

# Vertical Restraints: What does the evidence imply for policy?



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Luke M. Froeb,

Bureau of Economics, FTC

AEI-BROOKINGS Joint Center

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The views expressed herein are not purported to reflect those of the Federal Trade Commission, nor any of its Commissioners



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# Outline

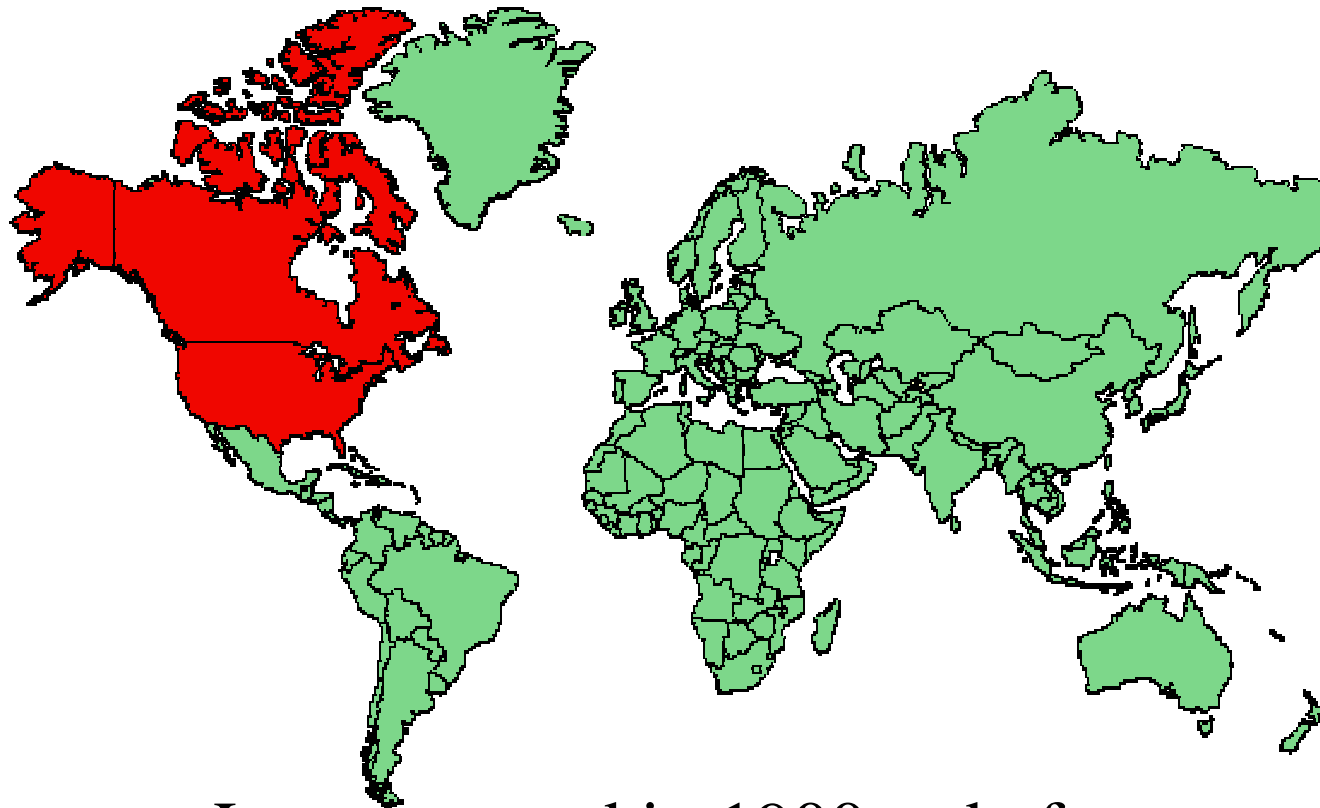
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- I. Spread of antitrust
- II. Coming Conflicts
- III. Solutions?

