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Behavioral Lessons for Antitrust Enforcement

Avishalom Tor
Notre Dame Law School, ator@nd.edu

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Avishalom Tor

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OVERVIEW

+ **Definition and basics**
+ **Reality check**
+ **Implications for doctrine / enforcement**
+ **Why antitrust?**

DEFINITION

The application of <u>empirical behavioral findings</u> to antitrust law and policy

- **Examining the antitrust implications of recognizing the *bounded rationality* of real consumers, business managers, regulators, and courts**

THE BASICS: RATIONALITY ASSUMPTIONS

Antitrust law aims to protect competition among rational suppliers to satisfy the demands of rational consumers

+ Familiar with respect to suppliers (e.g., *Matsushita*, *Brooke Group*), which are assumed to be **rational profit-maximizers**
+ While the basic consumer building block is only occasionally noted (e.g. *Brown University*), with little consideration of the significance of its rationality assumption for antitrust

THE BASICS: RATIONAL CONSUMERS

The standard approach assumes a great deal about consumers…

+ **Rational consumer beliefs**
+ **Rational consumer preferences**

THE BASICS: RATIONAL BELIEFS

+ **No <u>systematic</u> biases/errors of judgment**
  + No biased estimates of product quality
  + No mistaken judgments of absolute or relative prices
  + No erroneous predictions of one's own future needs / preferences (demand)

THE BASICS: RATIONAL CHOICE

- **Consistent choice behavior**
  - Complete and orderly preferences
  - Standard axioms of rational choice
    - *E.g.*, Transitivity, Dominance, Regularity (IIA)
  - Implied assumptions of rational choice
    - **Description invariance**
    - **Procedure invariance**
    - **Context independence**

THE BASICS: REAL CONSUMERS…

"Did we remember to get that thing we came here for?"

THE BASICS: BOUNDED RATIONALITY (BR)

- **Limited cognitive resources (Simon)**
- **Judgment and decision making under uncertainty**
  - Reliance on heuristics, environmental cues
- **Impact of motivation and emotion**
- **Social preferences**

Systematic, predictable deviations from (hypothetical) perfect rationality

THE BASICS: BR CONSUMERS

- **Systematic consumer bias**
- **Constructed consumer choice**

- **Particularly in the presence of sophisticated sellers that exploit consumers' bounded rationality**
  - Behavioral Industrial Organization

THE BASICS: BR MANAGERS—FIRMS

Firms designed to maximize profits, but…

- **Human managers—*agency problems***
- **Limits of *incentives* and motivation**
- ***Expertise* helps, to a degree**
- **Intrafirm *selection* beyond pure competence**
  - Commitment, **overconfidence**
- **“Organizational repairs” for routine tasks only**
- **Board monitoring/guidance**
  - Small group limits; managerial influence

THE BASICS: BR MANAGERS—MARKETS

In typical antitrust settings:

- ***Competitive discipline*** **obviously constrained…**
  - And can reward some BR when operates (e.g., entry)
- ***Arbitrage*** **often impractical**
- **Identifying errors and** ***learning*** **from them is difficult**

Hence, firms better approximate rationality, but only imperfectly

QUESTIONS SO FAR?

REALITY CHECK:

A MORE REALISTIC ASSESSMENT AND PREDICTION OF MARKET BEHAVIOR

REALITY CHECK:
HORIZONTAL RESTRAINTS

- **The real world is “sticky”**
  - Established patterns of market behavior more stable then standard models predict
    - Norms, status quo bias/loss aversion, etc.
    - Managerial incentives
- **Suboptimal collaboration (e.g., information sharing) among rival oligopolists**
- **Higher likelihood and stability of cartels in some market settings**
  - Much evidence from criminal enforcement

REALITY CHECK:
MARKET POWER

- **Not always fully exploited**
  - Reputation with consumers, social norms
- **Somewhat “sticky” market shares**
  - Particularly in consumer goods
  - Efficacy of rebates, loyalty programs etc.
- **Boundedly rational entry**
  - Higher rates of entry than assumed
  - But very low success rate, limited mobility
  - Limited short term impact on established incumbents
  - But important long term source of innovation

REALITY CHECK: MONOPOLIZATION

- **Seemingly irrational predation (e.g., recoupment unlikely) can be rational in fact**
  - Investment in predatory reputation with asymmetric information
- **Boundedly rational predation possible in certain circumstances**
  - Competition over market share / relative position
  - Loss averse dominant firms losing market share

