Competition and Consumer Protection in the 21st Century

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America has a market power problem

- Both monopoly and monopsony power
- Evident that current anti-trust/competition laws, as they are enforced and have been interpreted, are not up to the task of ensuring a competitive market place
  - If standard “competitive analysis tools” don’t show that there is a problem, it suggests that something may be wrong with the tools
  - Many changes in our understandings of economics, in the structure of the economy, and “innovations” in anti-competitive practices: competition law has not kept up
    - Much of current presumptions/law influenced by “Chicago” school
      - The competitive equilibrium model is not robust
      - The model provides a poor description of the economy
      - Any legal framework based on that as the underlying model will not serve the purpose of ensuring a competitive market place well

Broad economic and political consequences

Economic consequences

- Reduces opportunity—as a result of important barriers to entry
- Unlevel playing field—market power can lead to growth not based on efficiencies
  - Lower cost of capital of large banks as a result of implicit “too-big-to-fail” guarantee

Political consequences

- Concentration of economic power is translated into political, undermining democracy
- Broad sense of powerlessness in society System is “rigged” and unfair

All of these were among original concerns of anti-trust law

- Focus has been unnecessarily narrowed
- Most of this talk will focus narrowly on conventional economics

Failures of competition show up at macroeconomic level

- Growing inequality
- Lower investment
- Reduced innovation
- Decreasing entry and growth of small businesses
- Not only source, but an important contributor to many of these trends
- Broad inefficiencies
  - Efficiency of market economy based on individuals/firms facing same price
  - Price discrimination undermines “fundamental theorem of welfare economics”
    - Except in limiting case of *perfect* discrimination, attempt to extract more consumer or producer surplus distorts economy

Lack of competition in many sectors evident in limited range of choices

- Internet
- Cell phone
- Cable
- Airlines
- Health insurance

In many cases, lack of competition has to be assessed at local level

- Small businesses in many locales have only one or two providers of loans

But lack of choice is often hidden and pervasive through out the economy

- Drugstores
- Prescription services
- Dog food, batteries and coffins

Broader evidence of increase in market power

- Data on increased concentration across a wide range of sectors
- Increased mark-ups in many sectors
  - And typically linked to increased concentration
- In many sectors, pervasive price discrimination
  - Recall: in competitive model, no firm has ability to raise price above marginal costs, so all should face same price (unless different costs of serving different customers)
- Increased share of "rents"
  - Share of labor and capital (appropriately measured, but including intangibles) both falling
  - Only part of increased rents attributable to increased land rents—increased monopoly rents major source
  - Reflecting increased shared of corporate profits
    - Corroborated by data on high returns
    - Beyond that which can be justified by risk
    - Yet often limited entry

Explaining some of negative macroeconomic consequences

- Downward sloping demand curves result in marginal return to investment being lower than average return
    - Consistent with investment being weak even as profit share increases
- Constructed barriers to entry discourage entry and innovation
    - Remarkably little entry into some very highly profitable sectors
    - Even though there has been high levels of innovation in “neighboring” sectors

Firms have strong incentives to engage in anti-competitive behavior

- Longstanding presumption dating back to Adam Smith (1776)

  "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices"

Businessmen not only made their profits by taking advantage of their customers, but also by taking advantage of their workers:

"Masters are always and everywhere in a sort of tacit, but constant and uniform, combination, not to raise the wages of labour above their actual rate [...] Masters, too, sometimes enter into particular combinations to sink the wages of labour even below this rate. These are always conducted with the utmost silence and secrecy."

Our business leaders understand this

Peter Thiel:

"competition is for losers."

Warren Buffett

"The single most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. If you've got a good enough business, if you have a monopoly newspaper or if you have a network television station, your idiot nephew could run it."

Describing an entry barrier like being surrounded by a moat:

"[We] think in terms of that moat and the ability to keep its width and its impossibility of being crossed. We tell our manager we want the moat widened every year."

Major source of innovation in US is the construction of new forms of entry barrier, ideas that are transmitted throughout economy (including by our business schools).

