

Should Innovation Rationalize Supra-Competitive Prices?

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Basic proposition

- Should we allow firms to exploit market power in the short run in order to stimulate to more innovation?
- Should we for the sake of innovation:
 - allow mergers that otherwise would be blocked?
 - allow abuse of dominance that otherwise would be fined?
 - allow horizontal agreements that would dampen competition?
- Should we even encourage competitive industries to dampen competition?



What drives innovation?

- An issue that is, and has been for many years, heavily debated in the economic literature.
- What is the relationship between profit, market power or market structure and innovative activities?
- How do markets perform compared to a social optimum?



Basic answer

- There is no need to change antitrust policy
 - not because there is no conflict between static and dynamic efficiency, i.e. that competition always fosters innovation.
 - neither because innovation is unaffected by policy



Main arguments

- We know too little: the theoretical controversy
- Empirical evidence: The inverted U-shape
 - Reversed causality?
- We have other instruments to stimulate innovation (IP-rights, prizes, etc)
- Innovation considerations should be taken into account, and if we do it need not weaken enforcement (MS-case).



What do we mean by dynamic efficiency?

- An efficient level of innovation should provide us with:
- The optimal number and design of new products
- The optimal quality of existing and new products
- Optimal investments in cost reductions

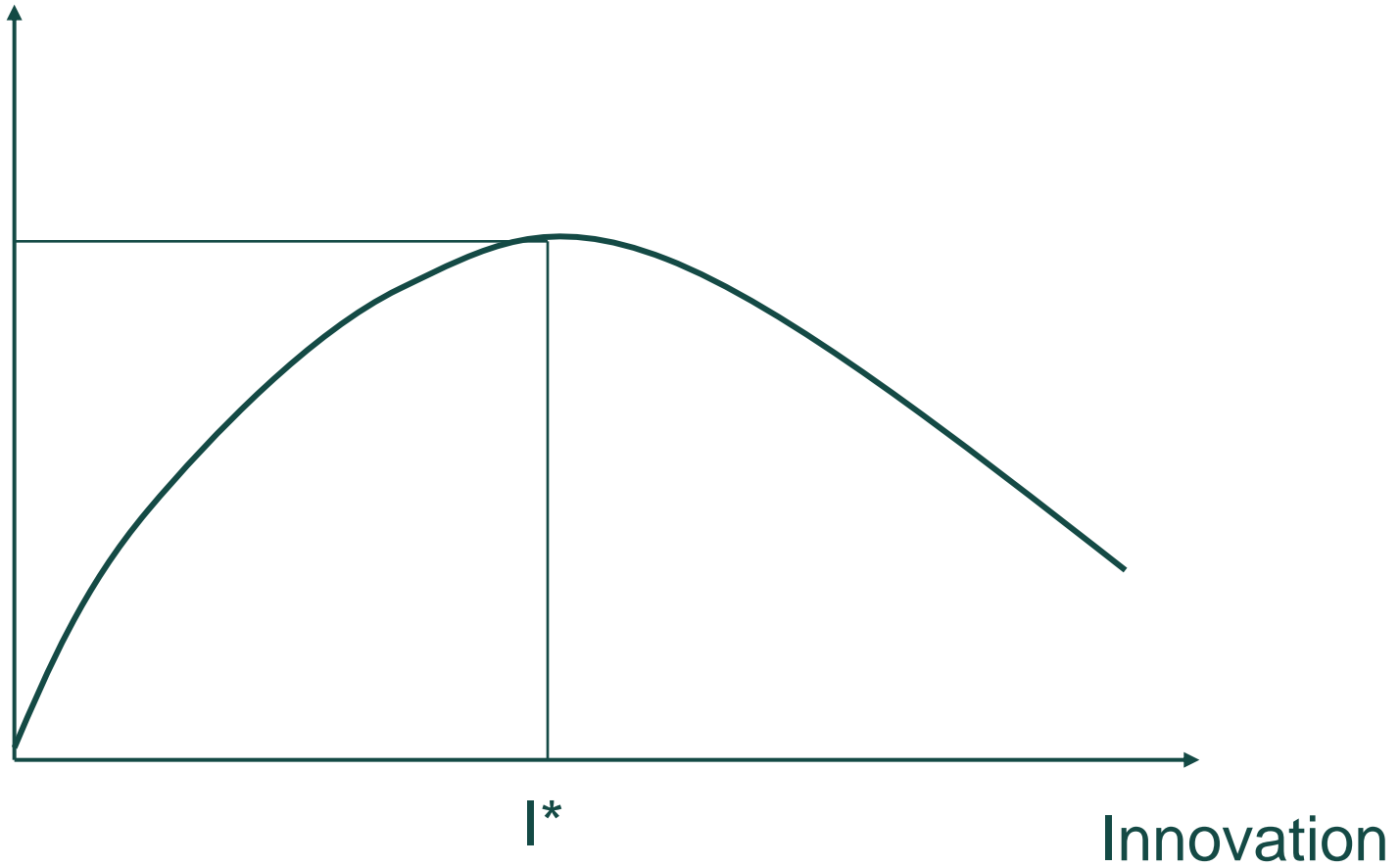


We know too little

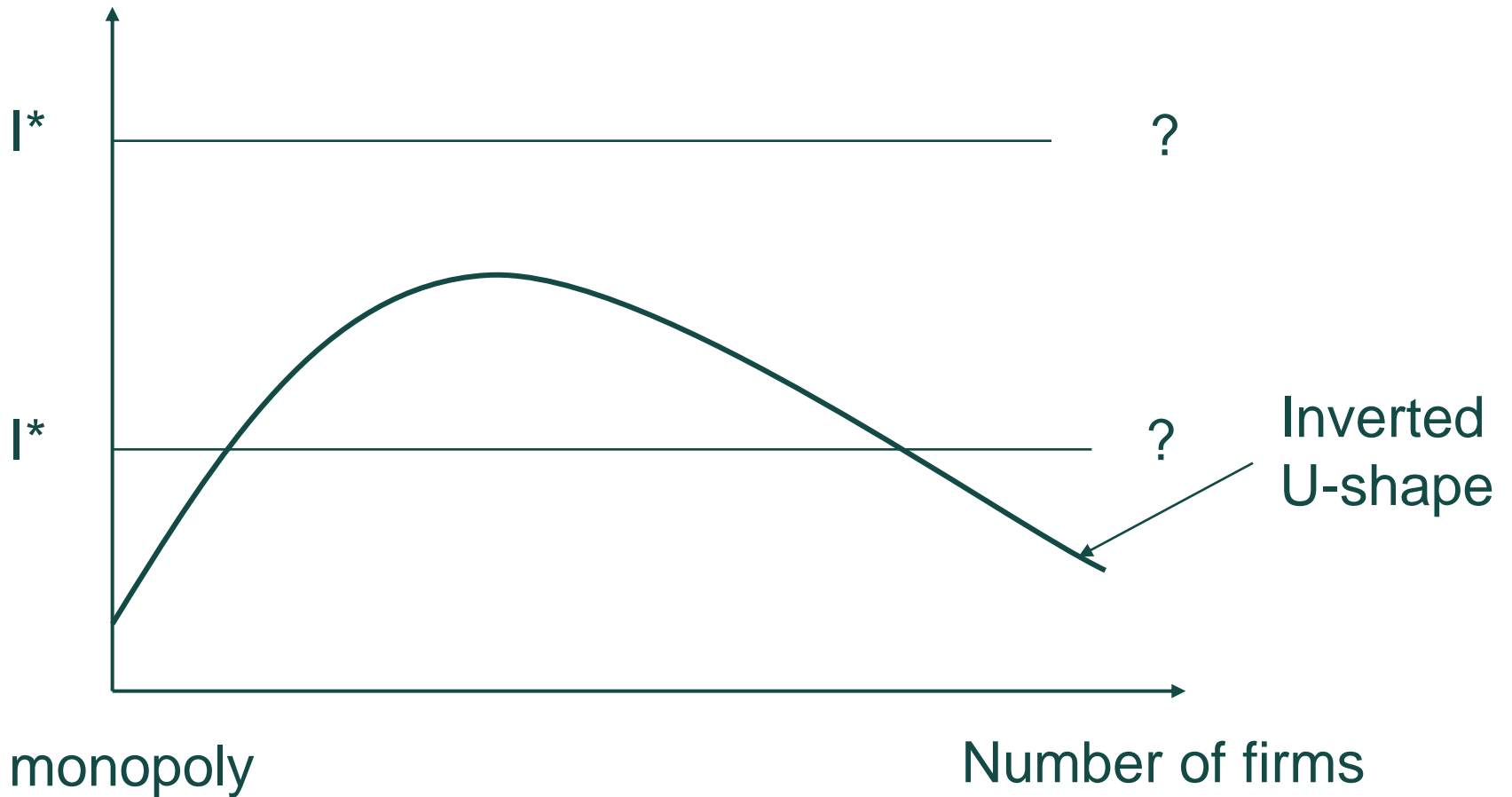
