

Book Review

Core Topics in Competition Economics

Michael D. Whinston

Lectures on Antitrust Economics

MIT Press • 2006

Reviewed by Tasneem Chipty

Michael Whinston is the Robert E. and Emily H. King Professor of Business Institutions in the economics department at Northwestern University and is a prolific writer on a broad range of topics in industrial organization. In his book, *Lectures on Antitrust Economics*, Professor Whinston presents a lucid discussion of several core topics in competition economics: price fixing, horizontal mergers, and exclusionary behavior. The book synthesizes a number of theoretical and empirical papers, and includes a historical overview of the intellectual debate on each topic. It provides a coherent summary of important concepts, modeling techniques, and empirical strategies available to students of antitrust economics. Professor Whinston is careful to close each topic with a discussion of the strengths and weaknesses of the state of the literature. In a number of places, he identifies areas ripe for research and recommends areas that are worth pursuing.

The book would make a worthwhile read for both antitrust consulting economists and antitrust attorneys. The reader should note that the tone of the book is somewhat mixed—ranging from casual to technical (with equations and first order conditions to motivate various results). In addition, Whinston assumes familiarity with various analytical tools, including interpreting regression results and setting up and solving basic theoretical models. However, the depth of the discussion and the insights offered along the way will make this book worthwhile for even the less technically proficient reader.

Chapter 1 presents an overview of U.S. antitrust policy. Whinston begins with a description of the federal antitrust laws and the motivation behind the laws—i.e., the tension between the total surplus standard and the consumer surplus standard. He talks about the need for courts to interpret the provisions of the laws and the differences between rule of reason and per se standards. He also talks about the three sanctions available as remedies: criminal penalties, equitable relief (requiring cessation of the bad act), and monetary damages. Missing from this discussion, at least explicitly, is the notion that the antitrust laws are intended to police abuse of market power, though there is nothing wrong with a firm's being big or having market power, at least legitimately acquired market power (e.g., by being more efficient or more innovative). Also missing from the discussion is the notion that market power is necessary but not sufficient to establish antitrust liability and that any action by a firm with market power—whether it is price fixing, a breach of contract, or a creative selling strategy—could, in principle, become the subject of an antitrust inquiry.

Chapter 2 presents a discussion of price fixing—focusing on explicit coordination among firms for the purpose of raising prices. Whinston provides a discussion of the per se treatment of price fixing, explaining that it is “really nothing more than an application of optimal statistical decision making,” (p. 18) intended to minimize the costs of administering antitrust policy. He goes through the theory of price fixing, evidence of the effects of price fixing, and detecting price fixing.

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On the theory of price fixing, Professor Whinston describes the coordination problem, some game-theoretic modeling, and a description of some experimental studies. He points out that in many of the models, allowing collusion may actually improve welfare by enhancing productive efficiency. He concludes with the observation that “[i]t is in some sense paradoxical that the least controversial area of antitrust is perhaps the one in which the basis of the policy in economic theory is the weakest.” (p. 26)

On evidence of the effects of price fixing, Professor Whinston looks to the empirical literature to see if there is any evidence that price-fixing enforcement leads to significant reductions in prices. He presents a summary of over ten different empirical papers, along with a discussion about the inherent difficulties in interpreting their results. Taking the results on their face, Professor Whinston concludes that the evidence is “somewhat mixed,” (p. 38) with some studies finding no change in price levels after antitrust prosecution and other studies finding substantial overcharges associated with episodes of price fixing.

On detecting price fixing, Professor Whinston explains that short of direct documentary evidence of meetings to set prices (or even with such documentary evidence), one might turn to two types of evidence: structural evidence and behavior evidence. Structural evidence refers to a consideration of the structural factors that might affect the likelihood that firms in the industry engage in price fixing. These include things like the level of concentration in the industry, the observability of firms’ prices, the lumpiness of demand, and capacity levels—all of which affect the potential benefits and expected costs associated with collusion. In this context, Professor Whinston describes the seminal 1974 work of George Hay and Daniel Kelley, discussing various structural factors and their relative importance in sixty-two price-fixing cases brought by the Department of Justice from 1963 to 1972. Behavioral evidence refers to studies of actual practices to determine whether they are more likely to have been generated from collusive or competitive behavior. These efforts, as Professor Whinston rightly explains, are very difficult, and fraught with issues of interpretation.