Multiple forces underlying growth in market power

- Structure of demand
  - Towards local services, in which competition may be limited (servicing Deere tractors)
- Technology
  - Network/platform economies
    - But potential competition has been circumvented by contract restraints, amplifying and extending market power
  - Industries with large upfront costs, low marginal costs
    - But if that were primary driver, one would have expected an increase in investment (say as a share of GDP), not a decrease
  - Big data
    - Providing new tools for price discrimination
    - Those with ability to discriminate better grow—not necessarily firms that are more efficient
    - Broader point: **with market power, firms with higher "value added" may not be most efficient firms; value added, as we conventionally measure it, is not true "value added." Includes large redistributive element, redistribution from consumers to firms**
- **To maintain competitive market place in presence of these changes will require more active competition policies, with new tools and presumptions**
  - Market equilibrium, on its own, will be far from competitive

But innovation in extending and amplifying market power is a major factor

- Big data (as discussed in previous slide) allowing exploitation/price discrimination
- Innovative contracts with restraints
  - Merchant restraints (GDS, credit cards)
  - Microsoft restraints
- Bundling and non-linear pricing
- Pre-emptive mergers
- Techniques in extending effective patent life
  - Evergreening
  - Data exclusivity
  - Other ways of undermining competition with generics

Major changes in understandings of economics over past third of a century

- Greater understandings of the limitations of the competitive equilibrium model
  - Model not robust
  - Information economics
  - Game theory
  - Behavioral Economics
- Presumptions based on “old” model no longer hold
  - Irony: critique of standard competitive model was in full force just as model’s influence expanded
  - Importance of lags in knowledge—and perhaps of ideology

New understandings of the functioning of the market economy

- The competitive equilibrium model does not provide a good description of the market economy
  - Pervasiveness of market power
  - Even small market power in multiple industries can add up to having large effects
  - Market power/market imperfections can be generated in multiple ways
    - Asymmetries of information: small information imperfections can give rise to large market power
    - Search costs: even small search costs can lead to large market power
    - Even small sunk costs can lead to large market power
  - And then can be amplified and extended in multiple ways
  - Serious problems of monopsony, especially in labor market
      - Only way to explain much of behavior in labor market

New understandings: dynamics

- Potential competition is not a substitute for real competition
  - The "contestability" doctrine was never robust—fell apart with even small sunk costs; didn't work in practice
- Schumpeterian doctrines (monopolies are only temporary, competition to be monopolist drives innovation) are also not robust
  - Monopolies can and have incentives to stifle innovation
- Competition policy needs to focus not just on the effect of competition today, but on competition in the future
  - Pre-emptive mergers

These new perspectives require new presumptions, new criteria and tools, and new remedies

- Abuse of "efficiency defense" for restraints
  - Anti-competitive practices should be presumed to be illegal, unless there is strong evidence that (a) there are significant efficiency gains and that a significant proportion of the benefits of these efficiency gains accrue to others than the firm; and (b) these efficiency gains could not be achieved in a less anti-competitive manner
- Example: "Two-sided markets" defense of platform restraints
  - In many cases, presence of significant externalities not even established
  - In many cases, no attempt to show that observed pricing patterns are those predicted by theory
  - Typically, no attempt at incidence theory: pretend that price imposed on merchant is not shifted to consumer (as would be the case in any competitive model)
  - Typically, no attempt to analyze impact of restraints on cross-platform competition (horizontal effects of vertical constraints)
  - Wrong measure of output: with cross subsidies (e.g. from cash customers to credit card customers, induced by restraints) credit card transaction is wrong indicator of "well-being" and efficiency

New presumptions

- Presumption against predation needs to be changed
  - Predation often works, at least for an extended period of time, and current presumptions put undue burden on plaintiffs
  - Innovativeness in predatory mechanisms—American Airlines expanding capacity to drive out competitor, then raising prices; Microsoft charging zero price for IE
- Presumption against intervening in vertical mergers needs to be changed
  - A vertical merger can change competitive landscape

