Predation, Monopolization, and Other Abusive Practices

Exclusionary practices

- Objective: deter entry or force exit
- Difficult to identify
- Important within…
  - Privatization and de-regularization
  - Network industries
- In this chapter…
  - Pricing strategies
  - Non-pricing strategies
  - Price discrimination

Predatory pricing

- Short-run welfare gains but… long-run welfare losses
- Short-run losses but… long-run profits
- Identification:
  - Short-run losses
  - Market power
- Competition authorities need to cautious:
  - High prices should not be encouraged!

Economic theory

- Deep pocket (“long purse”) story:
  - Large firm (“deep pocket”) start price war
  - Small firm (“small pocket”) exits the market
- But…
  - Large firm may lose more (higher market share)
  - Small firm assets can be re-used
  - Credit markets may help small firm
  - Merging may be more profitable
- However…
  - Targeted price discrimination
  - Sunk costs may be important
  - Financial constraints
  - Merging may encourage more entry, may not be allowed and predation and mergers may go together

Imperfect information

- Incumbent has more information than entrant
- Recent models:
  - Incumbent may want to create a reputation for being strong
  - Set low price to signal that he is strong

Predation in practice

- Two-tier test of predation:
  - Market power in the industry?
  - Relationship between price and costs:
    - Price above average total costs (“lawful”)
    - Price below average total costs but above average variable costs (“lawful” unless proved otherwise)
    - Price below average variable costs (“unlawful” unless proved otherwise)

Non-price monopolization practices

- Investments in R&D, advertising, product quality… could be used to force exit
- By tying-in sales the monopolist in one market might extend into a second market
- Similarly… by making the first product incompatible with the rivals of second product
- Refusal to supply and rising rivals' costs may also be anti-competitive

Price discrimination

- Examples: air fares, cinema,…
- First-degree price discrimination:
  - Firm knows each consumer's willingness to pay and charges accordingly
  - Social (but not consumer!) welfare enhancing
- Second-degree price discrimination:
  - Firm offers different deals and consumers self-select
  - Again social (but not consumer!) welfare enhancing
- Third-degree price discrimination:
  - Firm charges different prices to consumers having different (observable) characteristics
  - Can be good or bad for welfare