Market Power and Market Definition in Monopolization Cases: A Paradigm is Missing

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Overview

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- Implications of the model
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- The ongoing dilemma
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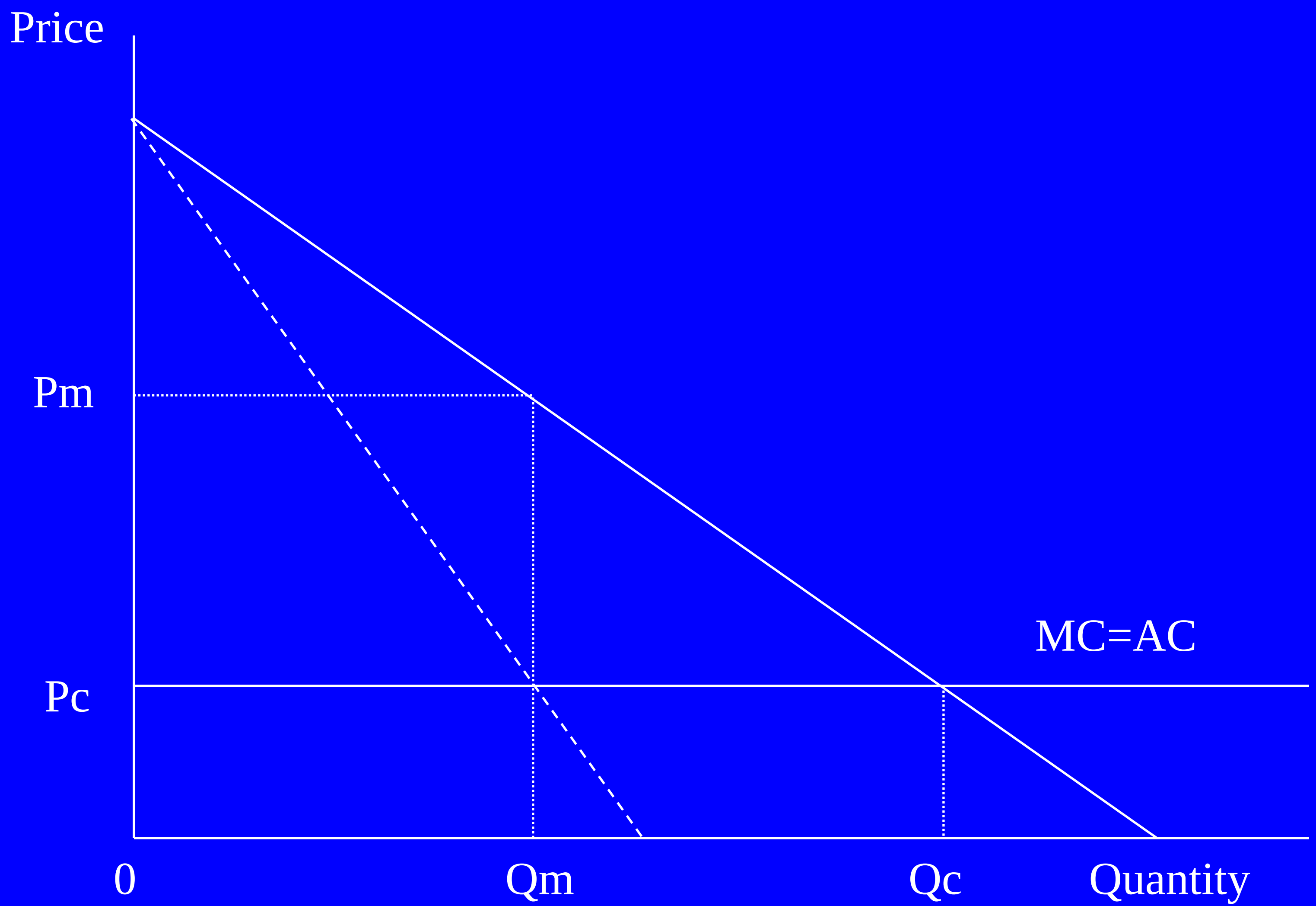
The issue

- A seller can *exercise* market power
  - Sell at P > MC, *and* earn rents
- A seller can *create/enhance* market power
  - Exclusionary/predatory behavior
- If a seller is exercising/enhancing market power, a likely pre-condition is that the seller has a large share of its market
- A threshold (safe harbor) issue: What is "the market"?
  - *There is no standard paradigm for this determination*

