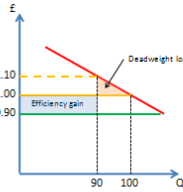


Reading map

This lecture was more about details of the regulatory view about competition and anti-competitive practices (and their rationale), than about economic models. The lecture closely followed Chapter 19 of the Carlton and Perloff text book. The lecture itself made one important point, namely, that regulators sometimes have to balance welfare and efficiency implications of anti-competitive practices, and the choice they make may vary across countries and contexts, e.g., the USA and the EU. However, it may be a good idea to give the whole chapter a read to get a broader perspective of the relevant issues.

<p style="text-align: center;">Antitrust laws – key points</p> <ul style="list-style-type: none"> • The interpretation of (US) antitrust laws varies over time. • Antitrust laws should promote efficiency. • Monopoly is not prohibited, but certain activities that can lead to a firm's acquiring or exercising monopoly powers are banned. • Price fixing is generally prohibited. • Certain agreements among competitors, vertical relations between firms, and various other strategic acts may increase or decrease welfare; hence, they should be evaluated on a case-by-case basis. • A few antitrust laws, such that the prohibition on price discrimination that allegedly reduces competition among customers, almost always lower welfare. • Prohibiting certain activities and not others can lead to inefficient organisation of firms. 	<p>These bullet points are taken from page 632 of the text book, and they summarise the issues covered in the chapter.</p>
<p style="text-align: center;">Are antitrust laws efficiency enhancing? - I</p>  <ul style="list-style-type: none"> • Demand curve for product (and hence for retailer) = D_R • Wholesaler knows that retailer uses the MR curve to decide on output, and hence $D_W = MR_R$ • Wholesaler charges price P_W, which then is the MC for the retailer • Price for the consumer is P_R • In the case of vertical integration, price would have been P_W 	<p>The market demand curve, which the retailer faces, is D_R. The corresponding MR curve is MR_R. The retailer maximises profit by setting $MC = MR_R$. Since the output of the retailer is determined by MRR, therefore, the effective demand curve for the wholesaler is MR_R, i.e., $D_W = MR_R$. The MR curve for the wholesaler is then MR_W. The wholesaler's profit maximisation gives us price P_W charged by the wholesaler, which is the cost of the retailer, i.e., $P_W = MC_R$. The profit maximisation of the retailer then gives us the price P_R for the customer. If vertical integration is allowed, the customer will pay the price $P_W < P_R$.</p>
<p style="text-align: center;">Are antitrust laws efficiency enhancing? - II</p>  <ul style="list-style-type: none"> • Merger outcomes: <ul style="list-style-type: none"> - Price raised from £1 to £1.10 - MC (= AC) declines from £1 to £0.90 • Implications: <ul style="list-style-type: none"> - Deadweight loss = $0.5 \times 0.10 \times 10 = 0.50$ - Efficiency gain = $0.10 \times 90 = 0.90$ • In general, efficiency gain is more likely to dominate if the output level sold in the market is large • Regulations generally take a dim view of price rises following mergers even if there are compensating efficiency gains <ul style="list-style-type: none"> - Conflicting views of US and European regulators about GE-Honeywell merger 	<p>The initial price is 1.00 and at this price 100 units of the product are being sold in the market. Suppose now there is a merger that creates a monopoly. One of the effects of the monopoly is to increase the price to 1.10 and reduce the quantity sold to 90. As we know, this will result in a deadweight loss. Suppose that the merger also increases efficiency such that the MC and AC declines from 1.00 to 0.90. In that case, there is an efficiency gain as well. If the output sold in the market is large (say, 90 million instead of 90), this efficiency gain may well dominate the welfare/deadweight loss. However, it is difficult to estimate the values of these gains and losses with certainty, and regulators may therefore have to use some degree of discretion. The GE-Honeywell merger demonstrates that regulators in two countries or contexts may take very different views about such situations.</p>

<p>Challenge I – estimating market power</p> <ul style="list-style-type: none"> • Market power <ul style="list-style-type: none"> – Definition: $(P - MC)/P = 1/\epsilon$, where ϵ is the elasticity of demand • Problem <ul style="list-style-type: none"> – How can we estimate ϵ of the firm created by mergers between two firms? • Rule of thumb <ul style="list-style-type: none"> – Compute HHI before and after merger – (a) If initial HHI less than 1000, merger is deemed unproblematic – (b) If initial HHI is 1000-1800 and HHI increases by 100, merger is deemed problematic – (c) If HHI is greater than 1800 and HHI increases by 50, merger is deemed problematic 	<p>This slide and the following one are based on material covered in pages 642-648, in the section entitled “Market Power and the Definition of Markets”.</p>
<p>Challenge II – estimating extent of market</p> <ul style="list-style-type: none"> • Are Coke and Fanta in the same market? Is tea? • Estimating the extent of the market requires the identification of all demand and supply substitutes <ul style="list-style-type: none"> – Product B is a <i>demand substitute</i> of Product A if a rise in the price of A increases the demand for B – Product C is a <i>supply substitute</i> of Product A if a rise in price of A makes a firm switch from production of C to production of A • Rule of thumb <ul style="list-style-type: none"> – Decide whether two products are in the same market either by interviewing producers or by checking correlation between their prices – More often than not, the (own) price elasticity – and not the cross-price elasticity – is taken into account to decide whether or not a firm has market power 	<p>See above.</p>
<p>Are all agreements among competitors bad?</p> <ul style="list-style-type: none"> • Price fixing and output agreements <ul style="list-style-type: none"> – Price fixing and output fixing are fundamentally in violation of antitrust laws – The court does not need to undertake additional inquiry about the “reasonableness” of these actions to deem them to be illegal – However, courts do take into consideration the question as to whether price fixing in specific cases might promote competition in some way • Information exchange among competitors <ul style="list-style-type: none"> – An important consideration is whether the group of firms exchanging information is small enough to effectively form a cartel • Oligopoly behaviour <ul style="list-style-type: none"> – Similarity of behaviour (e.g., with respect to pricing) is deemed unacceptable • Mergers <ul style="list-style-type: none"> – Mergers among competitors (and even among potential competitors) generally not allowed – However, courts do entertain the <i>falling firm</i> defence of such mergers 	<p>This slide is based on the material covered in pages 648-661, in the section entitled “Cooperation Among Competitors”.</p>
<p>The case of the US banking industry</p> <ul style="list-style-type: none"> • National Bank Act (1864) <ul style="list-style-type: none"> – Banks have to be chartered (licensing) • McFadden Act (1927) <ul style="list-style-type: none"> – Required national banks to restrict branching to the state in which they were located • Glass-Steagall Act (1933) <ul style="list-style-type: none"> – Separated commercial banking from investment banking (economies of scope) • Regulation Q <ul style="list-style-type: none"> – Prohibited banks from paying interest on demand deposits (and imposed interest rate ceilings for savings accounts) • Foreign Bank Supervision Enforcement Act (1991) <ul style="list-style-type: none"> – Federal Reserve must approve the entry of all foreign banks – Bars branches of foreign banks from accepting deposits of less than \$100,000 from US residents and citizens – Fed must be notified if a foreign bank owns 5% of a US bank; and Fed must approve foreign parent bank as a holding company if it owns 25% of a US bank 	<p>If you are interested in details about regulation of the US banking industry, refer to the following book: Mishkin, Frederic (2009), <i>The Economics of Money, Banking and Financial Markets</i>, 9th edition, Addison-Wesley.</p> <p>If you are interested in the events that led to the banking crisis in the US in eighties, you can read http://www.sumonbhaumik.net/EMERGO_1996.pdf.</p>