

# Price discrimination in input markets

Analyzing competitive effects following *Nationwide Poles*

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## The *Nationwide Poles* decision

- In dismissing the complaint, the CAC recognized that Sasol's pricing practices put Nationwide Poles at a disadvantage. But the CAC found (p.40):

**“However, competition law does not protect the competitor, it protects competition. Evidence which goes no further than suggesting that one competitor may be prejudiced is insufficient to bring the impugned conduct within the scope of Section 9(1)(a).”**

## **A dangerous possible reading of *Nationwide Poles***

- **If a complainant is able to show that it (unlike Nationwide Poles) is a “significant player” in the downstream market, will this be regarded as sufficient evidence of likely effect on competition to get over the Nationwide Poles hurdle?**
- **This would be bad economics. This is an approach to price discrimination cases that should be nipped in the bud.**

## Basic set-up of the model

- Firm M is the only supplier of X in South Africa.
- There are two distributors, A and B.
- Distributors A and B are Cournot competitors in the downstream market for X.
- There is another product Y that is an imperfect substitute for X.
- Distributors A and B also handle product Y and also are Cournot competitors in the downstream market for Y.
- Downstream demands for X and Y are linear.
- Distributor A can obtain Y at lower cost than distributor B.
- Distributor B is more efficient in distribution than distributor A.

## 2-stage game

- **Distributors A and B maximize profits in sale of X and Y subject to:**
  - Their costs of distribution
  - Their costs of procuring X and Y
  - Consumer demands for X and Y
  - Cournot competition
- **Against this backdrop, Firm M picks the prices of X that maximize its profits**

## The model implies price discrimination

- **Firm X has an incentive to price discriminate in the sale of X in favour of distributor A**
  - Because distributor A has better access to product Y
  - Because distributor B is more efficient

## Distributor B's hypothetical complaint

**“Price discrimination by firm M has a market-wide impact on the downstream market for X because distributor B is one of only 2 distributors and because distributor B is more efficient.”**

**“If distributor B were able to buy X at the same price now being paid by distributor A, consumers would be better off.”**

- **These are the claims that distributor B might make**

## The fundamental problem with this argument

- If firm M were not allowed to price discriminate in sales of X, it would not simply lower distributor B's price to the price now being charged to distributor A.
- Firm M would lower distributor B's price but it would increase distributor A's price.
- The analysis of the impact of price discrimination needs to consider both effects.

## Moving from price discrimination to uniform pricing

<b>Impact on input prices</b>	<b>Price of X to distributor B decreases; price of X to distributor A increases</b>
<b>Impact on sales of product X</b>	<b>Sales of distributor B increase; sales of distributor A decrease</b>
<b>Impact on sales of product Y</b>	<b>Sales of distributor B decrease; sales of distributor A increase</b>
<b>Impact on total sales of products X and Y</b>	<b>No net effect on either</b>
<b>Impact on downstream prices of products X and Y</b>	<b>No effect on either</b>

# Observations

- **The finding of literally no effect on prices is a product of assuming linear demands. More generally, effect of price discrimination in this setting on downstream prices is ambiguous.**
  - Should contraventions of an Act designed to promote consumer welfare ever be found where the effects on consumer welfare are ambiguous at best?
- **Determining what evidence is sufficient to meet the *Nationwide Poles* test remains a problem.**
- **But it would be bad public policy if the competition authorities in South Africa decided price discrimination cases based on a view that anti-competitive effects are likely if the victim is a “significant player” in the downstream market.**
  - There is no basis in economics for this assumption.

## Where does Section 9 fit in?

Complainant	Type of price discrimination	Section 8 analogue	
<b>Upstream rival</b>	<b>Primary line</b>	<b>Predatory pricing</b>	
<b>Downstream customer</b>	<b>Secondary line</b>	<b>Upstream firm is vertically integrated</b>	<b>Vertical foreclosure</b>
		<b>Upstream firm is not vertically integrated</b>	<b>What incentive to reduce downstream competition?</b>

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