



# The Appropriate Objective of Competition Policy

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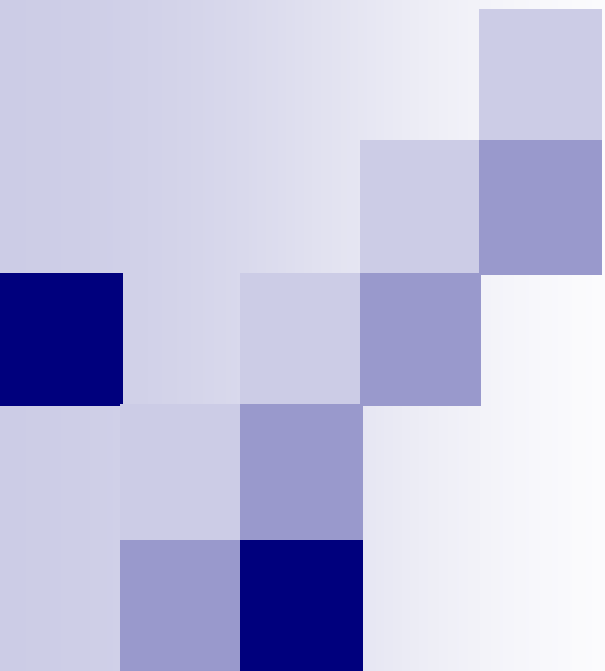
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# Agenda

