Buyer Power and Economic Policy

Article *in* Antitrust Law Journal · January 2005

1 author:

Roger G. Noll
Stanford University

210 PUBLICATIONS **8,100** CITATIONS

Some of the authors of this publication are also working on these related projects:

Project Positive Political Theory and the Law View project

Project Political-Economics of Development View project

This work is distributed as a Discussion Paper by the

STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH

SIEPR Discussion Paper No. 04-08

"BUYER POWER" AND ECONOMIC POLICY*

By
Roger G. Noll
Stanford University

March 2005

Stanford Institute for Economic Policy Research
Stanford University
Stanford, CA 94305
(650) 725-1874

The Stanford Institute for Economic Policy Research at Stanford University supports research bearing on economic and public policy issues. The SIEPR Discussion Paper Series reports on research and policy analysis conducted by researchers affiliated with the Institute. Working papers in this series reflect the views of the authors and not necessarily those of the Stanford Institute for Economic Policy Research or Stanford University.

"BUYER POWER" AND ECONOMIC POLICY

Roger G. Noll*

The rise to prominence of Wal-Mart and other big-box retailers has given new life to the debate about whether "buyer power" at intermediate links in a vertically related chain of industries is good or bad for consumers and hence whether it requires the attention of competition authorities. The term is rarely precisely defined, but as used by most commentators "buyer power" refers to the circumstance in which the demand side of a market is sufficiently concentrated that buyers can exercise market power over sellers. A buyer has market power if the buyer can force sellers to reduce price below the level that would emerge in a competitive market. Thus, buyer power arises from monopsony (one buyer) or oligopsony (a few buyers), and is the mirror image of monopoly or oligopoly. Like monopoly, the motivation behind monopsony behavior is to transfer wealth in the form of economic rents from one side of the market to the other.

Concern about monopsonization—and successful antitrust litigation against firms that use buyer power to extract price concessions from sellers—is hardly new. The first of the federal government's antitrust suits against the Great Atlantic and Pacific Tea Company found that A&P had violated the antitrust laws by obtaining discounts on its wholesale purchases of food products that were not available to others.[1] Numerous antitrust cases in professional sports have found that monopoly sports leagues violate the antitrust laws by adopting practices that substantially restrict competition among teams in the market for players.[2] More recently, the Federal Trade Commission has issued reports that discuss

---

* Professor of Economics and Director, Stanford Center for International Development, Stanford University. The author thanks Scott Nicholson for research assistance.

[1] United States v. New York Great Atl. & Pac. Tea Co., 173 F.2d 79 (7th Cir. 1949).

[2] The Supreme Court exempted baseball from antitrust law with respect to its player market operations in *Federal Baseball Club of Baltimore v. National League of Professional Baseball Clubs*, 259 U.S. 200 (1922), but this exemption was removed in 1998 by the Curt Flood Act, 15 U.S.C. § 26b.

monopsony in e-commerce,[3] health care,[4] and petroleum,[5] and more generally in merger enforcement,[6] while concerns about "big-box" retailers like Wal-Mart have given rise to government studies and investigations in the United States and Western Europe.[7]

This article reviews the economics of monopsony and policies that would seek to curtail the exercise of buyer power. The correct conceptualization of the policy issue surrounding buyer power is whether monopoly and monopsony should be treated symmetrically in antitrust law. That is, in reviewing actions that give rise to antitrust concern when undertaken by suppliers, such as mergers, price collusion, refusals to deal, and contractual requirements that erect barriers to entry, should the corresponding actions by buyers be treated in an equivalent fashion or are there important differences between buyers and sellers with respect to the effects of these actions on consumers that justify asymmetric treatment? While most antitrust scholars conclude that the treatment should be symmetric, there are some dissenters. For example, Jonathan Jacobson and Gary Dorman argue for more lenient antitrust treatment of collusion among horizontal competitors to form joint-purchasing organizations,[8] while Peter Carstensen argues that mergers among buyers in markets for agricultural products are more likely to be anticompetitive than is generally the case for mergers among sellers.[9] Because joint purchasing agreements and mergers produce identical effects in upstream markets, these two positions are mutually incompatible.

---

[3] U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, IMPROVING HEALTH CARE: A DOSE OF COMPETITION (2004), *available at* http://www.usdoj.gov/atr/public/health_care/204694.htm.

[4] FEDERAL TRADE COMMISSION, ENTERING THE 21ST CENTURY: COMPETITION POLICY IN THE WORLD OF B2B ELECTRONIC MARKETPLACES (2000), *available at* http://www.ftc.gov/os/2000/10/b2breport.pdf.

[5] FEDERAL TRADE COMMISSION, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT (2004), *available at* http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf.

[6] *See* U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, FTC/DOJ JOINT WORKSHOP ON MERGER ENFORCEMENT (2004), *available at* http://www.ftc.gov/bc/merger enforce/presentations/index.html.

[7] *See, e.g.*, OECD DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS COMMITTEE ON COMPETITION LAW AND POLICY, BUYING POWER OF MULTIPRODUCT RETAILERS (1999), *available at* http://www.oecd.org/dataoecd/1/18/2379299.pdf.

[8] Jonathan M. Jacobson & Gary J. Dorman, *Joint Purchasing, Monopsony and Antitrust*, 36 ANTITRUST BULL. 1 (1991); Jonathan M. Jacobson & Gary J. Dorman, *Monopsony Revisited: A Comment on Blair and Harrison*, 37 ANTITRUST BULL. 151 (1992).

[9] Peter C. Carstensen, Buyer Power and Merger Analysis: The Need for Different Metrics (2004), *available at* http://www.ftc.gov/bc/mergerenforce/presentations/040217 carstensen.pdf.

The issue of whether antitrust enforcement should be symmetric does not revolve around whether a firm can violate the antitrust laws by obtaining and exercising greater monopsony power through anticompetitive means. No serious argument can be made that antitrust law should make distinctions between buyer power and seller power if significant market power is obtained anticompetitively, such as through horizontal combination or collusion. As explained in the next section, if one adopts either the "harm to consumers" standard or the "deadweight loss" standard for evaluating monopsony, exercise of monopsony power is likely to be harmful, so that its acquisition through anticompetitive actions is as much a violation of antitrust law as is the anticompetitive acquisition of monopoly power.