REALITY CHECK: VERTICAL RESTRAINTS

- **Interbrand: Tying, bundling**
  - May offer somewhat more effective *foreclosure* in consumer markets due to consumer inertia (status quo bias etc.)
- **Intrabrand: Minimum RPM**
  - Mfrs. tend to use excessively
    - Overestimate harms of price cutting, prefer to control retail prices, and more
  - To their own detriment and that of discount retailers
  - Consumer harm only if pervasive in market or mfr. has market power (limited substitutes)

REALITY CHECK: MERGERS

- **Generally**
  - Many mergers fail to add value
    - Agency problems, managerial hubris
  - Efficiencies often overstated
    - Necessary to justify, desirability bias etc.
  - Accounting for boundedly rational entry
- **Horizontal**
  - Coordinated effects may be underestimated
    - Cf. criminal collusion cases

QUESTIONS SO FAR?

IMPLICATIONS FOR DOCTRINE AND ENFORCEMENT POLICY

IMPLICATIONS: THE VALUE OF CASE-SPECIFIC EVIDENCE

- **Horizontal restraints**
  - The *Matsushita* SJ threshold
- **Monopolization**
  - Recoupment (*Brooke Group / Weyerhauser*)
- **Merger enforcement**
  - Demand estimation—consumer surveys; simulations
  - Entry
    - Rapid entry
    - Future entry: sufficiency, actual history
  - Efficiencies skepticism

IMPLICATIONS: (REASONABLY) SIMPLE ANTITRUST RULES FOR A COMPLEX BEHAVIORAL WORLD

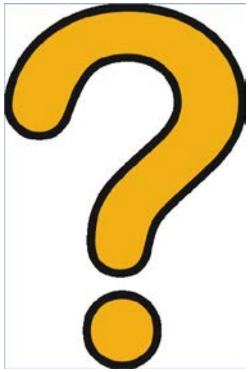
- **Structuring RPM’s ROR**
  - Recognizing the prevalence of BR RPM besides traditional pro- and anti-competitive uses
  - Per se illegality/legality / unstructured ROR unjustified
  - *Leegin* factors matter (also for behavioral reasons)
    - Burden on P to show them or direct harm (output reduction)
    - D can rebut, showing RPM necessary to address harm / undermine P’s main case

IMPLICATIONS: SUMMARY

- Greater concern for false negatives when courts / agencies rely on rationality assumptions to ignore factual evidence
- Improving agency investigations / analysis
- Tipping the scales in favor of one of the limited number of available rules
- Helping refine structured inquiries under existing rules

QUESTIONS SO FAR?

WHY ANTITRUST?

Competition →  **→ Efficiency**

Welfare

WHY ANTITRUST?
REHABILITATING ANTITRUST

1. **Competition *still (mostly) performs***
2. **More competition is *(usually) better than its alternatives***

WHY ANTITRUST?
COMPETITION (MOSTLY) PERFORMS (I)

- **Despite prevalent consumer bias**
  - Some product markets still reasonably approximate standard model
  - ***Heterogeneity in rationality*** can reduce market effects of bias (when substantial minority approximates rationality)
  - Deviations diminished where ***learning / incentives*** to educate consumers exist

WHY ANTITRUST?
COMPETITION (MOSTLY) PERFORMS (II)

- **Substantial fraction of approximately-rational preferences remains**
  - Within consumers
    - Some extant preferences
    - Many constructed “final” preferences depend on higher-order, more “authentic” preferences
  - Across consumers
    - Heterogeneity in rationality
  - Product-market characteristics
    - Repeat purchases
    - Complexity

WHY ANTITRUST?
COMPETITION (MOSTLY) BETTER

Increased competition

versus ***what****?*

diminished competition

(fewer firms w/more market power)

or

more direct regulation

of consumer choice

FINAL WORDS: ANTITRUST AGENDA

I. Identify market conditions that determine effects of competition

- Some markets sufficiently approximate standard model
- On occasion (more) regulation may perform better
- Would greater MP sometimes outperform competition?

II. Relate above market conditions to policy

- Inform antitrust rules / boundaries
  - ***Tolerate dominance more*** in some settings? (*cf.* natural monopoly)
  - Support ***deference to market-specific regulation***?
  - Innovation and competition—***<u>less</u> deference to IP***?

THANK YOU!

FOR MORE IN-DEPTH ANALYSIS SEE
MY AUTHOR PAGE