- 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

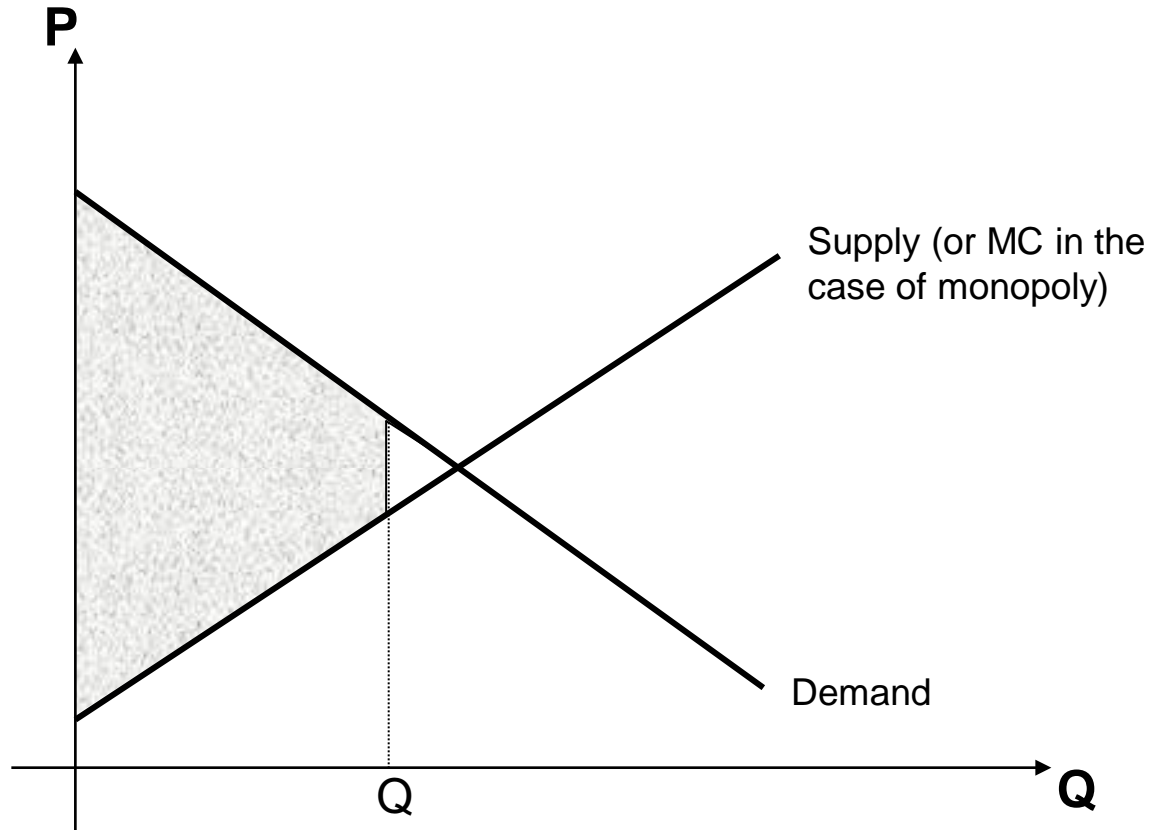
## ■ Process Based

- Block Harm to Competition
- Prevent Unfair Competition

# Pareto optimality is the most fundamental notion of economic efficiency.

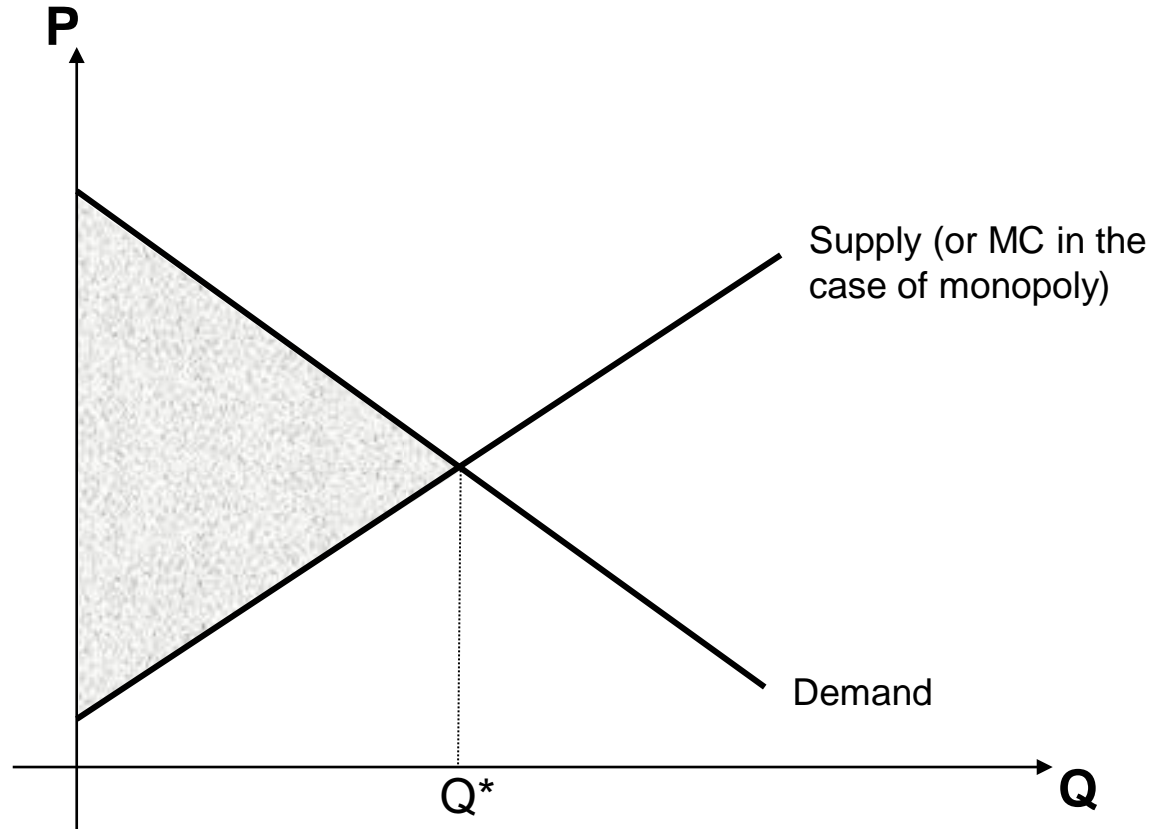
- An outcome is Pareto optimal if it is impossible to make anyone else better off without making someone else worse off.
- Outcomes that are not Pareto efficient intuitively are wasteful.
- A shortcomings of this measure for policy guidance is that it does not provide sharp rankings.
  - Consider the 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.



