The Appropriate Objective of Competition Policy

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Agenda

- Outcome and process measures.
- Dynamic efficiency.
- Distributional considerations.
- The treatment of uncertainty.
What objective should antitrust pursue?

- There are actually two questions:
  - What should be antitrust policy’s ultimate goal?
  - What objectives should specific agents in the enforcement system pursue?

- Context is important.
  - Antitrust is one of many public policies.
  - There are many decision makers within the overall system of antitrust enforcement.
The Ultimate Goal
(other than the Rugby World Cup)
Some Possible Objectives

- **Outcome Based**
  - Promote Efficient Outcomes
  - Maximize Total Surplus
  - Maximize Consumer Surplus
  - Maximize Employment

- **Process Based**
  - Block Harm to Competition
  - Prevent Unfair Competition
Pareto optimality is the most fundamental notion of economic efficiency.

- An outcome is Pareto optimal if it is impossible to make anyone else better off without making someone else worse off.

- Outcomes that are not Pareto efficient intuitively are wasteful.

- A shortcomings of this measure for policy guidance is that it does not provide sharp rankings.
  - Consider the division of 100 dollars.

- Requiring that an action generate a Pareto improvement would be unworkably stringent.
  - Using this standard for mergers would block almost all mergers: unlikely that all consumers, owners, employees, and competitors would be better off.
Total surplus is the leading concepts of economic efficiency used in practice.

Total surplus: the gross benefits to consumers minus the total costs to producers.
An outcome is efficient under this measure if it maximizes total surplus.
Consumer surplus: the gross benefits to consumers minus the total amount paid by consumers.
Apply a consumer-surplus standard can lead to inefficiently low consumption (monopsony problem!).
Dynamic considerations reduce the tension between total surplus and consumer surplus.

- If suppliers do not invest in infrastructure and innovation, then high-quality, low-cost goods and services will not be available to end users.
- Prices set to maximize short-run consumer surplus would create economic disincentives for suppliers to invest in future supply.
- Similarly, a policy of favoring new investors over those for whom investments already are sunk will raise serious credibility issues and very likely harm investment incentives (in addition to distorting competition).
- Consumers’ long-run interests are tied to firms’ long run interests, but they are not identical.
Which surplus is the “right” one to use?

- Even in the long run, consumer surplus and total surplus are different standards.
  - The prospect of profits can motivate firms to invest and innovate in ways that promote consumer welfare.
  - But there are still differences between the two standards.

- There has been a long debate in the U.S. concerning consumer surplus versus total surplus.

- Point to note in passing: occasionally it is argued that the welfare of competitors should get weight (beyond inclusion in total surplus).
  - Protecting competitors in this way could be expected to harm both consumer and total surplus.
Much of the debate misses the point that the U.S. approach is not purely welfarist.

- U.S. antitrust enforcement does not try to maximize consumer surplus in the short or medium terms.

- There are two prongs to the U.S. standard:
  - **Outcome:** Are consumers helped or harmed by the conduct in question (e.g., exclusive contract or a merger)?
  - **Process:** The focus on consumer welfare is conditional on "harm to competition."

- Similarly, the N.Z. Commerce Act of 1986 has outcome and process elements.
Expressions of the Process Component

- US: “To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.” *Trinko*

- US: “The Robinson-Patman Act … condemns price discrimination only to the extent that it threatens to injure competition.” *Brooke Group.*

- NZ: “Promote competition in markets for the long-term benefit of consumers within New Zealand.”

- NZ: Concern with acquisitions that “would have, or would be likely to have, the effect of substantially lessening competition.”
Economists generally favor competition for the efficiency benefits it can generate.

- Where tastes and technology are such that it is feasible, competition often drives suppliers to offer their goods and services at prices that promote efficient production and consumption.

- The elimination of excess profits per se is not an efficiency benefit under the leading economic conceptions of efficiency.
  - Dissipation through wasteful expenditures is not an efficiency benefit.
  - Dissipation through wealth transfers is not an efficiency benefit.

- Possible tension with the Commerce Act:
  - Regulatory objectives include sharing benefits with consumers and limiting excess profits.
Process component reduces tension between consumer surplus and total surplus objectives.

- Although the U.S. competition policy has a consumer welfare standard, pure transfers do not constitute grounds for action.
- The central concern is harm to consumers that arises from harm to competition.
- U.S. competition policy does not directly seek lower prices and the transfer of wealth to consumers.
  - For example, it is legal for a firm with monopoly power to charge “high” prices:
    “The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system.” U.S. Supreme Court in Trinko.
  - U.S. regulation of mobile telephone providers seeks to promote competition, not directly lower prices.
- N.Z. concern with exercise of market power focuses on blocking or retarding entry, as opposed to charging high prices.
Summary: Competition policy that fails to promote long-run efficiency is likely to harm end-users.

- Distortionary competition and regulatory policies reduce the economic benefits available to all market participants, including end-users.
- It is better efficiently to maximize the total pie available and then divide it fairly...
Should antitrust address distributional concerns?
Antitrust is poorly suited to address distributional concerns.

- Enforcers generally lack relevant information.
  - Incomes of different consumers.
  - Incomes of workers and a firm owners.
  - Many end-users (e.g., wealthy individuals or corporate customers) are richer than many of the employees and owners of suppliers.
  - A person can be a consumer, worker, and owner.

- Enforcers lack a mechanism for targeted income redistribution.
Potential Responses

- Act as if everyone is equally deserving.
- Act as if transfers are made, even if not (Kaldor-Hicks).
- Rely on other governmental policies for redistribution...
Useful division of labor between antitrust and income-redistribution policies.

- Broader tax and subsidy policies are better suited to achieving distributional objectives.
- Tax policies and social welfare programs can take into account a household’s full economic circumstances (e.g., income).
- Tax policies can be designed to account for economy-wide effects.