# Global Proliferation of Competition Laws

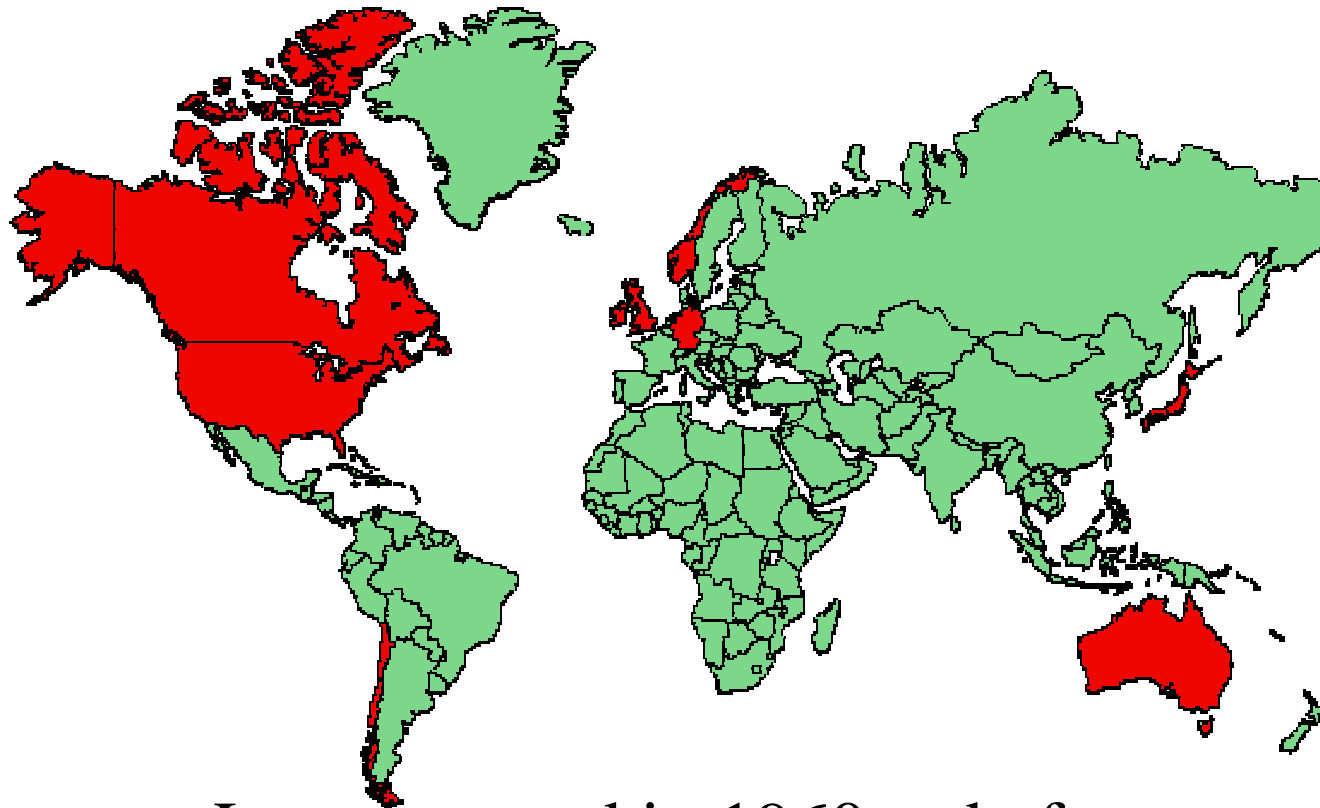


# 1900



Laws enacted in 1900 or before

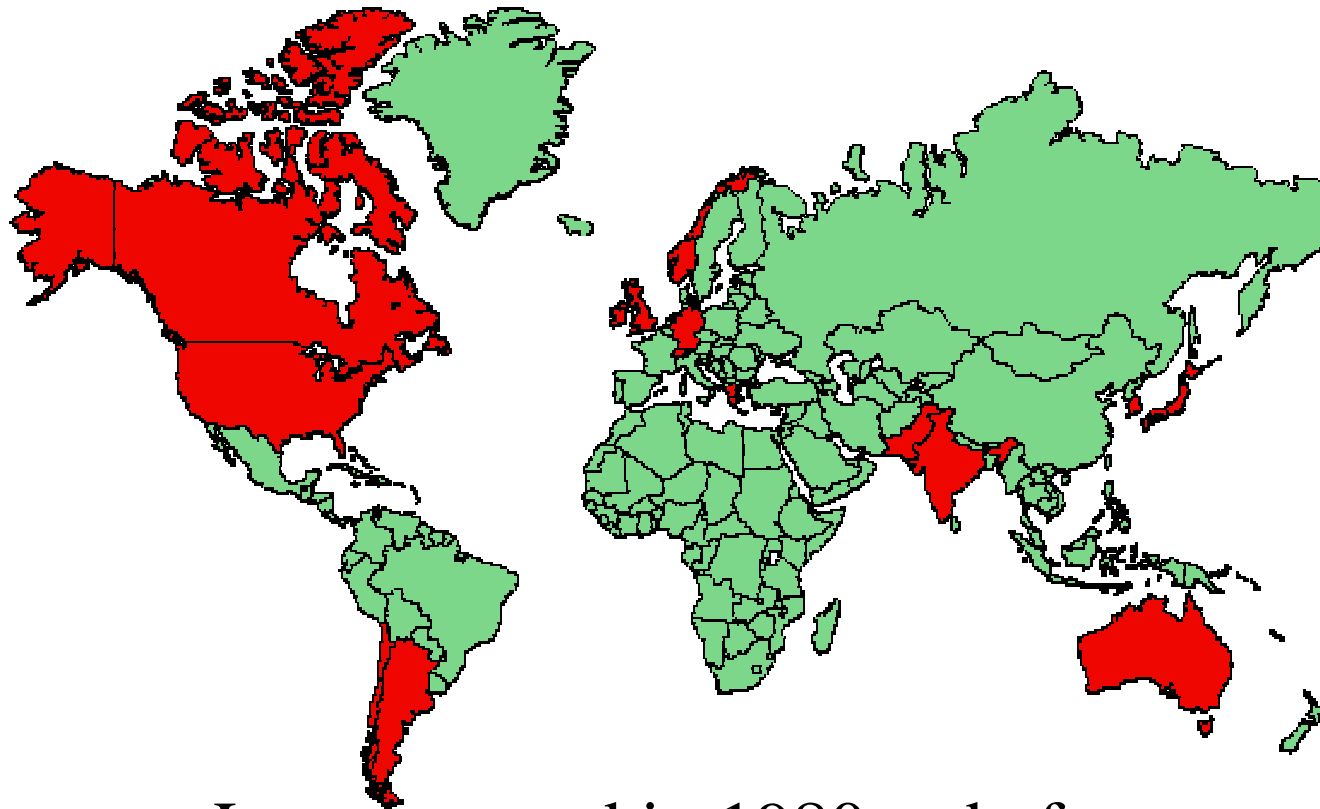