The core policy issues are whether the threshold market share at which a buyer is likely to acquire significant market power differs from the threshold for sellers, and whether the exercise of legally obtained monopsony power ought to be treated differently than the exercise of legally acquired monopoly power. In this article, I argue that the consequences of monopsony and monopoly are the same, so that the only basis for differential treatment is to place a different social value on the welfare of competitors in upstream markets and buyers in downstream markets. While some have argued that increases in concentration on the demand side of an input market are likely to be beneficial to consumers,[10] these arguments are based on an incomplete analysis of incentives and outcomes in monopsonized markets. The argument for prohibiting monopsony practices, but not the corresponding monopoly practices, has no theoretical or empirical foundation in economics.

Because asymmetric treatment of monopoly and monopsony has no basis in economic analysis, tolerance of anticompetitive behavior on the demand side of the market must rely on arguments about distributive justice. That is, the rationale for the asymmetry must be the argument that antitrust policy, at least as it pertains to monopsony, must be based on an argument that it is socially desirable to redistribute income to a group of buyers even if doing so is costly to other members of society. As is shown subsequently in this article, the distributive justice arguments for overlooking monopsony are basically the same as the arguments for facilitating some monopolies, such as marketing cartels in agriculture

---

[10] In *Kartell v. Blue Shield of Mass., Inc.*, 749 F. 2d 922 (1st Cir. 1984), the court erroneously concluded that using insurer monopsony power to reduce physicians' fees must benefit consumers by lowering their price of care. For an analysis of this case and others that followed from it, see Peter J. Hammer & William M. Sage, *Monopsony as an Agency and Regulatory Problem*, 71 Antitrust L.J. 949 (2004).

commodities and—in Europe and Japan—entry restrictions in retail shops, which is to say that such a position is difficult to defend.[11]

I. THE ECONOMICS OF MONOPSONY

The economics of monopsony is well developed in the economics literature, with the most comprehensive treatment being the book by Roger Blair and Jeffrey Harrison.[12] To make the argument clearer, the analysis in this article deals with the relatively transparent case in which a monopsonist buys an input that is used with other inputs purchased at a competitive price to produce a final product. However, the conclusions are also applicable to more complex cases.

A. Monopsony and Rents

A necessary condition for the presence of potential excess profits arising from monopsony is the presence of *economic rent* on the supply side of the market. As in other respects, the conditions under which monopsony and monopoly can be profitable are symmetrical. A necessary condition for the existence of monopoly power is the presence of consumer surplus—that is, consumers would be willing to pay more than the market price for some units of a good that they consume.[13] Likewise, rent is present in a market if, in the aggregate, suppliers of the product receive more revenues than are necessary to induce them to provide the quantity of goods that is sold. An example of a market without any form of rent is one in which each of many sellers faces constant average cost and has no sunk costs—all investments can be instantaneously moved to another market without cost. In this case, the competitive market price in both the short run and the long run is equal to average total cost. Should a monopsony arise, it would be powerless to reduce price

---

[11] For a review of retail stores policies and their effects, see OECD Economics Department, Structure and Change in Distribution Systems: An Analysis of Seven OECD Member Countries, ECO/CPE/WP1(92)7 (1992), *available at* http://www.oecd.org/findDocument/0,2350,en_2649_34569_1_119684_1_11_1,00.html.

[12] Roger D. Blair & Jeffrey L. Harrison, Monopsony: Antitrust Law and Economics (1993). For recent surveys of the economics of monopsony, see Dobson Consulting, Buyer Power and its Impact on Competition in the Food Retail Distribution Sector of the European Union (Prepared for the European Commission—DGIV 1994), *available at* http://europa.eu.int/comm/competition/publications/studies/bpifrs/; Paul Dobson, Michael Waterson & Alex Chu, The Welfare Consequences of the Exercise of Buyer Power (1998), *available at* http://www.oft.gov.uk/NR/rdonlyres/9A4F0B82-1514-43449C1F-39621912E9DE/0/oft239.pdf; OECD, Committee on Competition Law and Policy, *supra* note 7.

[13] Again, monopsony and monopoly are symmetrical, in that a necessary condition for the existence of monopoly power is the presence of consumers' surplus—that is, consumers are willing to pay more than the market price for some units of a good that they consume.

because if it tried to do so, all suppliers would instantly flee the market. Hence, monopsony in the absence of supplier rent does not create either market power or excess profits for the monopsonist.

Rents take three fundamental forms: Ricardian rent, quasi-rent, and monopoly profits. The effects of monopsony power are quite different in these three cases.

Ricardian rent arises from differential productivity or costs per unit among factors of production. The core idea is that if a group of substitute inputs all are acquired at the minimum expenditure that is needed to induce them into the market, the resulting output per dollar of input differs among them. For example, some land may be more productive than other land in growing a particular crop; some mineral deposits may be nearer the surface than others, and so easier to extract; some workers may be endowed with more skill than others, and so produce more output per time period from a given amount of effort;[14] and workers with the same skill may nevertheless differ in their willingness to work, and so differ in the lowest wage (or reservation wage) that would just be sufficient to induce their participation in the labor force. In these cases, monopsony power can be used to transfer Ricardian rents from more-productive suppliers to the buyer.

Quasi-rents are the difference between a supplier's total revenues and short-run total costs. If a production technology requires some sunk costs (i.e., some inputs must be committed to a specific market for some period of time), then these inputs need not receive any short-run financial return to keep them producing for the market. For example, investments in buildings and machines may be sufficiently specialized that they cannot be shifted from one productive use to another. In this case, a firm need not earn a competitive return on these investments in order to stay in business for awhile. In the long run, however, the firm must earn sufficient quasi-rents to yield a competitive return or its investors will not be willing to replace capital investments as they wear out or become obsolete. In this case, a monopsonist can extract quasi-rents for a while, but only for as long as the remaining useful life of the assets that are committed to supply the market.

Monopoly profits are the excess of revenues over long-run total costs of production that are created by the existence and exercise of market power by sellers. Thus, an important issue in the analysis of monopsony

_____

[14] Sometimes the term quasi-rent is used to describe extra earnings arising from additional labor skill, but the classification here has the advantage of lumping together analytically identical sources of rents.

is whether creating monopsony power to offset monopoly power causes a net improvement in efficiency and consumer welfare.