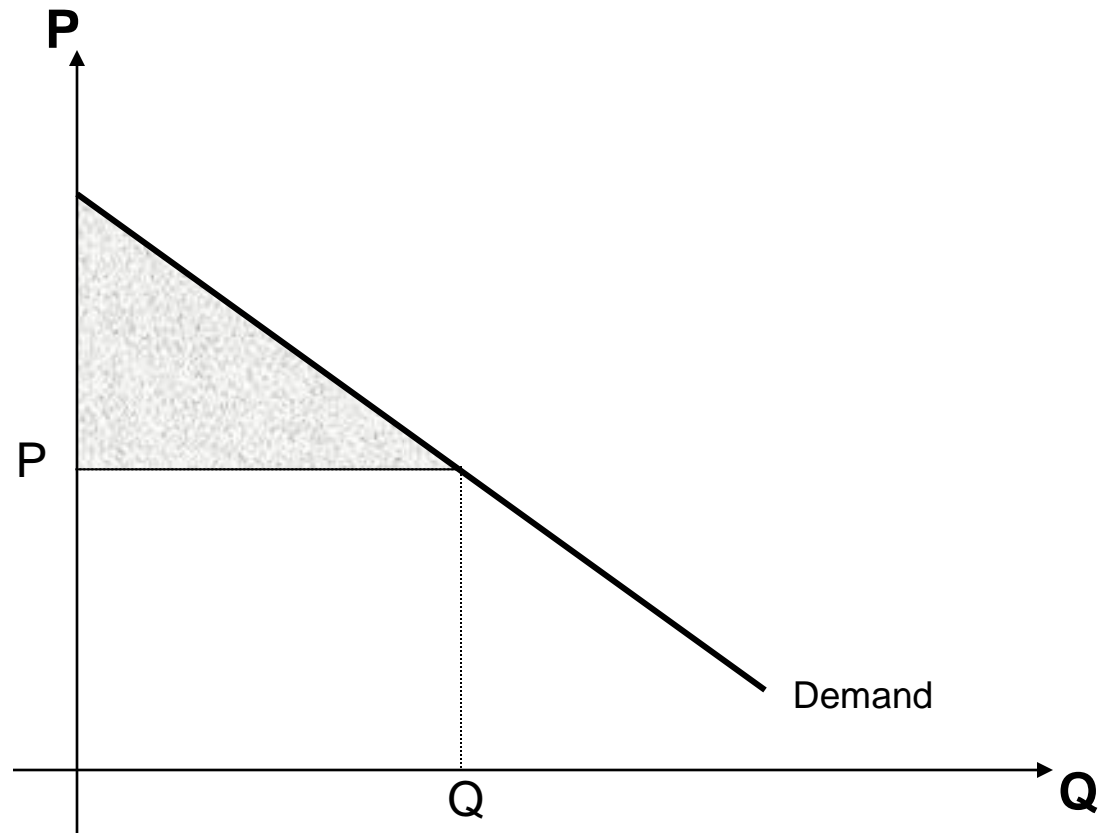
Total surplus: the gross benefits to consumers minus the total costs to producers.

An outcome is efficient under this measure if it maximizes total surplus.



