Policy and goals

Policy

- Firms tend to behave in ways that reduce ***social welfare***
  industrial policy and regulation may be ***necessary***
- Policy ***sets rules*** for competition to improve ***efficiency***
- But ***what is*** efficiency?
  1. ***Static allocative*** efficiency
     who gains what ***surplus*** and how much ***DWL*** is created
  2. ***Static productive*** efficiency
     the internal efficiency of firms, what to ***produce*** and how?
  3. ***Dynamic*** efficiency: both allocative or productive
     what is optimal now may not be optimal in a ***longer horizon***

The goal is not straightforward

Policy

1. One thing is fixed but ***another breaks*** down
   - A ***merger*** can reduce costs but can reduce competition, too
   - Policy to ***incentivize R&D*** might create barriers in the future
2. The result on ***welfare*** might be ***ambiguous***
   for instance, the implementation of ***RPM***
3. Should we ***target*** for efficiency or welfare?
   protect the consumer or the small businesses?
4. Industrial policies ***conflict*** with other policies
   should you allow ***domestic*** firms to merge in order to improve their positions against ***international*** rivals?

The problem of measuring market power

Policy

It is hard to ***measure*** market power

- ***Detection*** or ***proof*** of market exploitation might be ***hard***
- What level of market power is ***acceptable***?
- Even when the welfare implications are straightforward, what if market power is not ***fully used***?
- What if market power ***is fair*** because of innovation or efficiency?

More problems with market power

Policy

It is hard to answer ***more fundamental*** questions

- What is the relevant ***product***?
- How to define the (geographical) ***market?***
- How to ***calculate cost*** or ***demand*** with limited access to info?
- How to determine the ***dynamics*** that influence market power ***persistence*** in time?

Measurement of market power

Policy

- Price - cost ***margins*** and ***profitability***
- Estimates of the ***elasticity of demand*** for the product
  high elasticity would suggest low market power
- Volatility of ***market shares*** in the industry
  high volatility may indicate low persistence of market power
- Estimates of ***degree of substitution*** between products
- Competition ***extent*** (local, national or international)
- Existence of artificial entry ***barriers***
- Bargaining power of ***buyers***

Measurement distortions

- None of those indices can tell the story without ***distortion***
- While one index shows market power another might indicate the ***opposite***
- We should be ***careful*** when we use those indices for the sake of policy

Categories of policy

- We will focus on the ***economic background*** of the ***legislative*** and ***institutional*** frameworks in every jurisdiction
- There are ***three categories*** of market policy
  1. ***Antitrust*** policy: ensures that ***competition*** is not hindered
  2. ***Industrial*** policy: promotes the inter-temporally optimal allocation of ***resources***
  3. ***Development*** policies: incentivize the firms to undertake appropriate ***investments*** when market fails to do so

Methods of policy

There are ***two approaches*** to policy:

1. ***Rules*** – specific laws that define actions and reactions
   - ***Advantages: objectivity***, ***clear-cut*** conviction, ***signaling*** to industry for the government's intentions
   - ***Disadvantages:*** cannot consider ***qualitative*** differences, legal ***loopholes***
2. ***Discretion (rule of reason)*** – case by case examination
   - ***Advantages:*** ideally ***specific*** to each case
   - ***Disadvantages:*** high administrative ***costs***, ***corruption***, ***lobbying***

Limiting market power

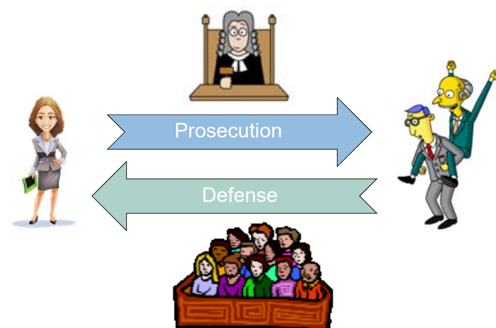
- Market power ***harms*** some players in the market – buyer or seller
  - Reduces output, leading to ***deadweight loss***
  - Raises problems of ***equity*** and ***fairness***
- What can we do to ***limit*** market power and keep it from being used anti-competitively?

  prevent firms from acquiring excessive power

Antitrust authority

- In every country there is a ***national trade and antitrust Authority*** in charge of protecting healthy competition
- Most systems use ***sequential mixture*** of rules and discretion
- In case the Authority ***identifies*** violation of rules
  - It can propose to ***settle*** with the perpetrator with a fine or even jail time
  - Take the case to ***trial*** via the national judicial system

The judicial system



Antitrust laws

* ***Rules*** and ***regulations*** designed to promote a competitive economy by
  * Prohibiting ***actions*** that restrain or are likely to restrain competition
  * Restricting the ***forms*** of allowable market structures
* Market power arises in a ***number of ways***, each of which is ***covered*** by the antitrust laws

