

Economic Challenges to Competition Policy Economics

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- I'll suggest a resolution...
- ...but it will be radical
 - or perhaps very old-fashioned

Harberger's Challenge

- Estimate DWL triangles

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- Estimate DWL triangles
- They seemed really small!
 - Perhaps 0.1 percent of GDP
- Had we already done a great job?
- Or was the job not so important?

Reactions to Harberger

- Deeper thought on gains from competition
- Costs as well as prices
 - Incentives?
 - Selection/evolution
 - Entry and exit
 - Market shares

Reactions to Harberger

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- Costs as well as prices
 - Incentives?
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 - Market shares
- **Very helpful reaction in the end**

Blaming the Hammer

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- If that's not what you want...
 - Jobs
 - Pollution
 - Traditional business models
 - Fraud

Blaming the Hammer: Response

- To an amazing degree, competition policy has simply *overcome* those concerns!

The Management Fallacy

- Someone should be in charge
- Avoid duplication of effort
- Coordinate all plans
- Get full economies of scale

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- Someone should be in charge
- Avoid duplication of effort
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- Get full economies of scale
- Management according to Stalin...
- ...but up to a point legitimate...
- ... “natural monopoly”

Response to the Management Fallacy

- Competition policy won!
- Iconic case: AT&T
- Imperfect competition policy defeated imperfect regulatory/natural monopoly policy

Competition and Innovation

- Are competition policy and innovation at odds?
- Subtle questions, but I'll suggest (v. briefly):
 - Innovation retarded by *fragmentation*, not by *competition* properly understood
 - However, we need to watch the public message as well as get things right amongst ourselves

Response to Innovation Challenge

- Some loss of confidence!
- Empirical research
- Deeper thought on nature of competition
- Not yet fully satisfactory, but going well...

That was fun...

- Several deep topics dismissed within minutes
- Let's take a deep breath...
- ... before the challenge I'll really focus on
- A challenge from *within* competition economics!

Economics and Competition

- How would standard microeconomic cost/benefit analysis evaluate entry against a monopoly incumbent?

Principal Affected Parties

- Entrant itself of course
- Consumers (customers)
- Incumbent

Change in Total Surplus

- Estimate impact on each affected party;
- Add them up;
- Welfare gain or loss?
 - Potential Pareto improvement...

Mankiw and Whinston 1987

- Entry that mainly “steals” business rather than improve offers imposes negative externality on consumers and incumbent jointly
- Compare tragedy of the commons
- On balance that’s a common case
 - Compare fragmentation in innovation

MW with stronger competition

- If entry mostly forces incumbent to cut price, too little incentive to enter
 - Bork's assumption in exclusive dealing argument
- *Not enough* competition?
- But on balance MW often find too much incentive to enter
 - Negative net externality

Correcting pro-entry bias?

- What would microeconomic policy do?
- Discourage or tax entry when predicted net externality is negative
- Mostly we don't, but one branch of microeconomics does...

Correcting pro-entry bias?

- With undifferentiated Bertrand competition post-entry, no response, inelastic demand:
- entry incentives efficient if entrant must (just) compensate incumbent for lost profits
 - Mutually profitable deal with customers is then efficient test
 - Two-sided markets in mediaeval France
- Version of ECPR
 - Access charge—for something or nothing?

What Does Competition Policy Say?

- How to evaluate entry against a monopoly

What Does Competition Policy Say?

- Ignore impact on the incumbent!
 - About competition, not competitors
 - Consumer surplus standard...
- So it's a very easy calculation:
 - Entrant gains (revealed preference);
 - Consumers gain
- Sometimes we barely restrain ourselves from subsidizing entry against monopoly...

A Puzzle

- Clearly wrong to give incumbent *too much* weight
 - Political economy bias
- But *none*?!!

A Pragmatic Story?

- Consumers will strictly gain, so net externality positive unless incumbent harmed *enough*
- Incumbents exaggerate and cry wolf
 - Harm hard to calculate/verify
- Might third-best rule be to ignore?
 - Other pragmatic stories, e.g. merger control

Pragmatic Stories

- But is that really what's going on?

Another Attempt

- Entrants ignore effects on incumbents in perfect competition
- Everything works out great there, so ignoring effects on incumbents seems right, despite cost-benefit analysis
- ?

Ignoring Incumbents in Perfect Competition

- But (for marginal entry) pecuniary externalities on consumers balance exactly
- So this doesn't rationalize approach

A Possible Resolution

- What I've called "standard microeconomics" embodies *hill-climbing approach* to efficiency:
 - For each "step" such as this entry, ask whether it increases total surplus
 - If each change does so, expect good outcomes
- Might "the competitive process" be something else?

Competitive Process?

- Edlin and Farrell, “Freedom to Trade and the Competitive Process”
- Suggest that process may instead evaluate each “step” to see whether it is an “improving coalition”
 - Better synonym for “blocking coalition”
- Calling on ideas of *the core*

(Getting to) the Core

- If someone finds a better way to do things—as evaluated by all its participants—do it
- Those who gained from previous way are out of luck
 - Blocking (improving) doesn't require compensating incumbent
- A cartel is *not* an improving coalition

Core Efficiency

- Core allocations are Pareto-efficient
 - But *not* because each step toward the core increased total surplus!
 - Standard proof is inapposite
- Edgeworth (1881, paraphrased): viewing competition as core, or formation of improving coalitions, makes it applicable to imperfect competition

Essence of competition?

- If someone can do it better, or is willing to offer it more cheaply, they can displace incumbent
- Perhaps reasonably well captured as “improving coalition” of entrant and customers
- If that’s the competitive process,
 - Consistent with good economics
 - Doesn’t ask whether step increases total welfare!

Conclusion

- CP has come through many challenges
- Consumer surplus standard and associated puzzles pose an internal challenge to those of us who think CP is good microeconomics
- Possible third-best pragmatic resolutions
- Different perspective on economics of competition policy is another possible soln
 - Not hill-climbing, but coalition formation

The Competitive Process

- What is it?
- How does it relate to “standard microeconomics”?
- Are these questions linked to debate over effects-based vs form-based policy?
 - What effects should one be looking at?
 - Form as a technique of gauging effects...