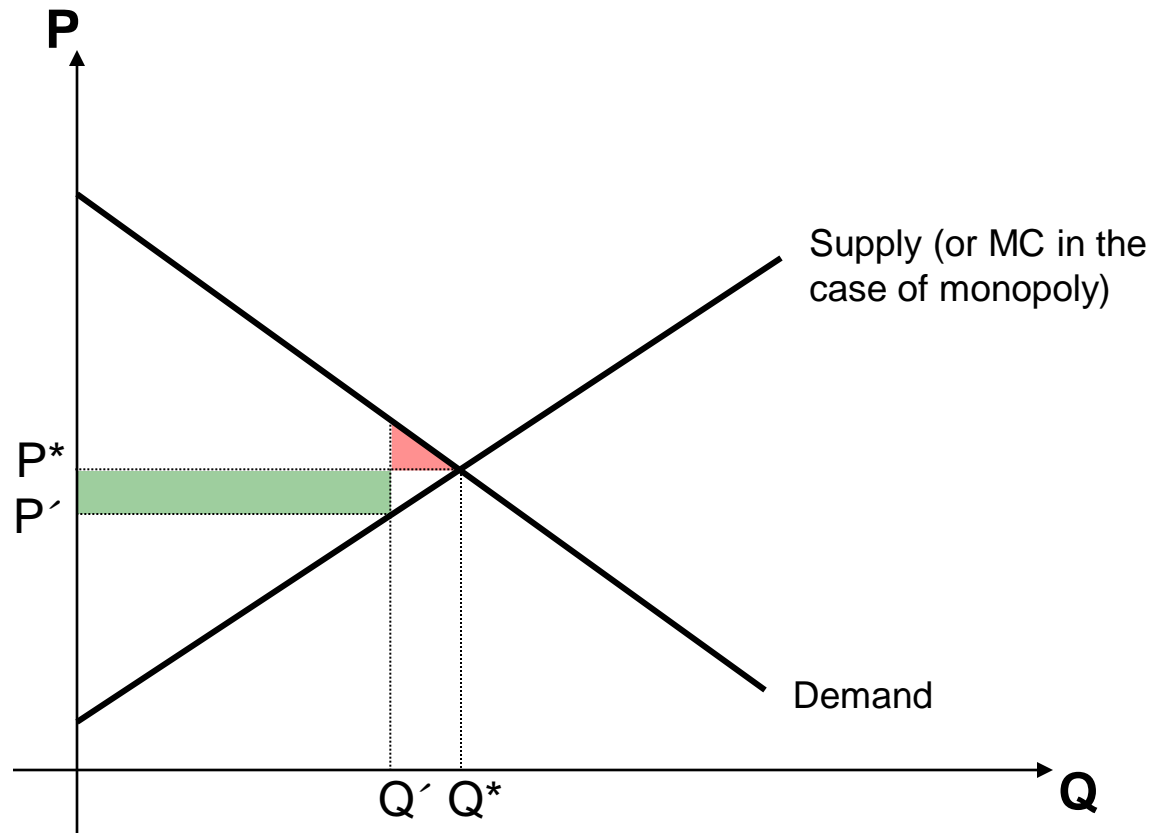


# Consumer Surplus



Consumer surplus: the gross benefits to consumers minus the total amount paid by consumers.

# A Tension



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.

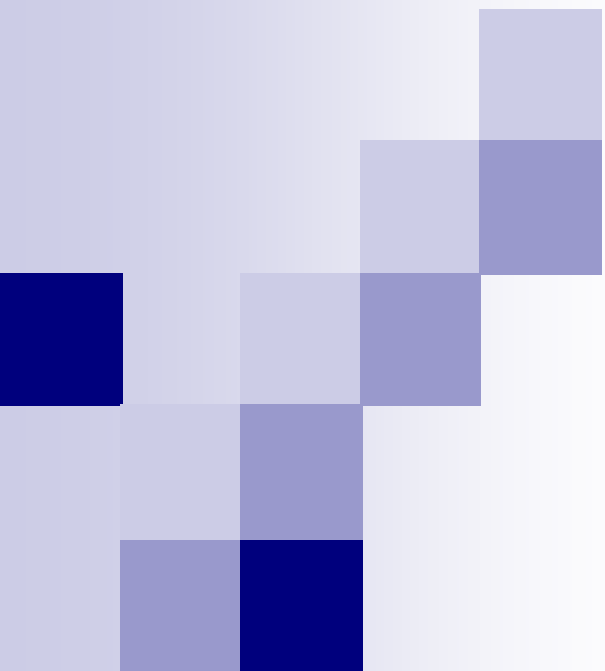
The same principles apply to competition policy and to economic regulation.