Professor Whinston ends his discussion of price fixing with a consideration of tacit collusion, in which he revisits an old policy question of whether an express agreement should be required in order for firms to be found guilty of a Sherman Act violation. Here, he explains the inherent limitations in accurately detecting episodes of tacit collusion, as well as the dangers of pursuing strong structural remedies or monetary penalties in cases involving allegations of tacit collusion. In particular, Whinston notes that sanctions may have an effect on ex ante incentives, whereby firms shy away from cost reductions or product innovations that may result in higher profit margins.

Chapter 3 presents a discussion of horizontal mergers. Professor Whinston provides a thoughtful overview of both the theoretical and empirical literature evaluating the effects of mergers as well as the techniques available for analysis. The theoretical discussion includes a description of the “Williamson Trade-Off,” which was one of the first insights (even though not quite right, as explained by Professor Whinston) stressing the importance of evaluating the efficiency effects of mergers. He describes at some length Joseph Farrell and Carl Shapiro’s model of mergers in the context of Cournot competition. He then catalogs a host of important issues that need to be considered in any responsible merger analysis, including: that firms engage in dynamic, not static, decision making; whether the good in question is a durable or non-durable; the effects of entry; and the role of multi-market contact.

Professor Whinston then turns to the U.S. Merger Guidelines and presents a discussion of market definition and consideration of other market factors, including substitution patterns within the market, substitution patterns between products in and out of the market, capacity limitations, ease

of entry, and procompetitive justifications. While he does not say so explicitly, some of his discussion suggests correctly that the definition of the market need not be hard and fast—that it should serve more as a guide. He notes, for example, that consideration of the substitution patterns between products in and out of the market is itself one way of “softening the edges of the previous determination of the relevant market.” (p. 82) Missing from this discussion is that the concept of market definition and the associated techniques can also provide guidance in evaluating whether firm behavior (such as exclusive dealing) could be a violation of the antitrust laws, apart from evaluating the antitrust risk associated with a particular merger.

In the next section, Professor Whinston provides a thoughtful overview of the empirical methods that have been used to define markets and to evaluate both the potential and actual effects of mergers. This overview includes discussion of demand estimation, issues of instrumentation, multistage budgeting, evidence of the effect of increasing concentration on prices, merger simulation (given information about demand and cost functions), residual demand estimation, event study approaches, and studying the effects of mergers after the fact (prices, efficiencies). For each of these topics, Whinston provides practical guidance on market definition, a discussion of associated empirical studies, and insightful commentary on the relative advantages and disadvantages of each of those studies. He does not discuss the empirical approach of bid analysis, which is an analysis of company bid data that shows when, where, and how often merging parties compete directly with each other. This type of analysis has been used successfully in a handful of recent mergers in both the United States and the European Union.¹

Chapter 4 presents a discussion of exclusionary contracts. The discussion is one of the most understandable and comprehensive theoretical discussions I have ever seen on the strategic use and value of exclusive contracts. Professor Whinston begins with a discussion of the original Chicago view that engaging in exclusive contracts cannot be a profitable strategy. He then turns to a class of richer models that show that reasonable variations of the Chicago model can make exclusive contracts a profitable strategy for excluding rivals. Students of economics will find that the model designs used by Professor Whinston, which allow him to focus on a particular dimension of the problem, are themselves pedagogically useful. However, this discussion is also more technically demanding; while the motivation and conclusions are just as straightforward as in the rest of the book, the analytical arguments are harder to follow. Finally, Whinston describes the various procompetitive justifications for exclusive contracts, chief among which is the protection of investments. In contrast to his discussion of horizontal issues, Whinston is silent on practical guidance for antitrust strategy. ●

¹ See, e.g., Case No. COMP/M.4214, Alcatel/Lucent Technologies (July 24, 2006), available at http://ec.europa.eu/comm/competition/mergers/cases/decisions/m4214_20060724_20310_en.pdf; Case No. COMP/M.4003, Ericsson/Marconi (Dec. 20, 2005), available at http://ec.europa.eu/comm/competition/mergers/cases/decisions/m4003_20051220_20310_en.pdf.