B. SINGLE-PRICE MONOPSONY

Most of the economic research on monopsony focuses on the partial-equilibrium theory of a single-price monopsonist. That is, the analysis assumes that a monopsonist sets a price per unit of purchase and that suppliers respond by deciding how much output to sell. Alternatives to a single-price market are negotiated contracts that specify both price and quantity; price discrimination, in which different buyers face different prices; and non-linear prices, in which the price of a good depends on how many units are purchased.

In the simplest case of single-price monopsony, one can imagine consumers banding together to force suppliers to lower their prices. In this case, consumers offer sellers a lower price and accept less output than would be supplied under competitive conditions. Consumers in the monopsonized market benefit from this action because the rents that are transferred to them exceed their welfare losses arising from under-consumption. The net effect on society is a loss of efficiency and welfare and a redistribution of wealth to consumers of the monopsonized product. Sellers in the monopsonized market also are consumers in other markets, and their lost income translates into lower demand and lower net welfare in other markets. Because the welfare loss to sellers exceeds the welfare gain to the monopsonist consumers, the overall effect of the efficiency loss of monopsony in one market is a net loss in economic welfare for all consumers in aggregate when all markets are taken into account.

The standard analysis of monopsony power does not deal with consumer buying cooperatives, primarily because a consumer cartel with significant monopsony power is unlikely to be feasible. Instead, most analyses focus on a profit-maximizing monopsony in an input market, examining its efficiency effects in both the monopsonized market and corresponding final-goods markets for which the monopsonized good is an input.

If competition prevails on the demand side of the market, buyers will purchase the quantity of a good at which the market demand curve intersects the market price, which occurs at the point at which the incremental value of one more unit to the buyer exactly equals price. If the supply side of the market also is competitive, the market price also intersects the market supply curve and equals the marginal cost of

production. Competitive markets are efficient because the incremental value of the last unit purchased equals the cost of supplying it.

The key observation of standard monopsony theory is that a profit-maximizing monopsony will take into account the fact that an increase in the quantity of a good that it buys usually causes an increase in the price that it is charged for each unit. In a monopsonized market in which the supply curve is rising, the profit-maximizing strategy of a monopsonist is to purchase fewer units than the quantity that would equate the buyer's marginal value of output to price and marginal cost.[15] To a monopsonist, the cost of the last unit purchased is its price plus the increment to the price of the other units that are being purchased due to the purchase of the last. Thus, the marginal cost of the last unit purchased is less than its stand-alone value to the buyer.

Regardless of the source of rents that gives rise to a profitable opportunity to exercise monopsony power, the single-price monopsony outcome causes inefficiency for three reasons.

First, if the supply of output in the monopsonized market is not perfectly inelastic,[16] output in the monopsonized market is too low compared to the competitive equilibrium. This effect is the one that is most commonly discussed in the literature, and applies to almost all circumstances because perfectly inelastic supply is extremely rare. Because the proper economic conceptualization of cost is opportunity cost (the loss of output from other productive uses should an input be used in producing a particular good), perfectly inelastic supply requires that the good have no other valuable use other than in the monopsonized market. For example, even if Iowa farm land is fixed in supply and would be farmed as long as the price of any farm product exceeds its variable cost, the supply of land for growing a particular crop is not perfectly inelastic because land has several possible uses.

Second, if other inputs in the production process of downstream industry are imperfect substitutes for the monopsonized product, production of the downstream good will be inefficient. The reason is that the monopsonist, in buying fewer than the efficient quantity of the

---

[15] If the input supply industry exhibits constant returns to scale—that is, the average and marginal cost of supply is constant over all relevant ranges of output—then a monopsonist cannot extract excess profits from the input market. This result is exactly symmetric to the result that excess monopoly profits are zero if the demand for the final product is perfectly elastic.

[16] Supply is perfectly inelastic if the same quantity would be brought to the market regardless of the price. This circumstance requires that production costs be zero for all units supplied but infinite for all units above the amount available.

monopsonized good, will engage in inefficient substitution of other inputs for the monopsonized input in producing the final product. As a result, the average economic cost (as measured by the opportunity cost of inputs) of the final product will be higher than it would be if social costs were minimized. For example, suppose hospitals use two types of inputs, medical professionals and physical products used in treatment. If medical professionals are hired in local labor markets with a rising supply curve and physical inputs are acquired in national markets with constant long-run marginal costs, a monopsony hospital, in extracting rents from labor, will engage in inefficient substitution of physical inputs for professional services.

Third, because output of the monopsonized good is less than the social optimum and other inputs are not perfect substitutes for this input, final goods will be under-supplied as well, causing real final goods prices to be higher than would be the case in the absence of monopsony. With respect to income distribution, the lower input price and higher output price raise the income of the monopsonist at the expense of sellers in the monopsonized market and consumers in the final goods market.

Although some have claimed otherwise, these fundamental results about the effects of single-price monopsony do not depend on either the extent of competition or the cost structure of other firms in the downstream market. Several examples illustrate this point.

1. *Single-Price Monopsony and Ricardian Rents*

One illustrative case arises when distinct local markets for an agricultural commodity are monopsonized but each local monopsonist then sells food products in the same competitive regional or national wholesale market. The most interesting example of this circumstance, because it appears to occur with some regularity, arises when some producers of food products enjoy scale economies that are sufficient to make some localities a natural monopsony, but all food processors then compete in competitive regional or national food markets.[17] This circumstance has

---

[17] A parallel monopoly example is rural railroads and grain elevators in the 19th century. Most rural communities were served by a single company that provided storage and shipment services, and so paid monopoly prices, while urban centers typically were served by several railroads and warehouses so that manufacturers normally faced competition in storage and transportation services. The resulting disparities in prices between rural and urban communities gave rise to the initial political demand in Midwestern farm states for railroad regulation. *See* Mark T. Kanazawa & Roger G. Noll, *The Origins of State Railroad Regulation: The Illinois Constitution of 1870, in* THE REGULATED ECONOMY 13 (Claudia Goldin & Gary D. Libecap eds., 1994).

given rise to many monopsony cases, including the tobacco conspiracy litigation[18] and the recent case against Tyson.[19]

In agriculture, land typically varies in productivity, so that the single buyer of agricultural products faces a rising supply curve. At higher prices, land of lesser quality will become profitable to farm. The additional output arising from this land consumes more inputs per unit of output than the rest of the output that is brought to market. As a result, more productive land earns Ricardian rents. The profitability of the best land will exceed the profitability of marginal land, and the profitability of the latter must be sufficient to earn a competitive return and so to induce supply. A monopsonist can extract some of the excess profits arising from good land without risking that this land will be withdrawn from production, but in doing so will set a local price for the product that is lower than the price that is required to keep the marginal land in production. But if each local monopsonist follows this strategy, total output in each local product market will fall, causing output in the final goods market to decline, final goods prices to increase, and the profits of processors to rise.