- 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.



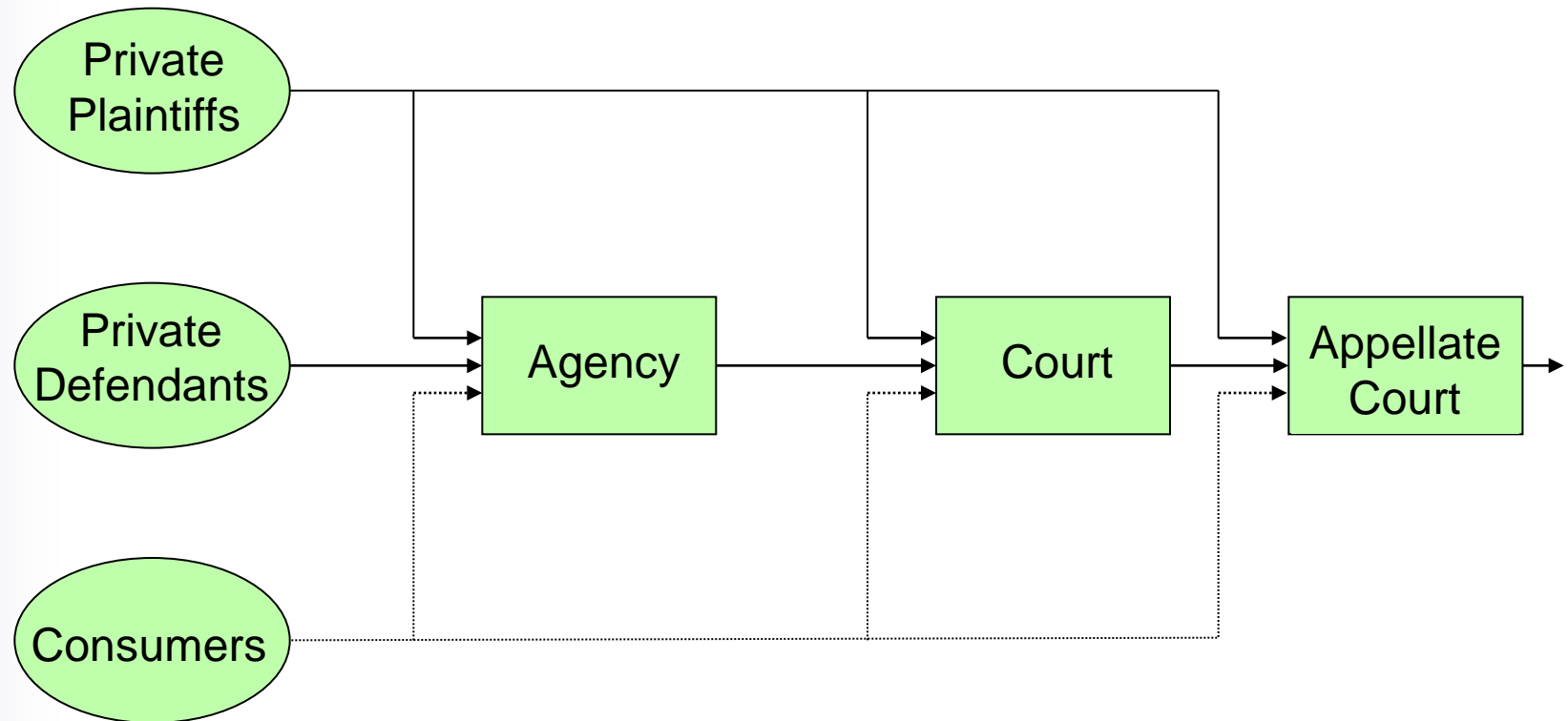
In sum, end-users have a strong interest in competition policy that promotes efficiency.

- 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

Deal	$\Delta$ Profit	$\Delta$ Consumer Surplus	$\Delta$ Total Surplus
A	30	-10	20
B	10	5	15
C	20	-10	10

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.