# 1960



Laws enacted in 1960 or before

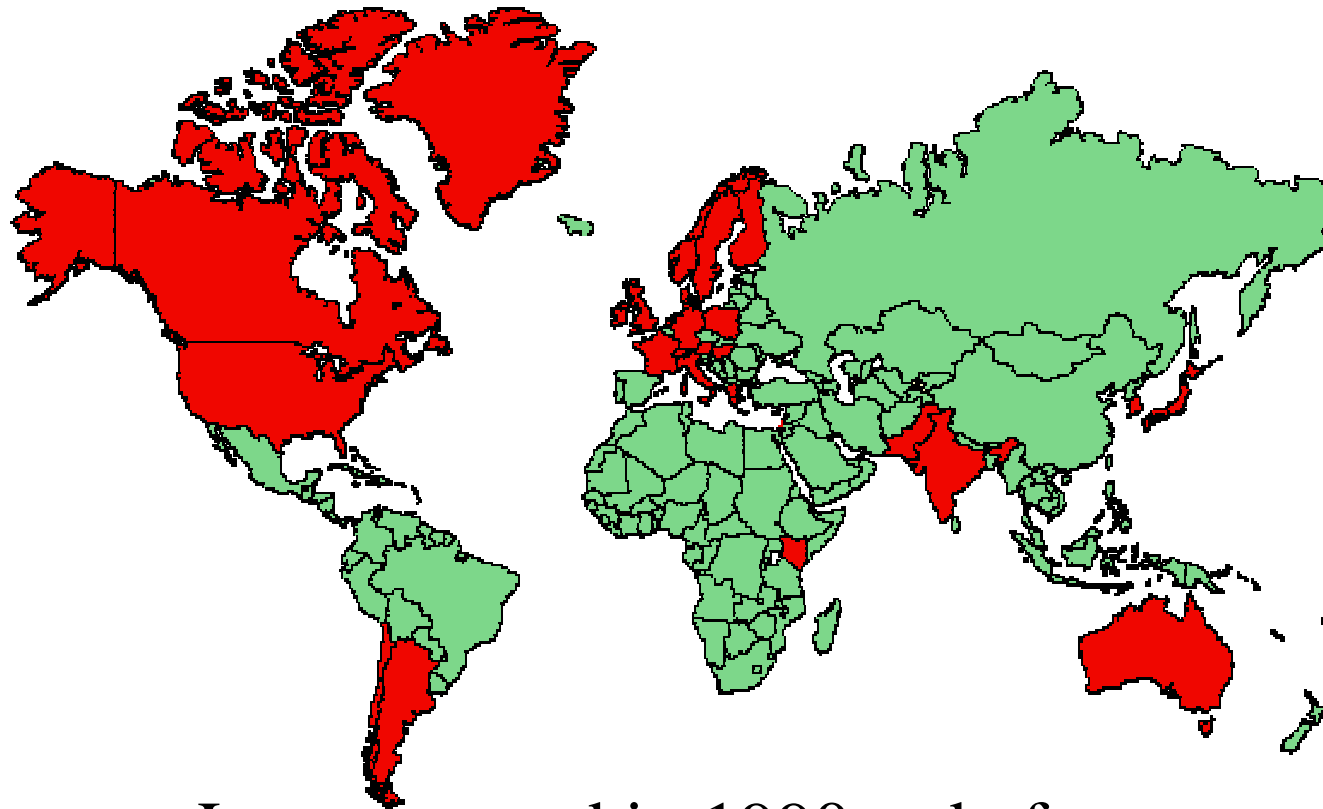
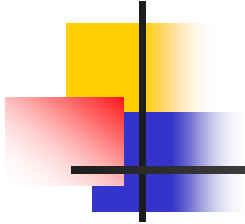
Note: EU introduced antitrust law in 1957

