



Better Regulation: New regulatory approaches of
the European Commission with respect to abuse of
dominant market positions

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Competition, Innovation, and Antitrust

A Theory of Market Leaders
and Its Policy Implications

 Springer

book about:

- markets where entry is endogenous (determined by profit opportunities)
- the role of market leaders
 - >> implications for abuse of dominance issues
 - but also for mergers & collusion

post-Chicago approach to antitrust

- ✓ Incumbent vs entrant
- ✓ entry is “exogenous”: no consideration of the incentives of other firms to enter
 - Dixit (1980) on entry deterrence;
 - Milgrom-Roberts (1982) on predatory pricing;
 - Rey & Stiglitz (1988) on vertical restraints;
 - Whinston (1990) on bundling...
... survey in Motta (2004)

Ex.: simple competition in prices (strategic complementarity)

- Incumbent (with price leadership) can be:
 - Accommodating: set a high price to induce the entrant to do it as well >> high profits with second mover advantage
 - Aggressive: set a low price to induce the entrant to stay out of the market
- post-Chicago implication for antitrust (at least its flavor): leaders are aggressive only for predatory purposes

with endogenous entry

Etro (2006, RAND J. E.):

- Accommodation induces high prices, but attracts entry >> prices go down >> until the entrants break even
but the incumbent must have negative profits (by the second mover advantage)!
- Aggressive (low) pricing wins: large market share but small mark up restore the first mover advantage!
>> without exclusionary purposes (under product differentiation/increasing marginal costs): entry occurs

Ex.: Competition in quantities

Quantity leadership

- Profit function:

$$\pi_i = x_i p(X) - c(x_i) - F$$

- Stackelberg equilibrium with endogenous entry:
- If $c''(x) \gg 0$:

$$p = \frac{c'(x)}{1 + 1/\varepsilon} = \frac{c(x) + F}{x} = c'(x_{Leader})$$

- If $c''(x) = 0 \gg$ limit pricing

Applications to strategic commitments under endogenous entry:

- *Bundling (is procompetitive)*
- *Vertical restraints (with below MC wholesale prices)*
- *Price discrimination*
- *Mergers*
- *Collusion*

<p>Fudenberg-Tirole (1984) taxonomy of SI</p>	<p>$\Pi_{13} > 0$ Investment makes the leader aggressive</p>	<p>$\Pi_{13} < 0$ Investment makes the leader accommodating</p>
<p>$\Pi_{12} < 0$ Strategic substitutability (Ex: quantity competition)</p>	<p>TOP DOG Overinvest to be aggressive</p>	<p>LEAN & HUNGRY LOOK Underinvest to be aggressive</p>
<p>$\Pi_{12} > 0$ Strategic Complementarity (Ex: price competition)</p>	<p>PUPPY DOG Underinvest to be accomodating</p>	<p>FAT CAT Overinvest to be accomodating</p>

Reforming EU antitrust

(I contributed to prepare the comments for the ICC, but here I express my own opinion)

EC 2005 discussion paper:

- Economic approach (positive)
- Lack of courage in adopting an effect based approach (negative)
- Excessive stress on market shares as a proxy for abusive dominance
- Efficiency defense, a good principle but limited by:
 - 1) the burden of proof on the leader,
 - 2) the requirement of no less anticompetitive strategies to achieve the claimed efficiencies
 - 3) the 75% market share rule above which efficiency defense is excluded

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- EC 2005 discussion paper on predatory pricing:
 - The analysis of dominance should not be based on the market share of the leader but on whether entry of the followers is endogenous or not (which is the relevant factor to establish whether recoupment is possible)
 - MC (AVC) is not the right cut-off in the presence of network externalities and multi-sided markets and when competition is *for* the market rather than *in* the market
 - The AAC can be higher than AVC and MC because it can take into account fixed costs, departing even more from the correct cut-off!

Rule for predatory pricing:

- 1) the Antitrust Authority should evaluate whether the undertaking is effectively constrained by endogenous entry of competitors in his strategic choices (if entry is endogenous dismiss the case)
- 2) the Antitrust Authority should evaluate the relation between price, average total cost (ATC) and average variable cost (AVC):
 - a) a price above ATC should be lawful without exceptions;
 - b) a price below ATC but above AVC should be presumed lawful with the burden of proving the contrary on the Antitrust Authority, and on the basis of the consequences on consumers and allocative efficiency;
 - c) a price below AVC should be presumed unlawful with the burden of proving the contrary on the undertaking, through an efficiency defense or proving that demand or technological conditions reduce the relevant cut-off below the AVC.

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- EC 2005 discussion paper on bundling:
too much emphasis on consumer demand for the tied product in the context of its distinct products test as a proxy for determining whether the tying arrangement produces efficiencies.
 - Ex.: there is clearly consumer demand for shoelaces, but shoes and shoelaces are not distinct products for the purposes of tying analysis. The right question is whether there is consumer demand for shoes without shoelaces.
 - In sum, whether or not consumer demand exists for the tied product is the wrong question; the correct question is whether there is any significant consumer demand for the tying product without the tied product.

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- EC 2005 discussion paper on bundling:
 - Strategic bundling is exclusionary when there is not entry in the secondary market (Whinston, 1990, A.E.R.), but is an aggressive (price reducing) strategy when there is endogenous entry in the secondary market (Etro, 2006, RAND J.E.) and is not exclusionary if there is enough product differentiation
 - Technological bundling (especially with network effects and multi-sided markets) should be left to firms decisions, not to antitrust control

Reforming EU antitrust

- EC 2005 discussion paper on IPRs (within refusals to supply):
- there is an ambiguous approach to the protection of IPRs as a primary principle to promote R&D (in the part on interoperability)
- The theory of market leaders emphasizes that leaders invest more in R&D when pressured by entry in the competition for the market (Etro, 2004, EJ) and the enhancement of their leadership increases the aggregate incentives to invest in R&D