

# Transaction Costs and Competition Policy

By

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# Introduction

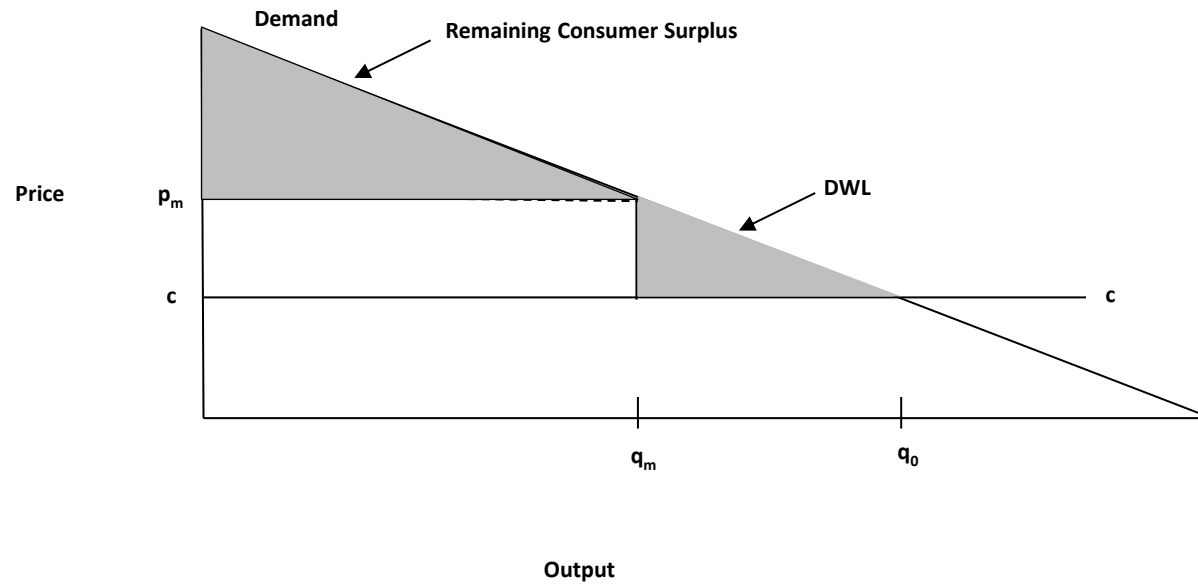
- There is an externality when there is a gap between price and marginal cost.
- There are incentives to avoid this inefficiency by using a more complicated contract other than a uniform price.
- Transaction costs limit the sophistication of contracts.

# Introduction

- Nevertheless, most transactions are more complicated than simply setting a uniform price and letting consumers choose output.
- Most antitrust analyses focus on models with uniform per unit pricing.
- How should our analyses change if we take account of transaction costs and contracting more sophisticated than uniform per unit pricing?

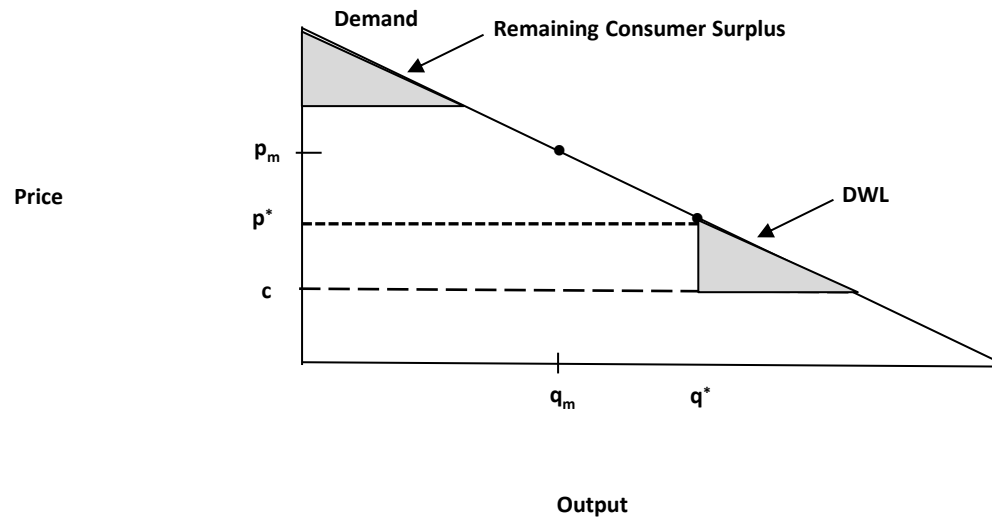
# Basics

- Typical DWL triangle



# Basics

- DWL falls and harms change with two part pricing



# Horizontal

- Usual assumptions ok for many consumer markets, though not all.
- Not very good for business to business markets.
- Consequence is likely underestimate of efficiency benefits and overestimate of harm (Carlton and Keating ).
- BUT not enough attention paid to long run harms, especially from reduced investments by buyers (though sellers may offset).
- Claims of countervailing market power represent a slippery slope.

# Vertical

- Vertical mergers alleging raising rivals' cost deserve special scrutiny/skepticism.
- Vertical MFNs and price parity conditions can enable coordination that is equivalent to illegal horizontal action (Carlton and Winter).
- Transaction costs for monitoring have fallen, making free riding defenses harder.

# Vertical- Mergers

- Firm U supplies Firms D1 and D2. Firm U buys Firm D1. Concern is that merged firm will raise rival firm D2's costs.
- No competition affected if D1 and D2 do not compete. Alcoa example.
- Even with competition, effect on consumers is unclear.
- Why do transaction costs prevent pre- merger contracts that create the same harm as merger?



# Vertical -vMFNs and Price Parity

- Raise price
- Tax others
- Harms entrants
- Efficiency claims
- Examples: *Amex, Sabre*

# Nash Bargaining

- Not a model of transaction costs
- More flexible than uniform price per unit
- Lots of assumptions especially if a Nash- in- Nash model
- Does make clear the transfer of rents from buyers to sellers-a possibly important implication for buyer and seller investment

# Multi-sided Markets

- Defined by presence of transaction costs (Rochet and Tirole)
- With low transaction costs, market is one-sided and certain conduct can no longer harm competition.
- Example of freight cases
- Special features such as output maximization are identical to those in Dorfman Steiner (Carlton and Winter) .
- Raises issues related to muddled US tie-in law.

# Output Maximization

- Profit( $p, a$ ) =  $(p-c-a) q(p,a)$
- Define  $x=p-c-a$ , then
- Profit( $x, a$ )= $x q(x+c+a,a)$
- Hence ,the profit maximizing choice of  $a$  (at the optimal  $x$ ) is the  $a$  that maximizes  $q( , )$ .

# Data

- Firms with big data sets have an advantage.
- Giving property rights to consumers unlikely to alter anything.
- Grant right that cannot be contracted away.
- Be on alert for attempts by a dominant firm to impose restrictions limiting rivals' access to data.