Phillip E. Areeda
Langdell Professor of Law
Harvard University

John L. Solow
Associate Professor of Economics
University of Iowa

Herbert Hovenkamp
Ben V. & Dorothy Willie Professor of Law
University of Iowa

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Antitrust Law

An Analysis of Antitrust Principles and Their Application

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There is only one respect in which externalities have implications for antitrust policy. If competitors *should* seek to collaborate in avoiding a low private-cost but high social-cost method of production, their agreement should not be automatically condemned as an anticompetitive restraint.

¶415. Collusion

The competitive model assumes that each seller and each buyer acts independently. Left to their own devices, they would not. It is more profitable for sellers to act collusively to raise prices and for buyers to act collusively to depress them. But this is no reason to abandon a competitive policy; rather, it is a powerful reason to have and enforce one.

Of course, restrictive agreements sometimes improve economic performance and benefit consumers, as later volumes will show. We have, however, already seen and rejected the argument that price-fixing agreements are an appropriate response to "ruinous" competition.

4C
Barriers to Entry: Meaning, Identification, and Antitrust Policy Consequences

¶420. Entry Barriers Generally[1]

420a. Definition; antitrust concerns. A barrier to entry is any factor that permits firms already in the market to earn returns

production cost and product price by $1, and that in consequence total output would be reduced by 10 percent. If a monopoly or cartel raises price by $1, only 10 percent of the pollution is eliminated, as compared to 100 percent with direct prohibition applied to a competitive industry. (A $1 tax on effluents would also reduce the pollution by only 10 percent. Imposing a tax, however, encourages the development of alternative and cheaper methods of effluent prevention or disposal in order to avoid the tax.)

¶420. n.1. This overview of entry barriers in ¶¶420-423 is supplemented by more specific discussions in ¶¶711.2d (predatory pricing); 725h (vertical practices); 917, 917.1 (horizontal mergers and government guidelines); 1011 (vertical mergers); 1103, 1135b (conglomerate mergers); 1612d-e, 1631c (distribution restraints); and 1729b (tying).

above the competitive level while deterring outsiders from entering.[2] In the perfectly competitive model, prices above the competitive level attract entry until the newcomers restore total market output to the competitive level, thus bringing about competitive performance. Indeed, if entry is both cost-free and instantaneous, the equilibrium price will be at long-run marginal cost, the competitive level, no matter how concentrated the market.

When these conditions are satisfied, no firm within a market can sustain monopoly pricing. Because such entry would deny firms monopoly profits, anticompetitive exclusionary practices would be unprofitable and presumably would not occur. The rationales for antitrust intervention would disappear.[3] Thus, the frequent inference of market power from a large market share is wrong if entry conditions are not taken into account. In the extreme case of cost-free and instantaneous entry, even a 100 percent market share entails no power at all. Because market share "is just a way of estimating market power, which is the ultimate consideration," easy entry "and the absence of barriers" matter even though "the defendant has a large market share."[4]

Obviously, entry is never absolutely cost-free and instantaneous.[5] At the very least, building new capacity takes time, and there may be other barriers (examined later).[6] As a result, many car-

2. This is the definition of J. S. Bain, Barriers to New Competition: Their Character and Consequences in Manufacturing Industries (1962). Although this definition is controversial among economists and may not be appropriate for all purposes, ¶420c shows that it best serves antitrust policy in most circumstances.

3. Indeed, without the potential for sustained supracompetitive pricing, the conduct or structure that antitrust agencies worry about — such as mergers or market concentration — presumably reflect economies of scale or other efficiencies.

4. *Ball Memorial Hosp. v. Mutual Hosp. Ins.*, 784 F.2d 1325, 1336 (7th Cir. 1986).

5. So-called "contestable market" theory relies on models with instantaneous and cost-free entry — as indicated, for example, by the ready transfer of aircraft from one market to another. See E. Bailey, D. Graham, and D. Kaplan, Deregulating the Airlines (1985); W. Baumol, J. Panzar, and R. Willig, Contestable Markets and the Theory of Industry Structure (1982); T. Moore, U.S. Airline Deregulation: Its Effect on Passengers, Capital and Labor, 24 J.L. & Econ. 1 (1986). However, the needed gate space and sufficient frequencies to attract customers were not available so readily. See S. Borenstein, The Evolution of U.S. Airline Competition, 6 J. Econ. Perspectives 45 (1992) (contestability "no substitute for actual competition"); P. Dempsey, Flying Blind: the Failure of Airline Deregulation (1990) (same); S. Morrison and C. Winston, Empirical Implications and Tests of the Contestability Hypothesis, 30 J.L. & Econ. 53 (1987) (contestability highly imperfect); P. Reiss and P. Spiller, Competition and Entry in Small Airline Markets, 32 J.L. & Econ. S179 (1989); W. Shepherd, Contestability vs. Competition, 74 Am. Econ. Rev. 572 (1984).

6. The barriers discussed in ¶422 are not the only ones. For example, entry may be deterred if incumbent firms charging a "high" price have excess capacity that would supply market demand at competitive prices. If such capacity were put to use after new entry adds more capacity, price would be driven below the competitive level. The resulting fear of losses would tend to discourage entry. See ¶714.6. Entry is especially likely to be deterred if it is a prolonged and expensive process requiring specialized assets that would have little sal-

tels and mergers are in fact motivated by the prospect of at least short-run monopoly profits — with the resulting detriments of restricted output, cycles of excess capacity, and other inefficiencies. Indeed, entry will not occur at all when the entrant's short-run marginal *costs* exceed the incumbents's short-run profit maximizing *price*.[7] Such an incumbent can charge his short-run profit-maximizing price with abandon and has no need for exclusionary practices to keep entrants out. In short, potential entry cannot dispense with all antitrust concern.

The particular input that is both essential and most difficult to obtain defines the relative ease of entry. For example, it may be easy to manufacture a product but difficult to distribute it. The manufacturer of an easily made soft drink may find it difficult to persuade grocery stores to allocate their scarce shelf space to it; the manufacturer would not likely open his own grocery stores or even a one-product shop. Similarly, it may be easy to buy airplanes and operate them between any two points, but entry is not possible unless the government allocates landing slots at busy airports and unless the airports make available terminal gates, which incumbents often control under long-term contracts.

Similarly, a barrier may protect a market incumbent without completely excluding entry. For example, a defendant producing a homogeneous product might enjoy a cost advantage over rivals that allows him to earn more than they; the rivals cannot therefore force his prices down to his costs. In a market of differentiated products, a defendant's product might enjoy a price-cost advantage that rivals cannot eliminate because patents, trademarks, or other factors prevent them from duplicating the defendant's version of the product. Whether such "mobility barriers" to rivals' moving into the defendant's corner of the market confer market power is examined later.[8]

420b. Proving entry conditions. Expansion by smaller incumbents or new entry is sometimes so easy as to prevent any power to achieve or long maintain prices significantly above the competitive level.[9] Entry conditions are therefore relevant to as-

vage value in the event of failure. While entry-deterring excess capacity precludes profit-maximizing monopoly pricing as measured over the short run, it might permit some monopoly profits more or less indefinitely.

7. An entrant may also stay out if his long-run marginal cost exceeds that price. In that case, the new entrant could not predict profits sufficient to recover his investment.

8. See ¶571; R. Caves and M. Porter, From Entry Barriers to Mobility Barriers: Conjectural Decisions and Contrived Deterrence to New Competition, 91 Q.J. Econ. 241 (1977).

9. New entry can add capacity that is ultimately unneeded to a market that already