Consumer welfare standard misguided

- Especially with monopsony and when long run dynamics are important
  - Even if firm with monoposony power passes on some of gain to consumers, there is a distortion in the economy, and societal welfare is lowered
  - Predation may lower prices in the short run, but reduced competition will hurt in the long run
    - Presumption that more competition is valuable in itself, more likely to lead to a dynamic and flourishing economy, with monopoly rents competed away

New approaches to determining market power

- Market share only one indicia
  - In some cases, there can be large market power even with small share, as conventionally measured
- Best to assess directly: is there evidence of pricing power or power to force buyers (sellers) to accept contract provisions that are prima facie not in their interests
  - Large mark-up should be prima facie evidence of market power
    - Usurious interest rates by banks
  - Price discrimination: If it pays to sell to some firm (consumer) at a low price, then selling to another at a high price should be prima facie evidence of market power, unless Defendant can show that they are justified by costs differences
  - Forcing buyers to acceptable terms that should be unacceptable
    - Arbitration clauses
    - Consumer protection needs to be extended to “transparency” of contracts
- Other considerations may reinforce conclusion that a market constraint is anti-competitive
  - Persistent profits with no entry for an extended period of time

Simplifications of past are not acceptable

- There are some case where one can reliably ascertain incidence, without full general equilibrium analysis
  - Illinois Brick puts a constraint on anti-trust enforcement
  - Going beyond it would be able to attack some obvious cases of anti-competitive behavior that have been left unaddressed

New remedies

- Need innovation in remedies corresponding to changes in economy (including innovation in anti-competitive practices)
  - Recognizing that market power, once established, can persist: strong hysteresis effects
    - Again, markedly different perspective than that of "Chicago School"
  - Recognizing that firms have incentive and ability to circumvent/innovate to reestablish market power
    - Will require more Court oversight
- New natural monopolies/oligopolies need new policies
- Just because market power arises from technology doesn't mean we should do nothing
- May require even more intense scrutiny of behavior, stronger policies to prevent leveraging market power
  - structural policies (break-ups, prohibitions from going into downstream or upstream activities)
    - Typically, economies of scale and scope have been exaggerated, seldom established
  - Regulatory policies: non-discrimination

Stronger remedies

- Restrictions on anti-competitive practices (EU actions against Google), contracts/constraints, forbidding pre-emptive mergers and vertical mergers and acquisitions that might adversely affect competition, restrictions on IPR (patent pools, compulsory licensing, shortened patent life)
- More active consumer protection—e.g. proscribing arbitration clauses, transparency requirements
- Net neutrality is a competition issue
- Abusive of market power—however acquired—should be illegal
- Temporary regulation of pricing (e.g. of merchant fees in credit cards, as in Durban Amendment), until competition is restored

Lack of workers’ bargaining power is a competition issue

- Results in abusive working conditions
- Results in low wages
- Contributed to by globalization
  - Competition authorities should articulate consequences of trade agreements for competition—including workers’ bargaining power

Big data and privacy

- Represents one of biggest challenges to our society, and to competition law and consumer protection
  - Individuals often don't know value of data that they are giving to companies—or even that their data is being taken
- May be returns to scale in data—giving those with more data a competitive advantage
  - Enhanced when they can combine their data with others
- In some cases, there may be social value in the data; in many other cases, data is being used to extract more consumer surplus out of buyers
  - An undesirable redistribution, which may actually impede economic efficiency
  - Little evidence on the balance of the two
  - At the very least, there needs to be far stronger regulation on individual privacy and the transparency of those who acquire data, on combining data sets, on the uses to which data can be put

In some areas concentration of market power are especially problematic

- Market place of ideas: media
    - Mistake to view it only as a mechanism for delivering advertising
    - Concentration of media in a few hands can reduce competition in the market place for ideas

The time is ripe for a re-examination of our competition and consumer protection laws

- Our economy has changed and our understanding of economics have changed
    - And we can better grasp the failures of the existing legal framework
- But the underlying political and economic concerns about power and exploitation that drove the original legislation are still present—even more so
- Competition law has been excessively narrowed, and excessively influenced by presumptions concerning a competitive market place
- Today, competition and consumer protection law needs to be broadened, to incorporate the realities of the 21st century and the insights of modern economics