Towards an effects based approach to price discrimination

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Introduction

- Price discrimination = individualisation of prices for economists, unfairness for lawyers.
- Ambiguous effects on welfare
  - In general PD benefits the firm…
  - And possibly some consumers;
  - Hurts other (those facing higher prices) : exploitative effect.
- Effects also depend on discrimination applying to final consumers or firms on an intermediate market.

Introduction (2)

- Many effects are examined holding market structure constant.
- But also impact on entry and exit.
- PD often takes the form of another practice (bundling, rebates…)
- May be explicit or implicit (menu of tariffs)

Case law

- Different at the european or at national levels
- Art 82-b of the treaty : applies to abuses of dominant position vis-à-vis consumers.
- Art 82-c : applies to discrimination towards firms which compete on a (downstream) market.
- French law : no distinction.
- In addition, at the European level, another objective interferes : building a single market.

An effects-based approach to price discrimination :

No matter

- to which agents price discrimination applies,
- whether or not it is involved in another category of conducts (rebates …),

price discrimination should be analyzed according to the same criterion, namely the existence of *exclusionary effects*.

Allows a uniform treatment of practices that have the same competitive impact.

Current approaches

- Art.82-c : should apply only to PD that aims at creating an davantage or a disadvantage to some *downstream firms that are competitors on their market.*
- From an economic point of view :
  - discrimination *vis-à-vis* firms that compete on a final market and
  - Discrimination vis-à-vis consumers

are different : in the first case, strategic interactions between firms (for which prices on the intermediate market are costs) ; in the second, no interactions.

But…

- PD towards final consumers or towards downstream firms may have the same impact:
  - Exclusion of competitors of the dominant firm.
- PD towards downstream firms may have different competitive consequences :
  - Exclusion on the downstream market
  - Exclusion on the home market

Many distorsions

Rigorous application of art. 82-c :

1. PD should apply to trading partners of the dominant firm
2. Trading partners should compete with each other
3. A competitive disadvantage should be created.

Requires identification of the downstream market

and that of the competitive disadvantage.

In fact, there are two types of problems:

1. Some cases are sanctioned under 82-c without verification of these 3 steps (and should be sanctioned under 82-b)
2. Others are sanctioned under 82-b despite the fact that the 3 steps are verified.

Examples (1)

- Michelin II :
  - Discrimination appears through rebates to retailers
  - whether or not we agree with the analysis of the competitive consequences, the decision points out the discriminatory use of these rebates with regards to retailers on a downstream market.
  - Should have been fined under 82-c instead of 82-b.
- Similar cases (sanctionned under 82-b rather than 82-c) : Eurofix-Bauco/Hilti

Examples (2)

- Hoffman Laroche :
  - Rebates have been condemned under 82-c without check of points 1-2-3;
  - Rather, effects of the practice : on the *home* market of the dominant firm. Strictly speaking, this is 82-b.
- Other cases, involving bundling, tying are subject to the same confusing interpretation.
- Some authors (D. Geradin and N. Petit) argue in favour of a more strict, case by case, application of 82-b and -c.

An effects based approach?

- Effects based approach :
  - Focuses on the identification of the competitive damage
  - Example : on which market (home market of the firm? downstream market?) does the practice have an impact?
  - But such an approach leads to a more uniform treatment of practices that have the same impact.
- Present confusing situation : due to a form-based treatment of practices under art. 82.
- In this spirit, an effects based approach of price discrimination includes all the practices in which buyers pay different prices (bundling, rebates, quantity discounts…) whatever the status of buyers (final cons. or downstream firms)

Elements of microeconomic analysis (1)

- First degree PD : the producer takes all the surplus of consumers through different prices, relies on perfect observability of preferences.
- Second degree : menu of tariffs offered to consumers.
- Third degree : the price charged to a given consumer depends on a signal (related to preferences) sent by this consumer.

Elements of microeconomic analysis (2)

- PD has different consequences according to whether it applies to consumers or to competing firms : the latter have interdependant strategic behaviour, a competitor having a demand function for inputs depending both on its price and on the prices of the rivals.
- Implications of PD : non- strategic and strategic aspects.

Non-strategic aspects:

- Effects of PD on consumers : depends on whether all consumers are served under a uniform price regime.
- If it is the case, then PD has only an exploitative effect (bad for consumers).
- If low valuation consumers don’t buy under uniform price and buy under PD, then positive effect of PD on consumers.
- Effect on the (dominant) firm : in general positive (except when commitment pbs). Not necessarily conflicting with interest of consumers.
- Effect on competitors : depends on the context.

Efficiency considerations in a non-strategic context :

- Recovery of fixed costs : with large fixed costs, pricing at marginal cost does not allow recovery of fixed costs.
- PD allows Ramsey pricing, i.e. consumers with a low elasticity of demand contribute more than others to the funding of fixed costs.
- A ban on PD could discourage investment.
- In general, in order to increase consumers'surplus, PD should at least increase quantities.

Strategic effects :

- Cf. D. Spector’s paper.
- Efficiency considerations : in a vertical relationship, incentives given to retailers through menu of non linear tariffs.
- Other pro-competitive aspects : may intensify competition on some market segments…
- But also anti-competitive purposes : exclusion of rivals, predation less costly if price cuts limited to some customers (those who would switch to a rival).
- Effects often examined under a given market structure, but PD also has an impact on entry and exit.

What should CA do?

- Firms’ and consumers’ interests are not necessarily conflicting : the fact that a firm earns more under PD doesn’t necessarily signal an anti-competitive practice.
- Some efficiency considerations may be at work whatever the context (strategic or non-strategic)
- ex. recovery of fixed costs. Then PD banning may discourage large investments.
- First assessment of the non-strategic effects of PD is useful.

What should CA do? (2)

- Other efficiency arguments :
  - Incentives in vertical relationships;
  - PD banning may discourage some selective price cuts that could have been further obtained by other retailers.
- PD potentially changes the nature of competition : from a market basis to a consumer basis. Can be more or less intense according to the context.
- Example : if switching costs, installed base of a rival is more difficult to attract.
- PD allows to make attractive offers to these consumers. These offers may be too costly at a market wide level.

What should CA do? (3)

- Effects on entry and exit : at the core of an « effects based » approach, that focuses on exclusionary effects.
- PD often involved in other practices : mixed bundling, rebates… have the same potentially anti-competitive effects than pure PD.
- The anti-competitive effects result from the exclusionary consequences implied by the practice, and not from PD as such.

Towards a check list?

- PD, like any other practice, can have pro or anti-competitive effects.
- In order to distinguish, CA should go through a series of questions :
  - Does the quantities bought increase or not?
  - Are there large fixed costs?
  - Does competition move to a customer basis?
  - In this case, does this intensify competition?
  - Are there (potential) exclusionary effects? On which market?
  - How can the CA identify the competitive damage?
  - Relevant facts?
  - Relevant theory?
  - Other possible theories?

What about exploitative effects?

- Leaving apart anti-competitive effects, PD can hurt some consumers. Should CA worry about it?
- Either legal monopoly (essential infrastructure): then regulation probably needed.
- If not, the problem comes from barriers to entry :if consumers dissatisfied with high prices, a new entrant should be able to enter profitably the market.

Conclusion

- Approach that focuses on damages to competition allows to treat in a unified way different practices that have the same impact.
- General method :

1. Identify the market on which there is a damage;
2. Identify the mechanism through which competitors may be excluded;
3. Are there other possible stories (efficiencies)?
4. Relevant use of facts and theory.