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PROBLEM MARKETS

ABSTRACTS

Prof Severin Borenstein, University of California, Berkeley, USA

'U.S. Airline Competition Problems: Addressed and Ongoing'

From 1990 to 2010, average U.S. domestic airfares declined by about one-third in real terms, while operating costs changed very little. Three critical changes to the industry since deregulation have had a large influence on airfares: (i) the formation of hubs and the associated efficiencies and marketing power from hub dominance, (ii) the increase in average load factors, and (iii) the expansion of low-cost carriers. In this paper, I examine how these and other factors have contributed to the decline in airfares. I estimate the impact of cost, demand and market power measures on the average price a carrier charges on a route. Grouping the 20-year estimation period into 4 sub-periods of 5 years each, I estimate the same equation for each of the sub-periods. I find evidence suggesting that the direct impact of airport dominance has greatly declined over the 20 years.

Similarly, I find that price premia for business-oriented routes declined substantially in the last decade. However, I also examine changes in ``share gap,'' which is the differential share of passengers a carrier captures on a route depending on the airline's competitive position in the customer's origin city. In contrast to the price results, I find no decline in share gap in the recent period and no decline in its association with airport dominance, suggesting that customer loyalty to the local dominant airline remained as strong in recent years as in the 1990s. I estimate that the loyalty effects associated with share gap continue to raise fares substantially above competitive levels in some markets.

Katie Curry & Geoffrey Myers, Ofcom

'Calls to Non-Geographic Numbers – Changing the Regulatory Regime in a Problem Market'

Non-geographic calls are to telephone numbers used to access services provided by businesses and Government agencies, information and entertainment services etc, such as freephone calls on 080, call centres on 084 (or 087) and premium rate services on 09. This has been a problem market not working well for consumers primarily due to poor consumer awareness of prices and externalities between different operators in the value chain. Following a fundamental review, Ofcom has announced a wide-ranging set of changes to the regulatory regime to alleviate the detriments by: (i) ensuring that calls to 080 from both mobile phones and landlines are always free to the caller; and (ii) unbundling the price paid by the caller for calls to 084, 087 and 09 between an access charge paid to the callers' telecoms provider and a service charge passed on to the call recipient (i.e. the service provider being called).

Adriaan Dierx & Fabienne Ilzkovitz[1], DG COMP, European Commission

***'Problem Markets: The EU Experience'*[2]**

Problem markets are markets raising concerns amongst policy makers and consumers, even though there is no clear breach of competition rules. The presentation considers the various policy tools needed to deal with problem markets. First, there is a need to identify by way of market monitoring and sector screening which markets pose the most serious problems. Second, market studies may be used to analyse the nature and source of the problems identified. And third, more in-depth investigations may be required to define appropriate policy measures to tackle these problems. These three policy tools, which feed into one another, have been increasingly used by the European Commission over the recent period. This is illustrated by the experience of the Directorate-General for Economic and Financial Affairs with the sector screening exercise carried out within the context of the Single Market Review. The sector screening showed that the food and beverages sector is economically important but performs rather poorly. This observation led to market studies investigating different aspects of the food supply chain.

In addition, the presentation illustrates the possible benefits of more in-depth investigations by showing how sector inquiries carried out by the Directorate General for Competition have nourished the pursuit of antitrust infringements. The presentation concludes that it is important for public authorities to deal with problem market and show citizens that they share their concerns. However, resource limitations require prioritisation based both on an ex-ante assessments whether the policy tools available are suited to address the problems identified and evaluations ex-post whether the policy intervention have worked.

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[2] The abstract and the corresponding presentation have been prepared under the sole responsibility of the authors and do not present the views of the European Commission. Please do not cite or quote without permission from the authors.

Prof Ariel Ezrachi, Faculty of Law, University of Oxford

'The Curious Case of Competition and Quality'

A central mantra of competition policy is that competitive market forces, besides lowering prices, can increase efficiency, product quality, the level of services, the number of choices, and ultimately consumers' welfare. Indeed, the antitrust community generally accepts a relationship between greater competition and lower prices and uses the latter as the prime metric in assessing competitive behavior and the effects on consumer welfare. Alongside the consideration of price, competition authorities recognize that quality can be as, if not more, important in some markets.

But as competition authorities also recognize, identifying the dimensions of competition important to many consumers is difficult. Even when these dimensions of quality are identified, measuring them represents additional challenges. To circumvent these challenges, competition authorities rely on several heuristics when assessing a merger's, cartel's or monopolistic restraint's impact on quality. One heuristic is that more competition will generally increase quality for a given price or reduce price for a given level of quality. A second heuristic is that when prices and quality vary, consumers will weigh the offerings using an internal price-quality metric. Price adjusts for quality, and consumers rely on the heuristic "you get what you pay for." Often the heuristics work well for the competition authorities.

However, at times, market realities are more complex and these heuristics fail to reflect the relationship between competition and quality. In this paper we focus on these instances in which the positive correlation between competition and quality breaks down. We explore two necessary, but not sufficient, variables, which affect that correlation. The first concerns imperfect information flows which result in a difficult or costly channel to convey to consumers the inherent quality differences in the product or service offerings. The second relates to the consumers' limited ability to accurately assess quality differences. With these variables in mind, we consider instances in which an increase in competition will not increase quality (when one would expect it should) and when competition is inversely correlated with quality, and its increase would lead to quality degradation.

Importantly, we do not posit a normative argument: namely that consumers are choosing poor quality goods and services (e.g., reality television show) when they should be demanding higher quality fare (e.g., investigative news program). Nor do we posit a social welfare argument, namely competition involving status goods (where price may correlate more with conspicuous consumption than quality), which increases envy to the detriment of overall well-being. Our assumption is that while different customers have different desires and seek a range of quality, many customers desire a specific dimension of quality. Our focus is on the ability of the competitive process to deliver that desired quality attribute.

