Economics and Antitrust: Enforcement R&D

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Historic Opportunity for Economists

Horizontal Merger Questions

- Backlash against structural models: "Do they fit the evidence?"
  - Bertrand, auctions, bargaining
- Rise in reduced-form estimation
  - Staples-Office Depot (FTC)
  - Oracle-PeopleSoft (Justice)
- How do we estimate consummated mergers?
  - Difference-in-difference estimators

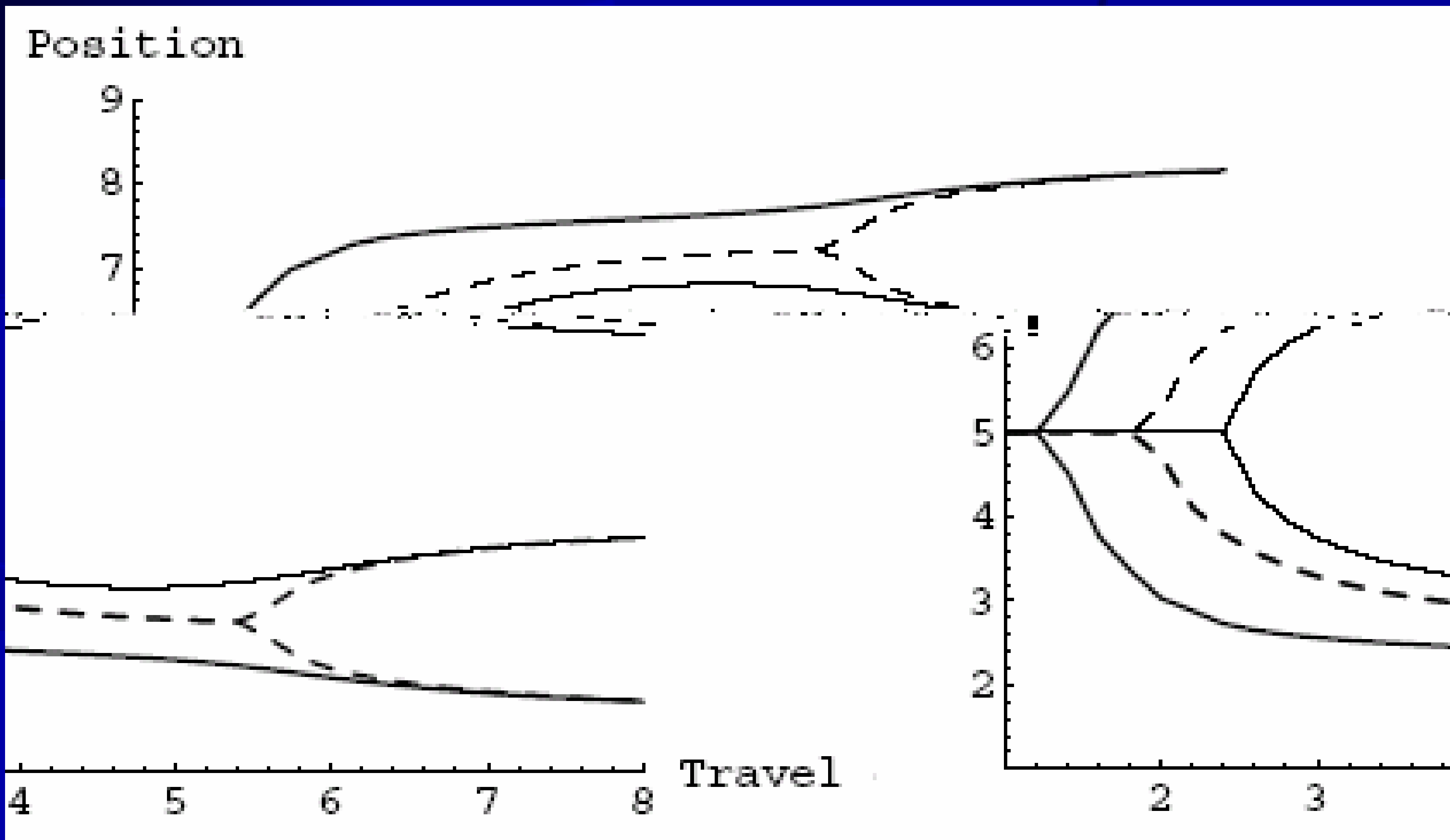
Cons. Goods Merger Questions

- What is effect of TPR's?
  - Hoarding by consumers   elasticity bias
  - Aggregation bias across stores and time
- What is role of promotion, seasonality?
- What causes price variation?
  - Price discrimination?
  - Mixed strategy equilibrium?
- How is equilibrium affected by merger?