Because excess profits in a competitive processor market will attract entrants, the reduction in total output and increase in the price and profitability of the final good will not be sustainable if the processing industry has no entry barriers. High final goods prices will encourage established food processors to expand production and new food processors to enter areas where land is less productive but now profitable to farm at the prices that entrants can afford to pay, given the higher prices of the final product. The equilibrium will be one in which some agricultural land with low productivity is brought into production, while in localities that have been successfully monopsonized, land with higher productivity has been taken out of production. These effects cause lower overall productivity in the industry and higher prices to consumers than would be the case if processors did not exercise monopsony power to extract Ricardian rents.

The same situation can arise in markets for natural resources, as illustrated by the complaint in the original *Standard Oil* case.[20] Differential productivity among oil wells and fields enabled Standard Oil, by virtue of its control over pipelines and refineries, to extract Ricardian rents from more productive wells. Although the evidence in the case did not

---

[18] American Tobacco Co. v. United States, 328 U.S. 781 (1945).

[19] Pickett v. Tyson Fresh Meats, Inc., 315 F. Supp. 2d 1172 (M.D. Ala. 2004).

[20] Standard Oil Co. v. United States, 221 U.S. 1 (1911).

focus on the complex effects of Standard Oil's practices on the efficiency of oil extraction, it did reveal that the prices paid by Standard varied substantially across oil fields, which implies an inefficient allocation of production among them.

The economic effects of monopsony in resource markets closely parallels the economic effects of price regulation of natural gas.[21] Natural gas production is fragmented among a very large number of fields and wells across the United States, so that individual producers possess no market power. Nevertheless, because of productivity differentials in natural gas extraction among wells and fields, competitive pricing causes most producers to earn very large Ricardian rents, while the market price equals the average cost of the most costly well in production.

Natural gas regulation sought to transfer these Ricardian rents to consumers through a three-step regulatory process. First, wellhead prices in each field were set equal to the long-run average cost of production of wells in that field, which was below the marginal cost of production from the most costly well. Second, pipelines, which buy gas from producers and deliver it to utilities and industrial consumers, were required to sell their gas at the average cost of acquisition plus their long-run average cost of transporting the gas to their customers. Third, utilities were required to sell energy at their average cost. The cumulative effect of average-cost pricing at each stage of the regulatory process was to reduce the price of energy to end-users, thereby transferring some Ricardian rents all the way from the well to the final consumer.

The system of natural gas price regulation was unstable because lower regulated prices caused demand to increase due to lower regulated prices but supply to fall because, in every field, wells were not brought into production if their costs were above average, thereby causing a shortage.[22] The instructive value of this history is to make clear why monopsony prices are not passed on to consumers, even when the final product market is competitive. If the lower costs of each local monopsonist were passed on, the result would be a shortage—excess demand at current prices that, in the absence of price controls, would then cause prices to increase.

Another illustrative case arises when only one of many buyers enjoys local monopsony power. Here the final product market is competitive,

---

[21] For a summary of this history, see PAUL W. MACAVOY, THE NATURAL GAS MARKET: SIXTY YEARS OF REGULATION AND DEREGULATION (2000).

[22] *See* Paul W. MacAvoy, *The Regulation-Induced Shortage of Natural Gas*, 14 J.L. & ECON. 167 (1971).

and a series of geographically separate input markets, all producing the same homogeneous product, are all structurally competitive except one. An example would be a circumstance in which one region has a single food processing plant but other regions each have a sufficient number that elsewhere food processors have no buyer power. In this case, the single local monopsonist will behave as before, restricting purchases for the purpose of obtaining Ricardian rents from low-cost suppliers. As a result, producers in the monopsonized market with average costs between the competitive price and the monopsony price will withdraw from production, causing supply in the final goods market to be less than demand at the competitive price. Other final goods producers will then expand output until the competitive equilibrium is restored. If other final goods producers collectively face a rising supply curve for the same input that the monopsonist acquires, expansion by the other processors will require them to buy from farms using less-productive land than the marginal land at the competitive price. As a result, the price of the final product will be higher than if there were no monopsony.

A closely related case arises when the monopsonist's downstream competitors and their input suppliers all have constant long-run average costs. Some studies of monopsony assert that consumer welfare is unaffected by the exercise of monopsony power in this case.[23] The essence of these analyses is that the monopsonist's downstream competitors will expand output to make up for lower production by the monopsonist, and the price of the final good will not increase because the firms that expand output face constant long-run average costs. This argument is incorrect.[24] To illustrate the problem, consider the case in which monopsony rent is extracted from farmers with highly productive land and replaced by increased production at marginal land (i.e., land that is profitable to farm only if the farmer can obtain competitive prices) that is available in perfectly elastic supply. Output curtailment due to monopsony causes a reduction in output by farmers whose productivity is between the marginal land and the land that can engage in break-even production

---

[23] *See, e.g.,* BLAIR & HARRISON, *supra* note 12, at 41 (claiming only that the cost-reductions captured by a monopsonist are not passed on to consumers); Jacobson & Dorman, *Monopsony Revisited, supra* note 8, at 161 (claiming that in this case "removal of the buyer's monopsony power will have no effect on downstream market price or output").

