Competition Policy in Selection Markets

E. Glen Weyl

joint work with Neale Mahoney, Chicago, and André Veiga, Oxford

Microsoft Research New England and University of Chicago

Seventh Annual Microeconomics Conference
Federal Trade Commission
October 16, 2014
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- Cost $C(q) = \int_{T(P(q))} c(t)f(t)dt$
- Average cost $AC(q) = \frac{C(q)}{q}$, marginal cost $MC(q) = C'(q)$
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  - Analyze, illustrate graphically
Visualizing adverse and advantageous selection

- Perfect Competition (P = AC)
- Monopoly Pricing (MR = MC)
- Social Optimum (P = MC)

Mahoney, Veiga and Weyl (2014)

Selection policy
Neale and I added imperfect competition to this:
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  - However, with advantageous, optimal \( \theta^* \)

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→ Pro-competitive reforms may have caused real harm

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Why and how beneficial is market power?

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Product design in selection markets

With adverse selection (common in insurance) opposite result
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But Rothschild-Stiglitz saw other problem with competition

Calibrate using empirical data from Handel et al. (2014)
Mean negatively correlated with risk-aversion
Could offset adverse selection on mean but...
Variance very positively correlated, so worsens!
Market power dampens this cream-skimming however
Can it restore positive insurance, or even good outcome?
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- Hoteling model w linear actuarial rate, as well as price
  - Cream skimming grows w competition (steal from rivals)
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With adverse selection (common in insurance) opposite result

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- André and I address, using EF-style approach
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⇒ Trade-off in competition: coverage ↑ but quality ↓

Calibrate using empirical data from Handel et al. (2014)

Mean negatively correlated with risk-aversion

Variance very positively correlated, so worsens!

Market power dampens this cream-skimming however

Could offset adverse selection on mean but...

Can it restore positive insurance, or even good outcome?

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Selection policy
Concrete challenges for merger policy

Most canonical tool of competition policy merger analysis
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Natural place to look for competition policy implications
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=> Natural place to look for competition policy implications

- Four principles in guidelines (partly) reversed:
  1. Price-raising incentives are harmful
     New standard is to measure this "upward pricing pressure"
     But this may also arise from advantageous selection
  2. Worst when reduces competition by most
     Under advantageous selection, more beneficial larger
     \( D \)
  3. Marginal cost should be used to calculate mark-up
     To predict price rise, mark-up over average cost correct
  4. Demand data more important than administrative data
     Administrative data only gives average, not marginal cost
     But this is what you want with selection
     First-order condition backs out incorrect cost for UPP

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  - Makes us think more carefully about how, when
  - But it is not a *carte blanche* counter-argument
  - Framework allows us to measure, and if wrong to rebut
  - Currently not formal, hard to say much about it!

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