Where is Academic Research Going?

- **Ever more precise methods for estimating demand, but…**
  - What about supply?
- BLP, now two-step estimation (auction, demand, dynamic) avoids computing equilibrium, but…
  - Equilibrium required for policy effects
  - Existence and uniqueness?
- How do we model…
  - Advertising & Promotion?
  - Post-merger product repositioning?

Results: Merging Firms Move Apart



Results: Repositioning Lower Prices

Summary: Post Merger Repositioning

- Merging firms move apart to avoid cannibalization, so less competition lost by merger.
  - Increased product "variety" increases welfare
- Non merging firms are squeezed towards the middle of line
  - Non merging firms do not gain as much,
  - Can even lose as a result of merger

Bargaining

<u>Theory</u>: Nash axiomatic bargaining solution

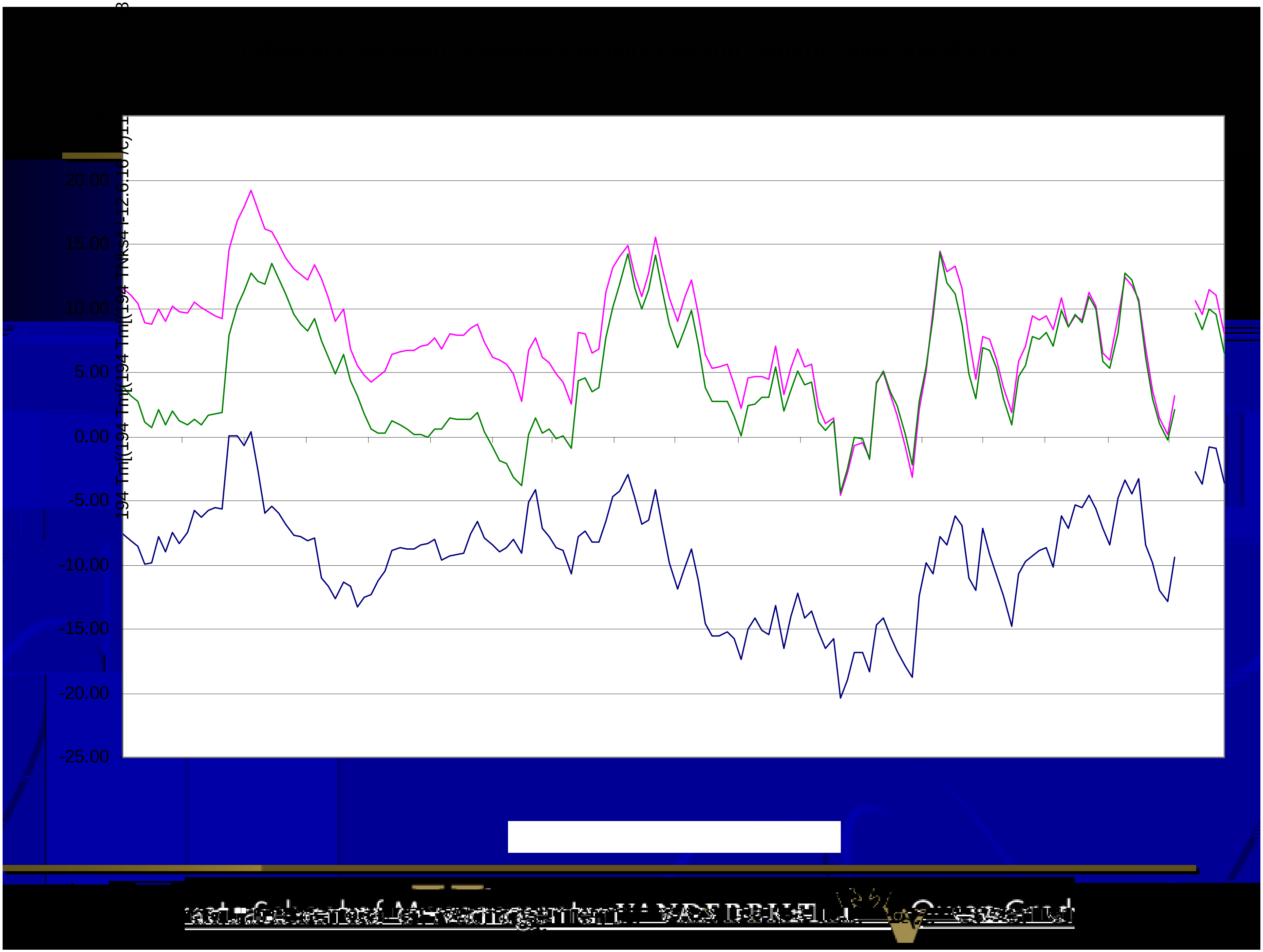
- Agreement "z" maximizes (S1(z)-D1)*(S2(z)-D2)
- Anything that increases my opponents surplus, or reduces mine, increases my bargaining "power."
- Nash research program antitrust policy program

