000)

z   *Beer*: UK divorcement of "tied" pubs raised price

   – Forced to offer the beer of at least one rival brewer.
   – Slade (1998).

Vertical Theory

z Anticompetitive theories

  – Softening horizontal competition.

  – Multilateral opportunism.

  – Dynamic entry/exit/investment effects.

z Pro competitive theories

  – Elimination of double mark-ups

  – Cost savings.

  – Dealer services efficiencies.

What Vertical Theory Tells us

z   There is possibility that vertical restraints harm competition

z   Harm occurs in same instances where restraints likely to have efficiencies.

– Search for screens is probably futile.

z   Î   The "possibility theorems" do not give us practical ways for distinguishing pro-competitive from anti-competitive restraints.

Lessons

z Theory-based inference about effects of vertical restraints is not likely to tell you very much.

z Take lesson from economists who use natural experiments to determine effects of vertical

z Î   Bring cases when good natural experiments indicate restraints are anticompetitive.

  – Before and after restraint
  – Compare markets with and without restraint

FAQ's About

z   Behind every competitive effects analysis is an economic model.

  – Simulation makes the model explicit

  – Forces economists to "put cards on table"

z   Every model makes unrealistic assumptions

  – Crucial question is whether model ignores factors that lead to biased predictions

z   No methodology has been shown to predict effects of real mergers

- No coordinated effects theory,
- No unilateral effects theory,
- No market concentration theory.

z   Model should be judged by how useful it is

- Does it focus investigation?
- Does it capture current competition?

z *Demand estimation*

z

z

ZZ

z