[24] The technical error in the analysis arises from failing to take into account that all prices in partial equilibrium analysis (the supply and demand analysis of a single market) ought to be *relative prices* in relation to an overall price index. The resources that are used in farming more poor land came from somewhere, and must be greater than the resources that were released by reducing production on good land. Thus, production elsewhere in the economy must have declined in order to maintain production in the market under analysis. Of course, even if the movement of resources is small, a reallocation of resources among industries will cause a change in relative prices, including the prices of inputs. In

at the monopsony price, while downstream competitors buy inputs from sellers that expand output on marginal land, where price equals average cost. When lower-productivity suppliers displace higher-productivity suppliers, more resources are used to produce the final good than would have been used in the absence of monopsony. If these additional resources have productive use anywhere else in the economy, the net result of the monopsony is to raise the real price of the final product and to reduce the value of total output to consumers.[25]

All of the preceding examples deal with the extraction of Ricardian rent in primary product markets. However, the results also hold for other types of markets. For example, the same analysis can be applied to labor markets. As in other input markets, if labor supply is perfectly inelastic, monopsony does not affect the quantity of labor supplied and hence does not affect either quantities or prices in final goods markets. Empirical research in labor economics finds that labor supply is not perfectly inelastic, however. The uncompensated wage elasticity is about 0.10 for men and 0.50 for women, with adjustments around this number depending on other demographic and skill characteristics.[26] Just as in primary product markets, a market wage generates economic rents for workers whose reservation wage (i.e., the minimum wage required to induce them to work) is below the market equilibrium. Monopsonists can extract part of this rent by reducing the quantity of labor that they acquire, but in so doing they reduce output and efficiency in final goods markets and thereby harm consumers.

2. *Single-Price Monopsony and Quasi-Rents*

The effect of single-price monopsony that extracts quasi-rents is similar to the analysis for markets with Ricardian rents, but it applies only to

---

the end, the overall effect will be that the prices of all goods are higher relative to the prices of inputs, so that consumers, on balance, are worse off in every market.

[25] BLAIR & HARRISON, *supra* note 12, at 41, examine the case of reduced output "by one textile mill . . . in North Carolina" under the assumption that the effect of this mill on the national textile market is infinitesimal and so can be ignored. Borrowing the example, this mill's reduced output will release some amount of productive resources, *X,* into the economy. To offset the lost production, additional resources, $X + x$, must be shifted to textile production elsewhere. Even if all local factor markets are perfectly competitive so that the marginal value product (*MVP*) is the same in all industries everywhere, the social loss will be $MVP(X + x) - MVP(X)$. The existence of monopsony exploitation requires that *x* be positive, even if the monopsonist's share of the competitive final goods market is infinitesimal. Moreover, competitive pricing in the final-goods market does not require a large number of firms with tiny market shares, so that competitive outcomes are consistent with circumstances in which *x* is a very large number.

[26] John Pencavel, *Labor Supply of Men: A Survey, in* 1 HANDBOOK OF LABOR ECONOMICS 3, 61–62, 82 (Orley Ashenfelter & Richard Layard eds., 1986); Mark R. Killingsworth & James J. Heckman, *Female Labor Supply: A Survey, in* 1 HANDBOOK OF LABOR ECONOMICS,

the short run. To illustrate the crucial distinction, assume that suppliers have constant long-run average costs but that part of their costs are sunk: long-term investments that cannot quickly be switched to other productive uses without occurring any switching costs. In addition to specialized buildings and equipment, another good example is human capital, such as the education required to become a physician or the training necessary to become a professional athlete.

In the presence of sunk costs, a seller's short-run cost (and hence supply curve) is lower than the (constant) long-run average cost as long as output is below the optimal production capacity for the sunk input. If existing capacity is optimal for demand at the long-run competitive equilibrium price and both sides of the market are competitive, suppliers will generate sufficient revenues to cover both short-run and sunk costs. If the market is monopsonized, the buyer can withhold demand to lower price and extract some quasi-rents.

The difference between this case and the case of Ricardian rents is that extracting quasi-rents cannot be sustained forever. Eventually the sunk investments will wear out or become obsolete. Because sellers do not receive enough revenue to justify their investments, they will not reinvest. If long-run average cost is constant, eventually this case evolves into the circumstance in which the monopsonist lacks market power because there are no rents left to extract.

In the case of physicians, extraction of the returns to medical education is feasible for physicians who have completed their education, but two additional sources of long-run erosion of the benefits of monopsony remain. First, if physicians must make continuing investments in human capital to keep their skills current, monopsony will reduce their incentive to do so and, as a result, quality-adjusted supply will decline. Second, for potential physicians contemplating entry into medical school or, after entry, the decision to pursue additional training for a specialty, the monopsony wage will discourage some from making these investments and so reduce the future supply of doctors. If (counter-factually) all doctors have the same reservation wage (including their minimum necessary return on medical education), so that the long-run supply of physicians is perfectly elastic, eventually the monopsonist will face a market in which no doctors offer services and no further quasi-rents can be extracted.

---

supra, at 103, 193; Richard Blundell & Thomas MaCurdy, *Labor Supply: A Review of Alternative Approaches, in* 3A HANDBOOK OF LABOR ECONOMICS 1559 *(*Orley Ashenfelter & David Card eds., 1999).

Although the extraction of quasi-rents is a transitory phenomenon, the "short run" in which it can occur can be very long indeed. One should not confuse the transitory period of price increases that is referenced in the Merger Guidelines[27] with the short-run period during which a monopsonist can extract quasi-rents. In deciding whether a merger causes monopoly harm, a key issue is whether an immediate profitable price increase by the merged entity will induce increased supply from others within a reasonable period of time (typically the test is six months to a year) so as to force prices back down to the premerger level. The necessary increase in production can arise quickly if some firms have excess capacity or easily can switch production from another product, and more slowly if firms must make long-term investments to increase capacity. The corresponding conditions in the case of a monopsony are whether others easily can enter the monopsonized market, or whether the investments that yield the quasi-rents can easily be shifted to another market if their quasi-rents are extracted. For monopsonistic extraction of quasi-rents to qualify as a non-transitory change in price, the monopsonist must be protected by entry barriers, and some investments that are committed to the monopsony market must not be easily and quickly transferable to producing other products. Thus, the "short run" in the analysis of the extraction of quasi-rents can be as long as the useful life of an asset if the asset has no other comparably productive use.

3. *Single-Price Bilateral Monopoly*

The last type of rent to be extracted by monopsony is monopoly profit. This case, while fairly uninteresting, is qualitatively similar to the others.[28] The logic of the argument is that a monopsonist understates its demand in order to induce the profit-maximizing monopolist to reduce price. But in so doing, the monopsonist also ends up buying less than the monopoly quantity if demand were not understated. This case is uninteresting because both parties can be made better off by mutually recognizing their market power and engaging in bilateral negotiation or merging, as is discussed in the next section. Thus, this case probably never arises.

