Brief History of Competition Policy - Part I

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Course material

- Motta, Massimo. Competition policy: theory and practice. Cambridge University Press, 2004
- Tirole, Jean. Economics for the Common Good. Princeton University Press, 2017.

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- The purpose here is not to have a complete description of the history of competition laws.
- Instead, our aim is to understand the circumstances under which competition laws were created and enforced, as well as the objectives which they purported to attain.

Anti-Trust Law in the United States

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  but at the same time preserving their separate individual existence, and without any consolidation (the act of joining together into one whole) or merger.

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    - Economies of Scale
    - Economies of Scope

- There are economies of scale when the unit cost of production fall with the total amount of quantity produced.
- There are economies of scope when unit costs fall because two or more goods are produced jointly.

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- All these developments created the possibility for the expansion of the size of the firms

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* It is not by chance that there was a massive merger wave in the US in the 1880s and 1890s.

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- Indeed, the fall in transportation and communication costs led not only to large single market for many industries, but also to a rise in competition!
    - Now, firms had to compete with more distant rivals that are located both in other states in the US and abroad (shipping rates also fell in this period).

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- Firms had to make large investments to
  - reorganize their production and distribution activities
  - buy new machines
  - enter new markets
- To operate at full capacity (to cover the large fixed costs), firms were tempted to decrease prices, giving rise to price wars.

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- **The advantages of price stability for the members of the cartels and trusts came with a cost to other groups in the economy**

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- Small firms complained about unfair business practices adopted by their large rivals that wanted to drive them out of the market.

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    - Canada adopted a similar law in 1889 but its enforcement was much weaker when compared to the Sherman Act.

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    - Note however that having a monopoly position is not by itself illegal.

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- The first enforcement of the Act came in 1897.
- The Supreme Court decided that a trust of eighteen railways (Trans-Missouri Freight Association) fixed the fares for the transport of goods, and clearly established that price agreements were illegal.

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- The prohibition of price agreements among competitors
  - is a very strong principle
  - is still valid
  - very few exceptions

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- If a reseller refuses to maintain prices, either openly or covertly (see grey market), the manufacturer may stop doing business with it.

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  - The Supreme Court overruled Dr. Miles, holding that such vertical price restraints as Minimum Advertised Pricing are not *per se* unlawful but, rather, must be judged under the "**rule of reason**."
- This marked a dramatic shift on how attorneys and enforcement agencies address the legality of contractual minimum prices and essentially allowed the reestablishment of resale price maintenance in the US in most (but not all) commercial situations.

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    - These practices were judged against Sections 1 and 2 of the Sherman Act.

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- *American Tobacco:* five tobacco manufacturers had merged into the American Tobacco Company, and engaged in a campaign of purchasing minor competitors, controlling stock interest in other corporations, and starting price wars to increase its power and drive other manufacturers out of business. This trust was condemned and later dismantled.

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Figure 1: St. Louis Bridge

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- The Court obliged these railways to give access on reasonable terms

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  - By doing so, firms could put themselves beyond the reach of the Sherman Act.

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- *Interlocking directorates* is a common business practice where a member of a company's board of directors also serves on another company's board
- Under antitrust legislation, interlocking directorates are not illegal as long as the corporations involved do not compete with each other.

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    - The victims can ask a compensation equal to three times the damage they have received + attorney's fees.

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    - at the federal level FTC shares the reponsibility with the Department of Justice (DOJ) to enforce anti-trust law
        - DOJ is a government agency which takes the reponsibility to enforce anti-trust law in the US at the federal level
    - at the state level, attorneys general can act on behalf of those adversely affected by anti-trust violations

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  - *The Hart-Scott-Rodino Act* of 1976 amended the Clayton Act's provisions relating to mergers by giving the DOJ and the FTC the power to review all mergers of firms above certain threshold.

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  - *The Hart-Scott-Rodino Act* of 1976 amended the Clayton Act's provisions relating to mergers by giving the DOJ and the FTC the power to review all mergers of firms above certain threshold.
    - at the state level, attorneys general can act on behalf of those injured by anti-trust violations.

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  - *The Robinson-Patman Act* was a product of such an environment

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- A great example of how competition laws and their enforcement are to be understood in the political, economic, and historic context in which they are made.

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  - "Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference ..."

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  - "Nor is it important that the prices paid by the combination were not fixed in the sense that they were uniform and inflexible. Price-fixing . . . has no such limited meaning. An agreement to pay or charge rigid, uniform prices would be an illegal agreement under the Sherman Act. But so would agreements to raise or lower prices whatever machinery for price-fixing was used. . . . Hence, prices are fixed . . . if the range within which purchases or sales will be made is agreed upon, if the prices paid or charged are to be at a certain level or on ascending or descending scales, if they are to be uniform, or if by various formulae they are related to the market prices. *They are fixed because they are agreed upon.*"

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  - The mere reason was Alcoa held 90% share of the market and took actions to increase its business, such as building new capacity.

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        - The Court added that the anticompetitive effects in one market could not be justified by pro-competitive effects in another.

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    - A conglomerate is the combination of two or more corporations engaged in entirely different businesses that fall under one corporate group, usually involving a parent company and many subsidiaries.

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- *Vertical restraints* are competition restrictions in agreements between firms or individuals at different levels of the production and distribution process.
- Vertical restraints can take numerous forms, ranging from a requirement that dealers accept returns of a manufacturer's product, to resale price maintenance agreements setting the minimum or maximum price that dealers can charge for the manufacturer's product.

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- The focus on *efficiency* also meant that it was more difficult to win a case against a firm, especially in cases involving vertical restraints and monopolization.

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  - helped by the introduction of successful leniency policy that grants amnesty (an official pardon) to managers that provide proof of the existence of cartels

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- ***Two-sided markets:*** there is a need for an increased focus on strategies of digital companies and how the two-sided markets can be regulated

Competition Laws in the European Union

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- This might also explain the favourable treatment to cartels accorded in the past by most of the countries mentioned.

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- The widespread idea was that allowing firms to cooperate closely or to merge their operations would make them stronger and create some "national champion(s)" which would outperform foreign rivals

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- Provisions against the abuse of a dominant position should be seen in the same perspective.

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- The central role played by the Secretary of State for Industry
    - (who has discretion on whether to accept or reject the Office of Fair Trading recommendations for referrals of merger cases to the Monopolies and Mergers Commission, and discretion on whether to accept the latter body's recommendations)

  reflects the role that political considerations may have on competition cases.

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- Then, what can one say about the effectiveness of the UK competition system in deterring anti-competitive agreements?

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- This can, however, change soon.

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- This is more typical of regulatory regimes (than competition policy)