Pros and Cons of High Prices, Stockholm
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The Paradox of the Exclusion of Exploitative Abuse

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Definitions of abuse

- Exploitative abuse is where a dominant firm directly harms consumers/customers
  - E.g. high prices
  - = textbook abuse

- Exclusionary abuse is where a dominant firm hurts rivals and so *indirectly* harms their customers
  - *Note*: hurting rivals is necessary but not sufficient for abuse
Types of abuse

• Exploitative
  – Excessive prices
  – Price discrimination
  – Inappropriate…
    • Quality: too low?
    • Variety: too little?
    • Innovation: too slow?

• Exclusionary
  – Predatory pricing
  – Exclusive purchase requirements/rebates
  – Tying & bundling
  – Refusal to supply
  – Closed aftermarkets
Quote from Commissioner Neelie Kroes

• ‘It is sound for our enforcement policy to give priority to so-called exclusionary abuses, since exclusion is often at the basis of later exploitation of customers’

• Ms Kroes is in good company…
EAGCP on Art. 82

• ‘An economic approach to Article 82 focuses on improved consumer welfare. In so doing, it avoids confusing the protection of competition with the protection of competitors and it stresses that the ultimate yardstick of competition policy is in the satisfaction of consumer needs.’ [EAGCP, 2005]

• And they go on to argue this line in relation to exclusionary effects…
EAGCP on Art. 82

‘whenever possible, competition is to be preferred to detailed regulation as the best mechanism to avoid inefficiencies and foster productivity and growth; this calls for a ‘non-dirigiste’ approach to competition policy that focuses in most cases on entry barriers; in the context of Article 82, it is then natural to focus on competitive harm that arises from exclusionary strategies. Possible exceptions concern some natural monopoly industries which may require ongoing supervision of access prices and conditions by regulatory agencies.’
In case you need more convincing, the US Supreme Court agrees…

- ‘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’ [Verizon-Trinko, 2004]

  – Watch that apparent triple negative!
The paradox

According to many intelligent economists and lawyers…

- It is good to prohibit only those exclusionary practices which can be expected to result in an exploitative abuse…

- But it is bad to prohibit directly exploitative practices!
Hazards of identifying and remedying exploitation

1. Measurement issues
2. Market dynamics
3. Multi-sided markets
4. Remedies and punishments
1. Measurement issues

• Problems of cost measurement
  – Accounting conventions
  – Complexity of input pricing
  – Cost of capital varies with market power
  – Common costs
  – Valuation of existing capital depends on monopoly rents
  – Similarly intangible assets
  – Survivor bias in risky markets

• But
  – Experience of regulatory agencies
  – Access remedies in exclusion cases face same problem
  – Cross-market comparisons
  – (but beware use of discriminatory prices – wrong counterfactual)
2. Market dynamics

• Entry process
  – High prices are only meaningful in relation to duration and speed of entry
  – Back to exclusionary behaviour?
  – But some barriers are structural

• Investment incentives
  – Property rights are necessary for any investment
  – Capacity, distribution, R&D, brand development, etc
  – Survivor bias particularly important for IPRs
  – Apparently high prices may be competitive
3. Multi-sided markets

• Distinct customer groups contribute to a common platform
  – E.g. ‘Free’ newspapers, Swedish ports, Visa payment system, British horseracing

• Optimal prices depend on
  – Price sensitivity on both sides of the market
  – Intensity of network effects on both sides
  – Marginal costs resulting from output change (e.g. congestion; capacity constraints)

• Prices on one side of market may appear high
  – Non-predatory prices on the other side may be low…
  – …below MC or even negative

• No simple formula relating price to MC
4. Remedies and punishments

• Structural remedies are hugely dangerous
  – Unknown transaction costs of break-up
  – Different from mergers where never integrated
  – Standard Oil, AT&T, (almost) Microsoft

• ‘Natural’ remedy for high prices is price regulation
  – Agency costs
  – Incentives problems
  – Surely not for all corners of the economy with a problem?

• Alternatively focus on consumer behaviour
  – E.g. print alternative suppliers on quarterly bill

• And beware of private actions filling the void
  – Non-specialist courts can get it badly wrong
  – E.g. charging bookmakers for horseracing pre-race data
Compared with exclusionary effects, exploitative effects are…

- Naturally shorter lived and more dangerous to remedy (Type 1 error)
  - E.g. price regulation destroying incentives
  - But compare with access remedies

- Mainly possible due to strategic entry barriers
  - And so are covered by exclusionary effects
  - But structural barriers do exist and exclusionary behaviour may have been missed (Röller calls these ‘gap’ cases)

- Harder to prove to the standard required in Court
  - Exclusion can focus on direction of effect; evidence from rivals
  - But should you trust rivals on this?!

- Politically more difficult to deal with
  - Harmonisation with USA; industrial allies for competition agency
  - But neither need be good economics
The appropriate treatment of exploitative effects under Art.82

- Correct to prioritise exclusionary effects
  - But unwise to dismiss exploitative effects
- Röller agrees with me up to a point…
  - Exploitative cases ‘should be based on acquiring a dominant position through exclusionary conduct. In this way, exploitative abuse cases are back to investigating exclusionary conduct, which is in fact the proper way to identify anticompetitive conduct’
- But nightmare of trying to prove past exclusion!
- Exploitation should be includes in Art.82 guidelines
  - Avoid profusion of specialist regulators
  - Avoid renegade actions in non-specialist courts
  - Remedy creatively by informing consumers and facilitating entry
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