# 1980



Laws enacted in 1980 or before

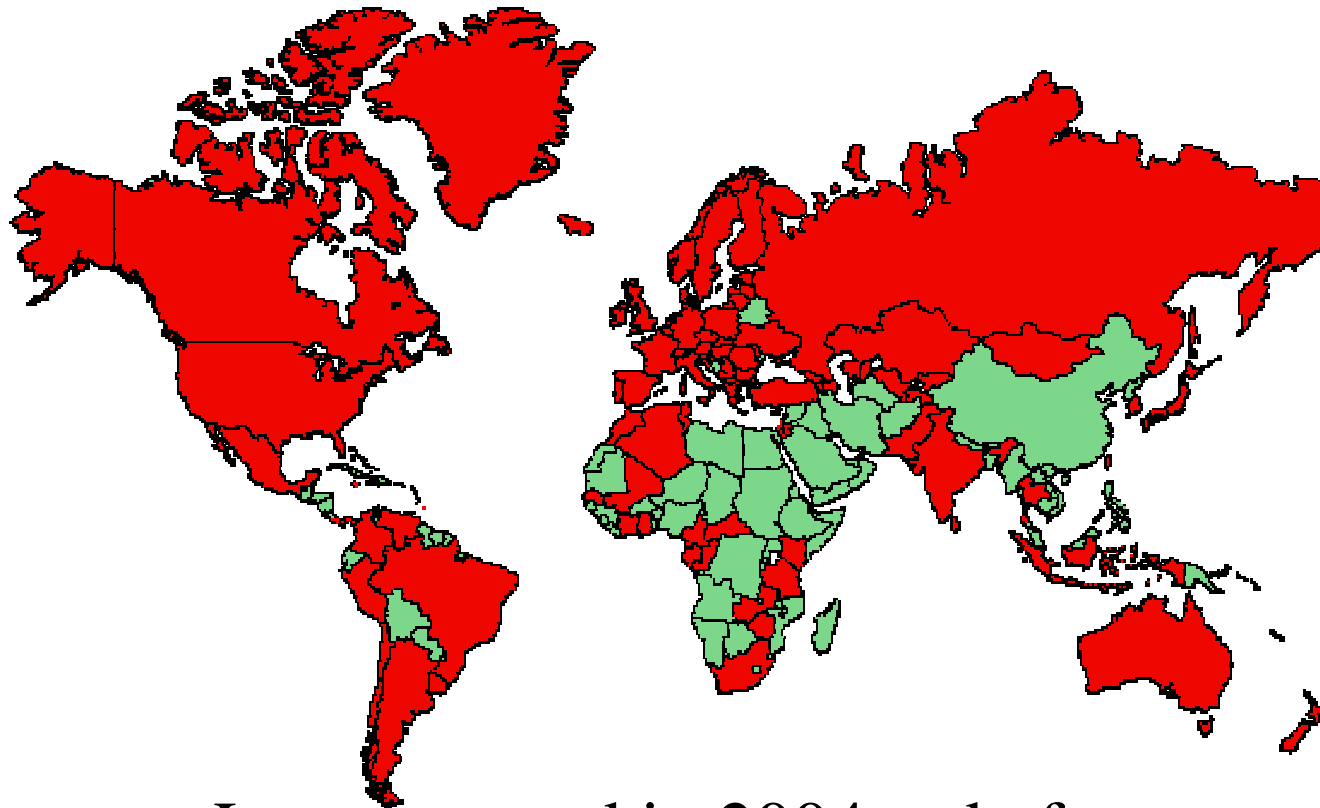
# 1990



Laws enacted in 1990 or before

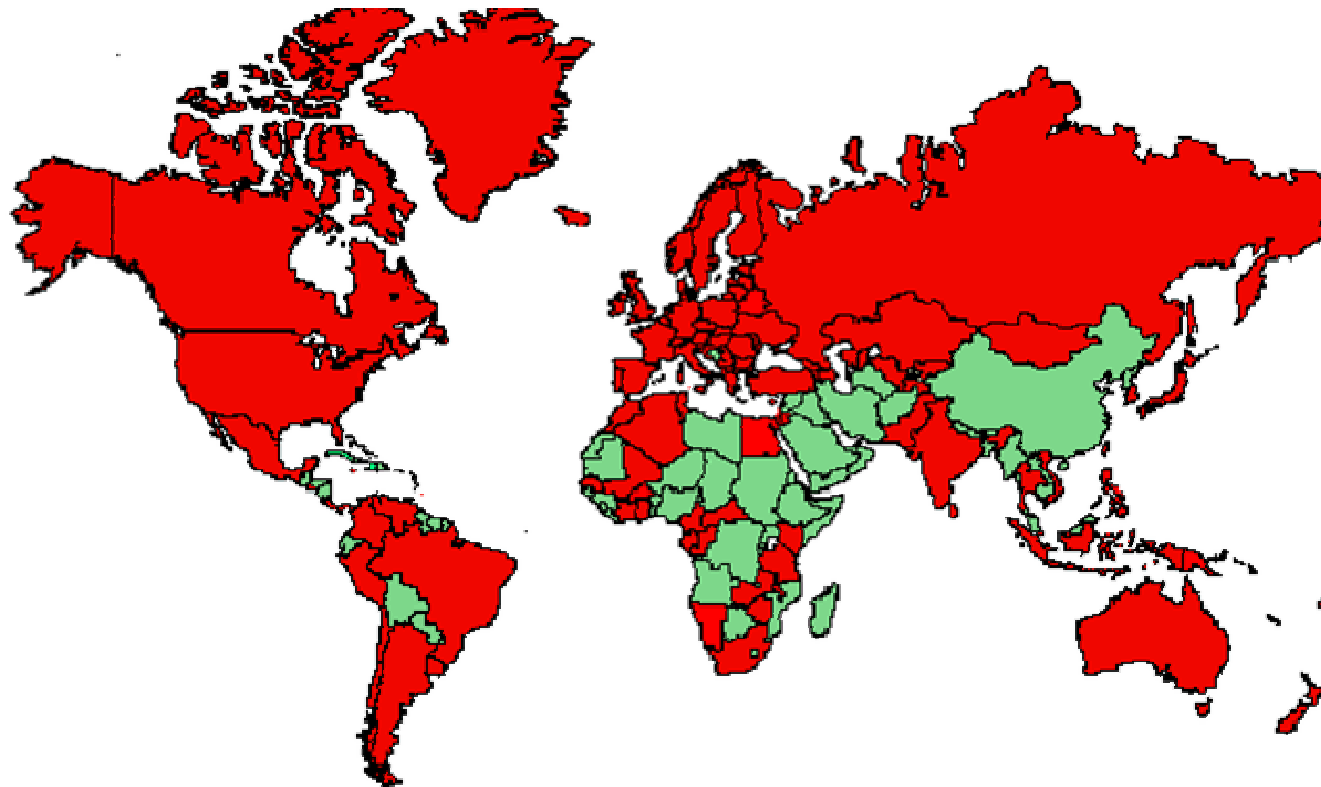
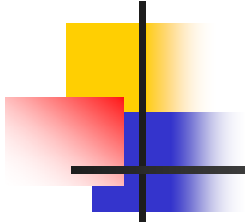


2004



Laws enacted in 2004 or before

# 2005



Laws enacted in 2005 or before



# Enforcement Priorities

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- US
  - 1. Cartels
  - 2. Mergers
  - 3. Abuse of dominance
- New antitrust regimes
  - 1. Abuse of dominance
  - 2. Mergers
  - 3. Cartels



# What Economics tells us about Abuse of Dominance Cases?

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- Theory gives us possibility theorems
  - Necessary conditions for harm → safe harbours
- What happens when we export necessary conditions to new regimes?
  - They become sufficient



# Can we find a screen?

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- Search for screen is elusive
  - conditions for harm are same as for benefits
- Choose screen based on beliefs about frequency and size of type I and II errors
  - Primary market power
  - Secondary market power
  - Makes no business sense “but for” exclusion
- Can we export a screen to another regime that doesn't share our beliefs?



