“Market Definition and…”: Comments

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When Are We Interested in Issues of Market Power? (1)

- Evaluation of mergers
  - Clayton Act Sec 7
  - SSNIP ("hypothetical monopolist") test for market delineation: Can this group of products be monopolized?
  - If "yes", then use other indicia (e.g., HHI, conditions of entry, etc.) to assess the likely consequences of a merger
  - If "no", then expand the collection of products until "yes" is reached
  - We can use the SSNIP test because a merger is prospective

When Are We Interested in Issues of Market Power? (2)

- Monopolization
  - Sherman Act Sec 2
  - Does the firm already have market power?
  - Are its past and/or current (exclusionary) actions enhancing that market power?
- The SSNIP test cannot be used for historical or current assessments
  - If the firm is a true maximizing monopolist, it will not want to raise its price higher than observed levels
  - If the firm is a competitor, it will not want to raise its price higher than observed levels
- Accounting profits today are suspect
- But the SSNIP test can be used for prospective monopolization

Illustration of SSNIP Test: *FTC v. Staples (1997)* (1)

- Staples wanted to buy Office Depot
  - Together they accounted for less than 4% of sales of office supply products nationally
- There were only 3 major OSSs
  - Entry was difficult
- Simple price comparisons (and more sophisticated econometrics) showed:
  - Prices highest when only one OSS in a MSA
  - Prices lower when there were 2 OSSs
  - Prices lowest when there were 3 OSSs

Staples (2)

- Conclusion:
  - OSSs could (and some were being!) monopolized
  - OSSs in MSAs were relevant markets
  - The merger would cause prices to rise in 2-to-1 and 3-to-2 markets
- FTC won its case, stopped the merger

The Difficulty of Market Definition in a Monopolization Case: *U.S. v. du Pont* (1956)

- U.S. accused du Pont of monopolizing cellophane (76% market share)
- du Pont claimed that the relevant market was all "flexible wrapping materials" (18% market share)
- The Court used a "can they succeed in raising their price?" test (for cellophane)
  - Decided that du Pont could not profitably raise the price of cellophane, therefore du Pont didn't have market power

Du Pont (2)

- This was not a good test
  - Even if du Pont had a monopoly of cellophane, it would not want to raise its price higher than observed levels
- du Pont's prices moved independently of the prices of other flexible wrapping materials
- du Pont's profits in cellophane were far higher than in rayon (where it also had a below-20% market share and faced 15-18 other producers)
- du Pont likely did exercise market power
- The "cellophane fallacy"

What is Needed to Ascertain Market Power in Monopolization Cases?

- Cross-section (or time-series) evidence that links higher prices to greater seller concentration
- The *Staples* case provided such evidence against the merger; this evidence could also be used to show monopoly power in single-OSS MSAs
- Airline city pairs can provide such evidence
- But often such cross-section or time-series evidence is absent

How New Are 2-Sided Markets?

- Not really
- Think of newspapers
  - Advertising
  - Readership
  - Positive externalities, etc.
- We know how to think about market power for newspapers

Payment Card Networks Are Easier!

- Fixed proportions: 1 card-user transaction = 1 merchant transaction
- So, there's just one product/service: network card services that link card users with merchants
- And there's just one price: the net price received by the network provider per transaction

Limits to the E&T Model

- Assumes that the network is separate from the issuing & merchant banks
- This is sort of like AmEx and Discover post-2004 (or even just AmEx and Discover if vertical integration is neutral)
- This is not Visa or MasterCard, which are joint ventures of banks
  - The world is considerably more complicated when the issuing and merchant banks own the network

Illustrations of E&T's Model

- A merger raises the net price of the merging entity
  - If merchants accept any card whose transactions cost (price) is less than handling cash but cardholders choose networks based on price, the merger leaves the price unchanged to merchants but raises the price to cardholders (issuers)
  - If merchants switch among networks based on differing costs (prices) but cardholders accept any card that has costs (price) less than handling cash, the merger raises the price to merchants but leaves the price to cardholders unaffected
- E&T need to remind us of externalities

Conclusion

- The context of the exercise of market power matters
- We have to be careful in using the SSNIP test
- 2-sided markets may be less complicated than they appear at first sight
- But we have to remember that Visa and MC are different from (and more complicated than) AmEx and Discover