The standard monopoly model



Implications of the standard monopoly model

- The monopolist *maintains* its price at a level above the competitive price
- At the monopoly price, the monopolist would find it unprofitable to *raise* its price further (unless the demand curve and/or costs changed)
  - The monopolist would lose too many customers to other sellers of *something*
- If a market *changes* from a competitive structure to a monopoly (because of cartelization or exclusion), the price increases

But some loose language (1)

- By economists (who do know better) (emphasis added)
  - "It is the ability of a firm to *raise* prices or market inferior products while excluding competition that constitutes monopoly power." (Fisher et al.)
  - "... substantial evidence was presented at trial that [OEMs] would not shift to another operating system, even if the price of Windows *rose* significantly." (Fisher & Rubinfeld)
  - "Economists usually define market power as the power to *raise* price above competitive levels." (Evans & Schmalensee)

More loose language

- By judges (who ought to know better?) (emphasis added)
  - "Market power is usually stated to be the ability of a single seller to raise price and restrict output..." Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 503 (1969)
  - "Market power comes from the ability to cut back the market's total output and so raise price." Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc., 784 F.2d 1325, 1335 (1986)
  - "More precisely, a firm is a monopolist if it can profitably raise prices substantially above the competitive level." U.S. v. Microsoft Corp., 253 F.3d 34, 22 (2001)

The danger of the loose language

- Suppose that the “test” of the presence of market power is whether the candidate seller has the ability profitably to *raise* prices above *currently observed* levels; conversely, is the seller *constrained from raising* prices because of its fears of losing too many customers to other sellers (of something)?
- All sellers should be found to be so constrained
  - All sellers will be deemed to be part of a “large” market in which they have only a minor market share

The *Cellophane* fallacy (1)

- U.S. v. du Pont, 351 U.S. 377 (1956)
- Was the market narrow: “cellophane”?
  - If so, Du Pont had market power
- Was the market broad: “flexible wrapping materials”?
  - If so, Du Pont had only a 17.9% share of that market and didn’t have market power

The *Cellophane* fallacy (2)

- The Supreme Court majority:
  - "cellophane's interchangeability with the other materials mentioned suffices to make it a part of this flexible packaging material market"
- The Supreme Court minority (and Stocking & Mueller (1955))
  - Du Pont's profits in cellophane were much higher than in rayon, where it faced 15-18 other producers of the same item and had about the same market share (less than 20%) as in cellophane
  - Du Pont’s price of cellophane didn’t vary when the prices of other packaging materials changed

The ongoing dilemma

- Profit data are often unreliable
- The relevant market definition paradigm of the Horizontal Merger Guidelines (HMG) is a forward-looking price increase test (SSNIP) and thus is generally *not useful* for complaints involving the *existence* of market power
  - Exception: If a complaint is about a *prospective* exclusionary practice, then the SSNIP test can be used
- Estimates of the elasticity of demand for the seller's product are unlikely to be helpful
  - A true monopolist and a Chamberlin/Robinson "monopolistic competitor" could have similar elasticities

What is to be done? (1)

- Sometimes a complaint will involve a prospective practice
- Sometimes there are cross-section and/or time series data on seller concentration and price that can help delineate markets
  - Local markets: retail services; transportation services; low value-to-weight commodities
- Sometimes profit data can be useful
  - Microsoft…?
- But what if none of these possibilities are available?

What is to be done? (2)

- Nelson & White (2003) proposal (similar to but expanding beyond Krattenmaker et al. (1987) and Werden (2000)): If a plaintiff alleges exclusion, would the (counter-factual) absence of exclusion have led to a "small but significant *decrease* in price" (SSN*D*P)?
  - What would the plaintiff's sales have been in the absence of the exclusion?
  - What would have been the consequences of those sales for the defendant's prices?
- This focuses directly on effect and implicitly delineates a market
  - Similar in this respect to the "unilateral effects" analysis under the HMG

What is to be done? (3)

- Develop a market definition paradigm for monopolization cases that is comparable in analytic power to the HMG market definition paradigm
  - Remember what pre-1982 market definition analysis for mergers was like?

Conclusion

- Market definition for monopolization cases remains in an unsatisfactory state
  - Comparable to the pre-1982 state of market definition for merger cases
- There are some potential/partial remedies; but
- The best remedy would be a new paradigm