Distributional objectives are better met through tax and subsidy policies.
Counting wealth transfers as a regulatory benefit invites unproductive rent seeking.

- It is widely recognized among economists that government policies designed to shift economic rents may give private parties incentives to engage in *socially unproductive* activities designed to induce public policy makers to favor them.
  
  “A major conclusion is that public regulation is probably as large a source of social costs than private monopoly.” (Posner at 807)

- Treating wealth transfers as a public policy benefit generates economic incentives for this type of activity.

- Two important side points
  - Not all rent-seeking behavior is unproductive. For example, the lure of monopoly profits can encourage productive behavior, such as innovation and investment in productive assets.
  - A total surplus standard is fully consistent with treating unproductive rent-seeking activities as a cost.
What about “taxing” foreign nationals?

- **Information**
  - Can competition authorities tell nationality of owners or buyers?

- **Gaming**
  - Would such policies create incentives to manipulate ownership?

- **Retaliation**
  - What if other countries do the same thing?

- **Investment Incentives**
  - Could discourage investment in NZ by foreign firms.
The same principles apply to competition policy and to economic regulation.

- Arguments supporting an efficiency standard apply equally well to both types of policy.
- Policy makers should be cautious about eliminating pure rents.
  - It can be very hard to distinguish pure rents from returns to past risky investments.
  - Policies designed to transfer pure rents often have adverse consequences for end-user welfare.
In sum, end-users have a strong interest in competition policy that promotes efficiency.

- Efficient policies maximize the total gains.
- Failure to promote efficient investment will harm consumers in the long run.
- Distributional concerns are better addressed by other policies.
- Adopting total surplus as the policy objective would achieve these ends.
- A consumer surplus standard that takes a long-run view and is coupled with a competition-based process standard can also work in many cases.
The Overall System and Objectives within It
The enforcement system has many parts.

What decision rules should specific decision makers use?
Accounting for the fact that firms choose which deals enforcers evaluate (Lyons Model).

- Firms choose which mergers to propose from the set of possible deals.
- Enforcer then approves or blocks proposed merger using rule known by firms.
- Compare effects on total surplus of using the following rules:
  - Approve if and only if change in consumer surplus $\geq 0$.
  - Approve if and only if change in total surplus $\geq 0$. 
An Example

<table>
<thead>
<tr>
<th>Deal</th>
<th>ΔProfit</th>
<th>ΔConsumer Surplus</th>
<th>ΔTotal Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>30</td>
<td>-10</td>
<td>20</td>
</tr>
<tr>
<td>B</td>
<td>10</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>C</td>
<td>20</td>
<td>-10</td>
<td>10</td>
</tr>
</tbody>
</table>

If firm chooses between A and B, it will propose A under a TS standard but B under a CS standard. TS will be higher under the TS standard.

If firm has to choose between B and C, it will propose B under a CS standard but C under a TS standard. TS will be higher under the CS standard.
Accounting for fact that firms are more active than consumers (Nevens-Röller Model)

- Merging firms and their rivals lobby enforcers but consumers do not.
- Enforcers act to maximize a combination of lobbyists’ objectives and statutory objective.
  - Lobbyists may obtain influence by presenting valid evidence, among other activities.
- Suppose lobbying proportional to value derived from the merger.
- Set statutory objective to provide a consumer-oriented counterweight.
May be able to use statutes to make agencies tougher bargainers.

- Antitrust litigation often settles.
- Outcome of settlement bargaining reflects threat points and preferences of the private parties and the government agency.
- Firms want to maximize profits.
- Legislature may want to tilt an agency’s objective to influence the bargaining outcome.
  - Induce agency to bargain on behalf of consumers.
Lessons from a Systems Approach

- One must analyze the entire system to predict the distribution of outcomes generated by a given decision rule.

- There is a logic to the view that, because firms push for profits, antitrust enforcers may need to push for consumer surplus as a countervailing force.

- We need to know more about nature of alternatives:
  - To what extent are firms’ interests negatively correlated with consumers’ interests?
  - How important are fixed cost savings?
Competition
Law and Uncertainty: We should expect better
Probabilities are not all either 0 or 1.

- A proper approach is to predict ranges of outcomes rather than a point estimate.
  - Don’t act like the most likely outcome is the one that will occur for certain.
  - Do not adopt arbitrary probability thresholds (e.g., “likely”).

- Create a point estimate of the expected welfare measure.
  - Weighted average of the different possibilities.

- It may be hard, but hiding from the problem does not make it go away.
Uncertainty is not equivalent to a probability of 0.

- U.S. antitrust agencies sometimes act as if uncertainty reduces expected effects of efficiencies to zero.

- U.S. antitrust agencies often consider a relatively short time horizon.
  - Sometimes justified as accounting for the fact that the future is uncertain.

- Discounting is not a good substitute for calculating expected values based on subjective probability distributions.
  - Can have increasing uncertainty but constant expected value, for example.
We should focus on what matters.

- Market boundaries can be hard to define precisely but also may not need to be defined precisely.

- Don’t create a false need for precision:
  - U.S. v. Peoplesoft and Oracle.
  - U.S. v. Sungard and Comdisco.
Conclusion
Summary

- Even in the long run, a total surplus standard is not equivalent to a consumer surplus standard.

- There is a process, as well as outcome, component to the N.Z. standard.

- Distributional concerns are better handled by other public policies.

- Use of a pure consumer surplus standard that counts wealth transfers as a social benefit will be harmful to New Zealand’s citizens.

- Even if total surplus is the best overall objective for antitrust enforcement, there may be a case for tilting agencies toward consumer surplus.

- Uncertainty can—and should—be handled in a systematic and rational fashion.