Sherman Act (1890) – section 1

* Prohibits contracts, combinations, or conspiracies in ***restraint of trade***
  * Explicit agreement to ***restrict output*** or ***fix prices***
  * Implicit collusion through ***parallel conduct***
  * ***Example:*** In 1999, four of the world's largest drug and chemical companies were found guilty of fixing prices of vitamins sold in US

Sherman Act (1890) – section 2

* Makes it illegal to "***monopolize***" a market and prohibits conspiracies that result in monopolization
  * It is OK if a firm gets the entire market because of ***superior skill and intelligence*** when nobody else could do it as well as this firm
  * It is not OK if a firm gets the entire market by the ***use of means*** which made it impossible for other firms to engage in fair competition

Clayton Act (1914)

1. Makes it unlawful to require a buyer or lessor ***not to buy*** from a competitor
2. Prohibits ***predatory pricing***
3. Prohibits ***mergers*** and ***acquisitions*** if they "substantially lessen competition" or "tend to create a monopoly"

Federal Trade Commission Act (1914)

1. Created the Federal Trade Commission (FTC)
2. Supplements the Sherman and Clayton Acts by fostering competition through a set of prohibitions against unfair and ***anticompetitive practices***

* Prohibitions against
  * Deceptive ***advertising***
  * Deceptive ***labeling***
  * ***Agreements*** to exclude competing brands from retailing

Robinson - Patman Act (1936)

* ***Prohibits*** price discrimination if it causes buyers to suffer ***economic damages*** and ***competition is reduced***
* Requires that the seller offers the ***same price terms*** to customers at a given level of trade
  * Only for ***tangible goods***, not services
  * Covers ***inputs markets*** only
* Outside of the Act's conditions, ***pricing mechanisms*** can yield wildly different prices for different customers

Antitrust | Russia

Antitrust legislation in Russia

- Antitrust issues in Russia are regulated by one law: ***Federal Law No. 135-FZ***, "On the Protection of Competition" (2006)
- The "***3rd antimonopoly package***", which entered into force in January 2012, is indicative of a general trend of liberalization of antimonopoly regulation

  indeed, its stated aim was to bring Russia more in line with ***European*** competition regulations
- The ***Code of Administrative Offences*** includes measures

Antitrust | Russia

Federal Law No. 135-FZ

- Defines thresholds for ***excess market power*** (dominance)
  - A company is "presumed dominant" if it has ***more than 50%*** of market share
  - Dominance must be established by Federal Antimonopoly Service (Федеральная антимонопольная служба России, ФАС России) if a company has ***more than 35%*** of market share
  - A company with ***less than 35%*** of market share is generally not considered dominant
- The law places restrictions on ***aids from the government*** that discourage competition

Antitrust | Russia

Code of Administrative Offences

- Amended to increase ***liability*** of anti-competitive practices and now includes ***measures*** against such practices
- Company directors can be ***criminally liable*** in cases of a repeated offense (7 years in prison)
- Practices that are considered illegal include
  - ***Establishing monopoly*** prices,
  - Unjustified evasion from the ***execution of contracts*** with individual customers,
  - Creation of ***obstacles*** for other entities entering the market

Antitrust

Antitrust in practice

- ***Evidence*** for conspiracy for agreement is ***sufficient for conviction***

  regardless of the actual ***effectiveness*** in creating market power
- ***Price-fixing*** and customer ***allocations*** are per se illegal

  other types of agreements are judged under a rule of reason
- In general, ***parallel pricing*** is ***not sufficient*** evidence
  - ***Cannot tell*** if it is due to an agreement or done independently
  - Was ***never upheld*** as proof at the US Supreme Court
  - ***Conscious parallelism:*** independent pricing by firms that are aware of the parallel pricing of their rivals

Antitrust

Legal process

- The ***courts*** attempt to determine:
  - The ***effect*** of the agreement on ***competition***
  - Whether there are ***benefits*** that justify the agreement
- There are distinguished ***3 sets*** of circumstances:
  1. ***Common course is obvious*** but no direct evidence of an explicit agreement exists
  2. ***Signaling methods*** are used to exchange mutual assurances and identify a common course of action (second best)
  3. ***Tacit collusion*** – firms coordinate by observing and anticipating the price movements of their rivals

Antitrust

Burden of proof

- ***Factors*** that allow ***inference*** of an agreement include
  - Econometric evidence
  - Hard evidence of ***direct communication*** between executives
  - ***Facilitating practices***
  - Evidence that firms ***acted contrary*** to their unilateral self-interest (for instance, by raising prices in a recession)
- A finding that firms would ***not have*** market power from agreement is usually enough for a ***dismissal***
- The problem is that the antitrust law expects from firms to behave ***dynamically irrationally***

  to ***not consider*** the behavior and reaction of their rivals

Enforcement of antitrust laws

- US antitrust laws are ***stricter*** and more ***far reaching*** than the rest of the world
  - some have claimed this has hindered US ***competing in international markets***
- With growth of European Union, methods of antitrust enforcement have ***evolved***
  - Similar to US laws with some procedural and substantive differences
  - Europe only imposes ***civil*** penalties

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Thank you!

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