

Resale Price Maintenance and Restrictions on Dominant Firm and Industry-Wide Adoption

BACKGROUND

- In June 2007, the nearly 100-year-old ban on retail price maintenance was overturned by the US Supreme Court. Like other vertical restraints, the competitive effects of retail price maintenance are now to be judged by the rule of reason. However, the Supreme Court did not offer guidance on how the rule of reason should be applied.
- The rule-of-reason approach is viewed by many as being more appropriate than a per se approach because, in addition to concerns about the use of retail price maintenance to facilitate cartels and dampen competition, it is widely believed that retail price maintenance can also have efficiency benefits.

METHODOLOGY

- The authors address the question of how a rule-of-reason approach to retail price maintenance should be structured.
- The authors construct a model in which firms use resale price maintenance to dampen competition, and in which there is perfect competition upstream and market power downstream. The equilibrium of the model is determined with and without restrictions on the use of retail price maintenance.
- Two types of restriction are considered:
 - (i) a restriction on the extent of industry-wide adoption of retail price maintenance, and
 - (ii) a restriction on the adoption of retail price maintenance by dominant firms.

KEY FINDINGS

Finding Heading

- The authors show that, even though the motive for using retail price maintenance is anticompetitive, market forces may limit the overall adverse impact on consumers. For example, retail price maintenance is shown to have no effect on welfare in the equilibrium in which all firms choose retail price maintenance.
- The authors show that a policy that prohibits dominant firms from adopting retail price maintenance may well improve welfare. But a policy that has the effect of reducing the number of firms that adopt retail price maintenance below the number that would otherwise arise in an unregulated market economy may instead, unless prohibited altogether, perversely lower welfare.

POLICY ISSUES

- While an increase in the proportion of the market covered by retail price maintenance can be welfare improving, this goes against the EU legal framework on vertical restraints, as well as guidelines that have been proposed in the United States, in which industry-wide retail price maintenance adoption beyond certain threshold levels is viewed adversely.

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