C. Negotiated Contracts and Bilateral Monopoly

Most examples of monopsony that have given rise to antitrust litigation or have been the basis for public debate about buyer power do not

---

[27] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines § 1.0 (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104, *available at* http://www.usdoj.gov/atr/hmerger/11250.htm.

[28] This case is called passive bilateral monopoly in Mark V. Pauly, *Market Power, Monopsony, and Health Insurance*, 7 J. HUMAN. RES. 111 (1988).

adhere to the assumptions of the single-price monopsony model. In the examples of A&P, local food processors, managed care insurers, professional sports teams, and big-box retailers, monopsony power is not exercised by simply posting a low buying price and waiting for sellers to arrive. Instead, the common practice is for buyers and sellers to negotiate a long-term contract that specifies both price and quantity. For example, in *Mandeville Island Farms*,[29] sugar beet growers in Northern California signed contracts with one of three sugar refiners that required them to sell all of their output to that refiner at a negotiated price that was the result of a collusive agreement among the refiners.

In principle, monopsonists (like monopolists) can avoid efficiency losses by engaging in perfect price discrimination, or "all or nothing" offers. In this case, a buyer offers a seller a contract to provide the same quantity of output that would be provided if the market were competitive, but at a price equal to the average cost of supply—not the long-run marginal cost of the last unit. If the supply curve is rising and the buyer has market power, the average unit price that will induce the supplier to sign the agreement is below the competitive market price, but the quantity brought to market is exactly the same as would arise under competition. Because the marginal cost of the last unit of the monopsonized good to the monopsonist is still the true marginal cost of production, the exercise of monopsony power does not distort the input market or cause inefficient substitution of other inputs for the monopsonized input. Thus, price, quantity, and efficiency in the final goods market are not affected, but the productivity rents in the input market are shifted to the final-goods producer. In *Mandeville Island Farms* the plaintiffs' complaint alleged that, in fact, the collusive contracts had no effect on the national price of refined sugar.

In practice, and notwithstanding the *Mandeville Island Farms* complaint, price discrimination through contract negotiation in monopsonized markets is unlikely to be perfect, in which case efficiency losses are likely. The reason is that perfect price discrimination requires that the monopsonist be able to observe the cost function of each separate supplier and offer each a different average price for the same product.

Markets for professional athletes provide a useful example of discriminatory monopsonization. Players and teams negotiate individual contracts, and player salaries vary enormously, with the most-skilled veterans earning salaries roughly 100 times the collectively bargained minimum wage. A common practice of leagues is to adopt some form of "player

---

[29] Mandeville Island Farms v. Am. Crystal Sugar Co., 334 U.S. 219 (1948).

reservation system," which gives each team exclusive rights to a proportionate share of players, such as through a rookie draft or exclusive geographical territories, and to adopt a rule that gives teams exclusive rights to employ these players for at least part of each player's career. For at least the first few years of a career, a player is faced with accepting the offer of one designated team or not playing professionally in the sport.

The salary-setting process for players whose services are effectively monopsonized is based on two considerations: the wage necessary to keep the player in the sport, and the use of incentives to induce high performance. Presumably each player has a reservation wage that must be paid to induce participation, which usually is the player's earnings in another occupation. Because the most-productive employment for nearly all players is to be a professional athlete, a team can set the player's wage between the reservation wage and the competitive wage (which would equal the value of the player's contribution to the team) and still induce all players to accept employment.

In addition to at least matching the reservation wage, a team has an interest in making wages sensitive to performance. If pay is related to performance, wages create an incentive for players to devote optimal effort to playing and to retaining their skills in the sport, such as by practicing, keeping fit, and reducing health risks. If an increment to playing skills causes teams to capture incremental revenues, as has been documented by studies of the demand for sports,[30] then teams can increase profits by offering players a sliding scale in which wages increase by no more (and probably less) than the associated incremental revenue as performance increases. In a competitive player market, players would be paid the value of their marginal product, which implies that the increment to pay arising from an increment to performance would equal the associated incremental revenue. A monopsonist's optimal wage scale generally will allow the monopsonist to capture some of the gains from greater player productivity, where the monopsonist balances the gains from extracting more rent from better players against the cost of creating a disincentive for the player to put forth best effort.

As has been documented by a substantial body of research, the player reservation system lowers player salaries for players of all skills until they become eligible for free agency, and transfers some of the value

---

[30] Roger G. Noll, *Attendance and Price Setting, in* GOVERNMENT AND THE SPORTS BUSINESS 115 (Roger G. Noll ed., 1974).

productivity of players to teams.[31] In all sports, players differ in terms of their best alternative to playing a given sport, which in turn determines the player's "reservation wage," or the minimum that they must be paid to induce them to work as professional athletes. Players also differ with respect to their skills and hence their ability to bring value to their teams. The difference between a player's value product and wage is Ricardian rent, which a monopsony team tries to extract.

Teams can extract all of the difference between the player's value to the team and the player's reservation wage if they possess two types of information: the player's reservation wage, and the extent to which a player responds to the prospect of higher salaries by putting forth more effort in playing games and improving skills. As a practical matter, teams are not likely to possess either type of information. As a result, some players will be paid more than their reservation wage plus the performance incentive that is necessary to induce best effort, while others will be offered less than is required to keep them in the sport or, of they do continue to play, to put forth best effort.

If effort to improve skills is costly and the cost of work effort varies among players, each player will respond somewhat differently to financial incentives to improve performance and to avoid risks to playing skills, such as engaging in reckless or illegal behavior. Consequently, employers are not likely to put in place the combination of base wage and performance incentive that causes every player to put forth the optimal amount of effort and all of the player's Ricardian rent to be extracted by the team. In a competitive player market, competition among teams will lead to a competitively determined relationship between wages and performance that applies to all players, thereby causing all but marginal players—players whose contribution to value exactly equals their opportunity cost in sports—to earn Ricardian rents. To the extent that the pay-performance relationship under monopsony attempts to extract this rent but does so in a manner that does not precisely match the effort supply curve for each player, the exercise of monopsony power in the market for athletes will lead to inefficiencies in the production of sporting events by causing some players to abandon the sport when it is their most productive occupation and others to continue to play but at less than optimal effort.