Prof Rachel Griffith, Institute for Fiscal Studies & University of Manchester

'Food Markets, Health and Nutrition'

Diet-related chronic diseases including obesity, hypertension, diabetes, and cancer are a major public health concern. Addressing this concern is a key government policy objectives and a number of policies are aimed at improving diet. What market failures are these policies aiming to address? Why are food markets failing? Are there externalities from food consumption? Are individuals fully informed about the characteristics and consequences of food consumption? Do they have the cognitive ability and willingness to process this information? Do individuals behave "rationally" when making food choices? Do these combine with market power by firms to lead to suboptimal outcomes.

I will talk about a large programme of work at IFS under the ERC funded project "Microeconomic Analysis of Prices, Food and Nutrition" that aims to provide a deeper understanding of consumer food purchasing behaviour and firm food pricing behaviour, and their impact on nutrition.

Ashleye Gunn, Which?

'How Which? Chooses What to Campaign on'

Finding the sectors that are real 'problem markets' for consumers often involves challenging the accepted wisdom on markets and competition. For competition to thrive we need markets that work for consumers as well as business. In deciding which markets to campaign on Which? uses particular tests to identify levels of detriment and their sources. We aim to deliver positive change on issues that really matter to consumers, from 'everyday frustrations' through to structural and cultural issues in major sectors of the economy. While some of our campaigning involves 'traditional' policy reports and lobbying of government, regulators and business, at other times we will intervene directly in markets where consumers are at a disadvantage.

Hillary Jennings, Independent Consultant
Prof Hussein Kassim, Centre for Competition Policy

'Market Studies – An International Success Story'

Drawing on original research, this presentation assesses the global spread of market studies and examines how it is used by national competition authorities in different parts of the world. Its central focus is the role played by the International Competition Network (ICN) in disseminating the use of market studies. The presentation looks at how market studies came onto the ICN's agenda and the contexts in which it has been prescribed by the ICN as a tool of best practice. Provisional research suggests that the UK Office of Fair Trading was especially active in promoting the use of market studies internationally.

Prof William E. Kovacic, George Washington University Law School & Competition and Markets Authority

'Preeminent Problem Market: The U.S. Petroleum Products Sector'

Since the establishment of the first US national competition law in 1890, the US national competition authorities have devoted more resources to the petroleum industry than any other sector of the economy. The experiences of the Antitrust Division of the Department of Justice and the Federal Trade Commission demonstrate why the petroleum sector is a singular example of a "problem market" in the United States. The difficulty of the sector for competition policy makers arises from the combination of several factors: gasoline is a frequently purchased "high visibility" product for consumers, whose demand (at least in the short-term) is relatively inelastic. Consumers and elected officials tend to have highly unrealistic expectations about the terms on which firms should supply petroleum products and other forms of energy. The sector has featured important episodes of past misconduct, which inform the modern narrative about the sector's performance and inclinations.

Regulation is enormously complex and encompasses numerous domains of policy intervention. No sector is subject to more intensive political scrutiny.

As this description suggests, the US competition agencies have found their work in this field to be particularly difficult. Elected officials (and consumers) have unrealistic expectations about what competition law and (for the FTC) consumer protection policy can accomplish by way of affecting the price and quality of energy supplies. Intervention in this field also requires careful attention to the interaction of competition law with other forms of regulation. The vesting of a broad portfolio of policy tools in the FTC (antitrust and consumer protection law enforcement, market studies, advocacy) has created an expectation among legislators that the FTC is able to solve all problems.

Prof Catherine Waddams, Centre for Competition Policy

'Consumer Response in Energy'[1]

The UK energy regulator has recently assessed the energy market as being 'problematic', citing evidence of weak consumer response as one of the problems. We identify consumer reaction in retail energy by analysing residential consumer decisions, namely choice of energy suppliers in a collective switching exercise. We use the decisions made by nearly 150,000 consumers to identify switching barriers amongst a particularly active group of consumers. The decision whether or not to accept an offer can be viewed as a pure switching choice, since participants had already undertaken the equivalent of 'search' activity by providing their energy consumption details to the auction, in a process very similar to that used by switching websites. Very little further action was required to accept the offer made in the auction, and participants were sent many reminders to make such a decision.

The dataset used is particularly rich since it includes: the energy characteristics reported by each consumer; whether or not participants saw one or two offers; the offer(s) which they received; the savings that these offers represented; and whether or not each consumer switched supplier. We deduce the switching costs (including those of inertia) by observing whether or not participants decided to accept the offer of the auction. For around 10,000 consumers we have additional survey data regarding their motivation to switch and preferences. This enables us to identify how these additional factors affected participants' switching decisions.

We use probit analysis to identify the effects of many different factors on the switching decision. Our main result is that seeing two offers rather than one reduced the likelihood of switching by five percentage points, providing potential evidence of 'choice overload'. We also identify confidence as an important factor in determining activity.

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Prof Michael Waterson, University of Warwick

'Electricity- A Problem Market'

In this presentation, I argue that the original pioneering design for the electricity industry in 1990 has now been distorted significantly, such that it is almost unrecognisable. The original market faced problems of perceived market power in generation, but also produced significant negative pollution externalities. Attempts to "fix" problems or perceived problems in a piecemeal fashion, then tackling each as it arose, or alternatively putting them off until too late, have led to a market situation in which there are looming issues at several levels that mean a much distorted market exists, particularly at the generation level but also extending into supply.