# What is the Evidence on Abuse of Dominance?

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- Estimating effects of vertical restraints
  - Control Group (with restraint)
  - Experimental group (without restraint)
- → vertical contracts and integration
  - Reduce price
  - Induce demand-increasing services



# Representative Experiments

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- *Gasoline*: prices 2.7¢/gallon higher in states with vertical divorcement laws
  - Vita and Sacher (2000)
- *Beer*: UK divorcement of “tied” pubs raised price
  - Slade (1998)



# Exclusion Experiment

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- FCC regulations (and Cable Act) required cable TV to carry local over-the-air channels
- Natural experiment: In 1980's, Appeals Court overturned "must carry" on 1<sup>st</sup> Amendment grounds
- Question: Would Cable monopolist "exclude" competitors, when allowed?



## Results: Probability a Channel was Dropped or “Excluded”

	NOT Advertising competitor	Advertising competitor
Broadcast Competitor	1.5%	1.1%
NOT Broadcast Competitor	8.4%	6.2%

- Competitors LESS likely to be dropped
- Channels with low ratings dropped
- Refutes “Exclusion” hypothesis



# Summary of Empirical Evidence: LaFontaine & Slade

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- when manufacturers ... impose ... restraints, not only do they make themselves better off, but they also typically allow consumers to benefit from higher quality products and better service provision.
- In contrast, when contract limitations are imposed on manufacturers via government intervention, the effect is typically to reduce consumer welfare as prices increase and service levels fall.
- ..., the interests of manufacturer and consumer welfare are apt to be aligned, while interference in the market is accomplished at the expense of consumers (and of course manufacturers).



# Should we use an evidentiary standard?

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- Bring cases where we have a good natural experiment?
  - Comparing markets with and without restraint, what is effect of restraint?
    - Time Series data (before vs. after)
    - Cross section data



# Can we use Evidence to Guide Policy?: Competition Advocacy

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- Vertical divorcement
  - FTC study showed Gasoline divorcement raised prices by 3 cents per gallon.
  - New York appears to have listened to FTC, and did NOT pass vertical divorcement.
- Irish Comp. Authority spends 25% of its budget on competition advocacy



# FTC Non-merger Agenda

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- “Cheap” exclusion non-merger challenges
  - Abuse government process to exclude competitors
  - “Cheaper” than reducing price or increasing quality
- Patent settlements, standard setting, state action



# What new antitrust enforcers are saying

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- “our economies are different from yours”
  - Former state-owned monopolies are deregulated, and abuse dominant positions
- Does this distinction matter?
  - Deterrence is a forward-looking analysis.



# Regulatory Evasion

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- Regulated local monopolists can evade regulation
  - By tying, bundling, excluding
- Implications
  - Vertical restraints bad
  - Consumers hurt
    - Price goes up
  - Competitors hurt
- → Theory and evidence supports prosecution



# Deregulated Monopolist

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- Can extract profit with price alone
  - Exception: price discrimination
- Now, tying, bundling, exclusion eliminate double markup
  - Consumers helped
    - Vertical restraints reduce price
  - Competitors still harmed
- And don't forget efficiencies





# Advice to New Regimes

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- Do not apply regulatory evasion intuition or policy to an unregulated environment.
- In an unregulated environment, we know that we don't know very much.



# Concluding thoughts

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- Nations are not powerful because they possess wide lands, safe ports, large navies, huge armies, fortifications, stores, money, and credit. They acquire those advantages because they are powerful, having devised on correct principles the political structure which allows the flow of energy to take its proper course."
  - Isabel Paterson, *The God of the Machine*, 1943



# Good Government Matters

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- People living in countries with high levels of economic freedom
  - \$23,450 annual income
  - 2.6% income growth
- with low levels of economic freedom
  - \$2,560 annual income
  - (0.9%) income LOSS



# Do new antitrust regimes lay the micro foundations of poverty?

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- Conclusion: not just more research, but more research that informs policy
  - What are we doing?
  - What is effect of enforcement on price, quantity, quality?
  - More empirical research on effects of restraints generally