Behavioral Lessons for Antitrust Enforcement

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Behavioral Lessons for Antitrust Enforcement

Avishalom Tor

Presentation to the DOJ Antitrust Division
June 4, 2020
OVERVIEW

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

The application of empirical behavioral findings to antitrust law and policy

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

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THE BASICS: RATIONAL BELIEFS

+ No systematic 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

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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 than 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

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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

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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 $\rightarrow$ ? $\rightarrow$ 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

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WHY ANTITRUST?
COMPETITION (MOSTLY) BETTER

*Increased competition*

*versus what?*

*diminished competition*
(fewer firms w/more market power)

*or*

*more direct regulation*
_of consumer choice_
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—*less deference to IP*?
THANK YOU!

FOR MORE IN-DEPTH ANALYSIS SEE

MY AUTHOR PAGE

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