A longer term consequence of monopsony in player markets is that it causes reduced entry into the player market. In picking a career, a rational worker will compare the costs of preparing for an occupation

---

[31] The seminal paper on the effect of player reservation on salaries is Gerald W. Scully, *Pay and Performance in Major League Baseball*, 64 AM. ECON. REV. 915 (1974).

with the expected gains. In the case of an athlete, the costs are the time, effort, and expense that are devoted to improving athletic skills, and the benefit is the probability of becoming good enough to be a professional athlete multiplied by the wage that a professional athlete earns plus any additional psychic gratitude that comes from being a major-league athlete.[32] If a player's earnings are suppressed by a monopsony employer, the optimal amount of preparation declines as does the number of people who attempt to enter the occupation. Eventually the reduction in competition for jobs in sports also reduces the quality of play, and thereby the consumer satisfaction derived from the sport.

D. Consumer Welfare and Monopsony

An important feature of the foregoing monopsony models is that the reduction in input costs is not passed on to consumers. The standard justification for the desirability of buyer power is that the input monopsonist will "pass on" lower costs to consumers.[33] This argument has no support from the standard monopsony model in which the input market is assumed to be competitive on the seller side, but it can be true if the transition is from monopoly or monopsony to bilateral monopoly, as shown in a paper by Roman Inderst and Christian Wey.[34] This observation forms the basis for the defense of purchasing cooperatives[35] and, when managed care organizations monopolize physicians' services, physicians' unions.[36]

To create a circumstance in which the benefits of monopsony power are passed on to consumers requires assuming that sellers in the input market possess market power,[37] so that creating market power on the

---

[32] While teen-agers probably do not make careful calculations when deciding among playing high-school sports, working at McDonald's, and loafing, the expected returns to a high-school athlete who attempts to become a professional athlete are roughly the minimum wage, which is the occupational opportunity cost for most teen-agers. Roger G. Noll, *Economic Perspectives on the Athlete's Body*, 6 Stan. Human. Rev. 69 (1998).

[33] *See, e.g.,* Kartell v. Blue Shield of Mass., Inc., 749 F.2d 922, 930 (1st Cir. 1984).

[34] Roman Inderst & Christian Wey, Buyer Power and Supplier Incentives (Working Paper, Department of Economics, London School of Economics, 2002).

[35] *See* Jacobson & Dorman, *Joint Purchasing, supra* note 8.

[36] *See* Roger D. Blair & Jill Boylston Herndon, *Physician Cooperative Bargaining Ventures: An Economic Analysis*, 71 Antitrust L.J. 989 (2004).

[37] The extraction of Ricardian rents, even if accomplished through perfect price discrimination, never is passed through to consumers, regardless of the structure of the final goods market, because final goods prices will be based on the marginal cost of the final good. This marginal cost in turn depends on the cost of the last unit of the input that was produced, which is the competitive price in the absence of monopsony. Likewise, if the motive for monopsonization is to extract quasi-rents, the marginal cost of the input at the competitive level of supply will equal long-run average cost. Thus, the only circum-

demand side leads to bilateral monopoly.[38] The simplest example begins with monopoly in an input market. Presumably the monopolist sets price above average cost, earns excess profits, and creates a distortion because its customers buy fewer units of the input than is socially optimal. If buyers form a purchasing cartel, they will do no worse than reproduce the monopoly circumstance, and by coordinating their purchases they may be able to force the monopolist to lower price and increase output. Any price between the competitive and the monopoly levels will allow buyers to purchase more of the input, and so will reduce the distortion in the final good market. Thus, bilateral monopoly can produce a more efficient outcome and lower prices in the final product market, thereby benefiting consumers.

Whether bilateral monopoly *will* improve welfare is uncertain, as is apparent from the previous discussion of passive bilateral monopolists in Part II.C. Even if the bilateral monopolists engage in bargaining, other dangers arise from creating a monopsony to bargain with the monopoly, or *vice versa.*

1. *Negotiation Failures*

Substituting negotiations for market processes usually increases transactions cost. One advantage of market processes is the information that is created by numerous arm's-length transactions. This information enables participants in a market to form reliable expectations about their future transactions. The presence of strikes and lock-outs in collective bargaining illustrates the down-side of bilateral monopoly, which is a failure to reach a mutually beneficial agreement because of non-overlapping expectations about the terms of a reasonable or realistic transaction. Likewise, in principle, all lawsuits should settle because litigation imposes costs on both sides, yet often parties are not able to reach a negotiated settlement, again because of mutually inconsistent expectations about the outcome of the litigation process.

2. *Spillovers into Other Markets*

One problem with creating a bilateral monopoly is that the monopsonist in the input market may gain market power in the final product market. If the upstream product is a necessary input for all competitive substitutes in the final product market, and if the geographic market for the final product is not substantially larger than the geographic

---

stance in which pass-through is plausible is when the input supplier sets price above the competitive level and earns excess profits.

[38] The term bilateral monopoly conventionally applies not just to a monopoly facing a monopoly but to any circumstance in which both buyers and sellers enjoy market power.

market of the input, monopsonization of the input necessarily risks monopolization of the final product. The problem arises from the difficulty of limiting the activities of a buyer's cartel to just negotiating with the monopolist, and not creating a monopsony in other competitive input markets or a collusive cartel in the final product market.

3. *Containing Bilateral Monopoly*

Creating a monopsony to offset a monopoly also risks creating opportunities for extracting rents other than monopoly profits, which can cause inefficiency. An input monopolist may capture all three kinds of rents, and a monopsonist will find all three equally attractive opportunities for exercising monopsony power. If the price-elasticity of demand for the input is relatively high, the amount of monopoly profit that the input supplier can extract is relatively low.[39] In this case the input price under bilateral monopoly is likely to be lower than the competitive price. For example, if the input supplier experiences steeply rising marginal cost and therefore captures substantial Ricardian rents, a monopsonist has far more to gain from extracting these rents than from offsetting the market power of the monopolist.[40] In this case, as shown by Inderst and Wey,[41] a bilateral monopoly outcome that divides producers' surplus roughly equally between the two players will lead to a reduction in output by the input supplier and to greater distortion in the final product market. Similarly, if the monopolist combines weak market power with substantial quasi-rents, capturing the quasi-rents will offer a more inviting target to the monopsonist than extracting the monopoly profits, thereby leading to reduced output.

