

A few differences between competition law enforcement and industry regulation

Fiona Scott Morton
Yale School of Management



Yale SCHOOL OF MANAGEMENT

Policy question: Can antitrust enforcement achieve the same beneficial outcomes as industry regulation in the case of cable broadband?

Answer: No

Why? I will focus on two reasons in this talk



1. No competition

Suppose we have a monopolist. What can a competition enforcement agency do?

- Sherman Act s1: no one with whom to collude
- Sherman Act s2: already a monopolist
- Clayton Act: no one with whom to merge

=> No scope for enforcement of antitrust law.

Monopolist can charge high price (set low quantity) and not violate antitrust laws. DOJ/FTC cannot prevent adverse effects on consumers



Alternative: *create* competition

- The antitrust authority could decide to challenge the monopolist as DOJ did in the case of AT&T
- Such an action would create competition – through an access or entry requirement - thereby giving scope for application of antitrust laws
 - Trinko?
- One could imagine an analogy to choosing a long distance phone service: which video provider does the consumer want to use the broadband capacity?
- Strong action by competition agency; something the regulator might not do if it is captured or lacks authority



Is broadband a 'monopoly'?

- Many will say cable broadband faces fierce competition from mobile, satellite, DSL, and fiber overbuilding
- Others note limitations of each of these technologies in providing fast broadband:
 - Mobile: still developing
 - DSL: too slow
 - Satellite: lacks capability
 - Overbuilding: limited number of households: Fios 13%, Google Fiber 7 cities listed on website)
- Clearly most consumers have one or zero fast fiber optic cables into the home



Why is regulation difficult?

- Jean Tirole, this year's economics Nobel Prize winner
 - Great contributions in the area of regulation
 - If vigorous competition, no need to regulate
 - Hard issue: regulating firms with market power, or monopolies
- Real-world assumptions
 - The regulator does not know as much as the firm knows (asymmetric information)
 - The firm has to break even (cannot be subsidized by the taxpayer)
 - The regulator has trouble committing to policies over time



Asymmetric information

Costs

- How large are a firm's marginal costs?
- What about cost of investment?
- How are joint costs allocated across projects? What rate of return is used? Risk?

If the regulator is going to allow prices that cover costs, this lack of information is a problem.

Effort

- what unseen actions can managers take that improve performance?
- A manager could have travel regulations that minimize cost, take more care over decisions, hire based on expertise rather than friendship, etc.

If the manager's behavior can't be fully observed by affects profits, the lack of information is a problem



Regulator

- The regulator sets up managerial incentives to induce effort
- The regulator creates a payment scheme that provides incentives to lower costs
- Will regulation naturally create errors?
 - Yes, imperfectly imitating competitive outcomes
- Compare to lack of regulation?
 - Will with certainty achieve monopoly price and quantity
 - Firm with market power will determine direction of technology



2. Regulator has more tools

- Tools: Price, rate of return, technology choice, interconnection rules, shared cost rules, access.
- Statutes that permit regulation of those dimensions using some process
- Often wide discretion to “fix” outcomes that are not considered in the public interest
- The antitrust laws only cover certain kinds of behavior, and in an imperfectly competitive environment, society may benefit from restricting or promoting certain actions by the regulated firm.



Innovation

- Protecting and stimulating innovation is a setting of interest and importance for the comparison between antitrust and regulation.
 - Not a merger, nor monopolization, nor collusion
 - Antitrust authority cannot mandate direction of innovation, amount, or incentives
 - Yet may have large impact on social welfare
 - Status quo may not be favorable to innovation
- Incumbent monopolist developing (or not developing) new technology is often not an antitrust violation
- Incumbent monopolist investing (or not investing) in new capacity or infrastructure is often not an antitrust violation



Broadband OTT hypothetical

- Consider the structure of the contract between content and a cable system: eg. Netflix and Comcast.
- Suppose Netflix pays a lump sum for favorable speed from Comcast
 - Netflix's costs rise and its price rises –for all users, not just Comcast customers
 - What are Comcast's incentives to invest in more capacity?
- Consider payment by consumer to cable system for speed, or for speed of a particular source of content: e.g. I pay \$60/mo to get Netflix at 25mb
 - Netflix's costs do not rise; expenses are higher for the consumer who desires speed
 - The incentive to invest in infrastructure may be different. The cable provider will reap a return on any customer to whom it can sell speed
 - Entry incentives may be different: In particular, a small entrant with few customers may not be able to offer a lump sum that is large enough for Comcast to be willing to improve its infrastructure. But if customers designate the entrant's content in their speed contracts, it can sell successfully.



Structure of contracting

- We see from this example that the terms on which contracts can be written and the parties permitted to write them may affect:
 - Investment incentives
 - Prices
 - Entry / innovation incentives
- An antitrust authority cannot instruct an industry on which type of (competitive) contracts are allowed
- A regulator often can

