

Economics of Parities and Differentials

Greg Shaffer*

Centre for Competition Policy and Norwich Business School

University of East Anglia

and

University of Rochester

27 June 2012

Introduction

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- sometimes the restraints are purely vertical in nature
 - they restrict a retailer's freedom in selling a manufacturer's product but do not restrict the retailer's freedom in selling anyone else's product
- but sometimes they also have “horizontal elements” embedded in them
 - they explicitly or implicitly also restrict the retailer's freedom in selling a competitor's product

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- such requirements may be phrased in terms of fixed or maximum relative retail prices

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Economic effects of parities and differentials

- agreements of this nature, in which a manufacturer fixes or puts a ceiling on the relative retail prices of linked competing products, thereby affecting a retailer's independent setting of its own relative retail prices, would be expected to have anti-competitive effects

Economic effects of parities and differentials

- how do parity and differential requirements affect A's incentives

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- $P_A \uparrow$

- $P_B ??$

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- manufacturer A has a **decreased** incentive to lower its wholesale price when it specifies fixed relative retail prices
- there is **no change** in manufacturer A's incentive to lower its wholesale price when it specifies maximum relative retail prices

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 - its incentive to lower its wholesale price is reduced because it is unable to shift relative retail prices in its favour
- higher wholesale prices will lead to higher retail prices
- all consumers will be harmed — not just those who buy manufacturer A's product, but also those who buy manufacturer B's product

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- retailer participation?
 - higher retail prices might be expected to increase overall channel profits; if so, then transfer payments can make all firms better off
- efficiencies?
 - parity and differential requirements do not solve a double mark-up problem — because the anchor, P_B , is floating
 - parity and differential requirements do not prevent free riding on retailer services — because retailers are free to set different absolute prices

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 - even though absolute retail price levels are not stipulated
 - even if a retailer would have chosen the same parities and/or differentials in the absence of the requirements

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