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### 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

# 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 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

# 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 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



# 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 / Weyerhaeuser*)

## + **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

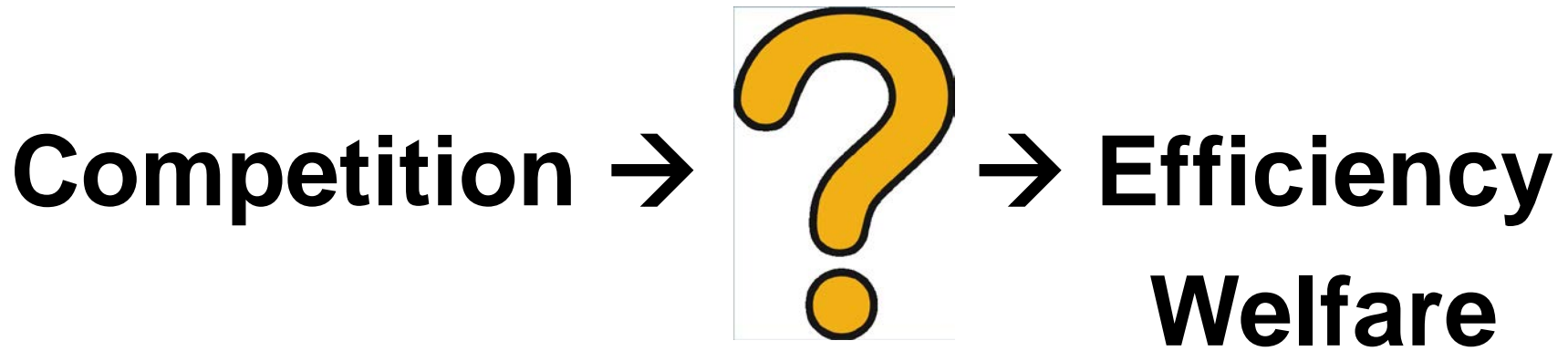


# IMPLICATIONS: SUMMARY

- + **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?



# 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—less *deference to IP*?





**THANK YOU!**

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