<u>Competition Advocacy</u>: "Any-willing-provider" (AWP) laws compel managed care plans to include any health care provider willing to accept the plan's terms and conditions.

- Reduces bargaining position of managed care plans, i.e., no threat to exclude them from network.
- Threat of exclusion from network induces aggressive bidding by providers to be included.

Consummated Merger Estimation

- Marathon / Ashland oil refinery joint venture change in HHI of about 800, to 2260
- Isolated region
  - uses Reformulated Gas
  - Difficulty of arbitrage makes price effect possible
- But prices did ***NOT*** increase relative to other regions using similar type of gasoline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Monopolization Cases

- "Cheap" exclusion vs. more traditional monopolization cases.
  - (1) cheap, (2) effective, and (3) inherently unlikely to generate plausible, cognizable efficiencies.
- Orange book listings
- Restrictions on others' output by agreement (as in *South Carolina Board of Dentistry*1)
- Unilateral conduct (as in *Rambus* and *Unocal*).
  - Unocal, by deceiving CARB and the other refiners into adopting Unocal's patented technology into a binding standard, acquired monopoly power

Why the Focus on "Cheap Exclusion"?

- Economic theory:
  - Combining substitutes is bad
  - Combining complements is good
- "Post Chicago" economists constructed theoretical examples of harm caused by
  - Raising Rivals' Costs
  - Softening Competition
  - Multilateral Competition
  - Agency Theory
- But what does the empirical evidence say?

Vertical Restraints Induce Provision of Demand-increasing services

Ippolito (1991) and Ippolito & Overstreet (1996)

Evidence of Anticompetitive Vertical Theories?

Various: Gilligan (1986) finds negative abnormal returns upstream when RPM contracts challenged.

- Consistent with efficiency and manufacturer cartel.

Cable TV: Ford and Jackson (1997) find vertical integration small losses in consumer welfare ($0.60 per subscriber per year).

Cable TV: Waterman and Weiss (1996) found that cable systems that owned pay movie channels were less likely to carry rival pay channels .

- consistent both with pro- and anticompetitive behavior.

Gasoline: Hastings (2004) found rivals of acquired gas stations raised prices post-acquisition, but that the tendency to raise prices did *not* depend on the vertical structure of the rival station.

- Price increase attributed to “branding” formerly “unbranded” retailers

Summary of Vertical Evidence

- Most studies find evidence that vertical restraints or integration pro-competitive
- This efficiency often attributable to elimination of double-markups
- Studies also find evidence consistent with “dealer services” efficiencies
- Evidence of anticompetitive uses of vertical controls generally ambiguous
- Overall, difficult to find evidence that vertical controls reduce welfare

Property Rights & Rule of Law

Top twenty percent of countries…

per capita Income of $23,450,

Growth 2.6 percent a year

Bottom twenty percent of countries…

per capita Income of $2,560,

Negative growth: -0.9 percent a year