- We do not know if there is a causality between market power and innovation, or if the causality is the other way around.
- Equally important: We do not know whether a given competitive environment provides too little or too much innovation from a social point of view.
- The latter point is too often ignored.



Net social benefit of innovation



Innovation



One size fits all?

- Inducements to innovation may differ:
- Can it be that competition drives investments in cost reductions?
- Can it be that some degree of market power is beneficial for product innovation?
- What about product quality?



..and even if we knew

- What would be the policy implication?
- Should we sacrifice competition in the short run, or should we intensify antitrust enforcement?
- Depends on:
 - The relevant type(s) of innovation
 - Whether the given competitive environment, say before a proposed merger, provides too much or too little innovation compared to a well-defined social optimum



Other policy instruments

- There are other policy instruments.
- I agree, but we are still left with the basic question whether profit protection stimulates innovation or not.
- And also: If we could resolve the causality question, we still need to know in which direction to go.



Innovation considerations may strengthen enforcement

- True, but as with the opposite claim this does not hold as a general rule
- In specific cases one might come up with the reverse conclusion



Where does this leave us?

- No support for the general proposition that antitrust enforcement should be weakened
- Optimal policy probably depends of the type(s) of innovation in question
- Innovation considerations as part of an efficiency defence?
- Does this solve the problem?