4. *Eliminating Technological Competition*

Creating a monopsony to bargain with a monopoly raises issues about why the monopoly existed in the first place and what its fate would be in the absence of the creation of a bilateral monopoly. If a monopoly exists because of anticompetitive acts or prior public policy (such as entry regulation), the appropriate policy is to create competition on both sides of the market, not bilateral monopoly. If a monopoly arises from a competitive process, such as a race to produce a superior technol-

---

[39] The demand for the input will have a high demand-elasticity if any of the following circumstances pertain: (1) the input has close, though imperfect, substitutes; (2) the price-elasticity of demand for the final product also is high; and/or (3) the final goods producer can switch production to another final product that does not use the input at little or no cost.

[40] Jacobson & Dorman, *Joint Purchasing, supra* note 8, assume that the seller has constant average costs, which means that Ricardian rents are not present.

[41] Roman Inderst & Christian Wey, *Bargaining, Mergers, and Technology Choice in Bilaterally Oligopolistic Markets*, 34 RAND J. ECON. 1, 11 (2003).

ogy, the excess profit of the winner in the technology race is the carrot that induces firms to participate in the race. A systematic policy to cut back or eliminate this ex post reward would reduce the intensity of technological competition and thereby could reduce efficiency in the long run.

Consider the case of novelists. Thousands of novels are published every year, and nearly all sell very few copies. Royalties of a few dollars per copy for sales of a few hundred to a few thousand copies are insufficient to compensate a novelist for the time required to write a novel at a normal market wage. But a few novels sell extremely well, and their authors receive royalties in the millions of dollars. Now imagine that bookstores were permitted to form a cartel to extract the excess returns of best-sellers. In this example, the possibility of an enormous financial payoff to a novelist would disappear, and so would most of the financial incentive for anyone to try to write a best-seller. Undoubtedly some novels still would be written, but if novelists generally are motivated by financial reward, a bookstore cartel would have the effect of reducing the number of successful novels that are written.

5. *Instability of Bilateral Monopoly*

Regardless of the outcome of negotiations, in general, firms in a bilateral monopoly relationship are likely to be better off merging. In a merged entity, efficiency and profits are maximized by basing input decisions for the final product on the assumption that the prices of inputs are set equal to marginal cost. The final goods division will adopt the most efficient combination of inputs and will base the final product price on actual marginal costs of production. In so doing, the firm will maximize the sum of the rents accruing to all divisions taken together. Of course, if the bilateral monopoly is between a firm and a labor union, merger is implausible; however, the incentives that give rise to vertical mergers under bilateral monopoly provide an explanation for the creation of some labor-managed firms.

Whereas separate firms theoretically can duplicate the outcome of a vertically integrated entity, for reasons developed by Oliver Williamson[42] this result is unlikely. The inability to write complete contingent contracts and the incentive ex post to take opportunistic advantage of circumstances not foreseen or not fully enforceable in the contract are likely to make bilateral monopoly less efficient than merger.

---

[42] OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975).

6. *Applications to Labor Markets*

The problems with bilateral monopoly are especially apparent in some markets for skilled labor, such as for physicians or professional athletes. Useful examples are a family practice doctor in a small town that is served by a single insurance company, the only heart surgeon for a hundred miles in a sparsely populated region, or a Hall of Fame-caliber baseball player in a market with a reserve clause.

In the case of a physician, a fee-for-service system encourages doctors to perform too much service. With a monopsony insurer or managed care organization, the optimal "all or nothing" contract requires specifying price, quantity, and quality, but in medical care quantity and quality agreements are very difficult to observe and to enforce, especially if one cannot rely on peer review (as one cannot if the physicians form a cooperative). Physicians can be required to accept a certain number of patients, but the quantity and quality of service they provide can be only imperfectly observed, which creates an opportunity to take opportunistic advantage of the other party to the contract by providing too little service. Likewise, professional athletes can be required to play a certain number of games, but the effort that they put forth to improve their skills also is only imperfectly observable, again leading to providing too little service.

In both cases, merger implies the creation of a labor-managed firm, which is likely to lead to inflexibility in defining jobs and determining employment levels. For these reasons, bilateral monopoly is not necessarily more efficient than monopoly or monopsony, and almost certainly is less efficient than competition on both sides of the market.

E. MONOPSONY WITH PRODUCT DIFFERENTIATION

Bilateral monopoly represents the simplest circumstance in which both buyer and seller have market power. Another case arises when the demand side of an intermediate market is concentrated (for example, a few big-box retailers) and the supply side exhibits product differentiation. Suppose that the upstream products are branded differentiated products, such as premium wines or designer blue jeans. The producer of each brand has borne some fixed cost in product development and advertising to create brand loyalty, so that the equilibrium in this market is one in which the producer of each brand has some market power. If this type of market has no entry barriers, brands will enter until excess profits are dissipated, creating a monopolistic competition equilibrium. At this point, the fixed costs will have been spent, the price charged by each supplier will equal long-run average cost (thereby recovering fixed costs

but earning no excess profit), and price will exceed the marginal cost of production.

In this environment, a firm that acquires monopsony power can offer a seller an all-or-nothing bargain—sell a substantial amount of output to the monopsonist at a price below long-run average cost, above marginal cost, and below the former competitive price, or reject the deal. If the deal is rejected, the supplier's total sales at the competitive price will be less than before monopsony power was acquired because the seller will be denied access to the monopsonist's share of the market. As long as the contract price is above the average variable cost of production, each firm has an incentive to sign rather than to lose the monopsonist's business. Competition among sellers then drives the contract price toward marginal cost, enabling the monopsonist to extract the quasi-rents that would have recovered the supplier's sunk costs.

An important consequence of this form of monopsony is that the marginal cost of production of the final good is reduced because of the reduction in the input price. In a competitive final goods market, the monopsonist that succeeds in extracting quasi-rents will expand output in the final product market at the competitive price, leaving a lower market share for other competitors and hence a lower demand by them for the input at the competitive price. If the monopsonist also has market power in the downstream market, one plausible long-run effect is that the price of the final good will be lower. In this case, the effect of monopsony is to reduce the extent to which sequential monopoly leads to "double-marginalization." Even a monopsony that also has market power in the downstream market will respond to a reduction in its marginal cost for the final product by reducing its price. However, if monopsonization in the input market increases the market power of the monopsonist in the final product market, the effect of the latter can offset the effect of the former, leading to higher final goods prices.

In the long run, monopsony that extracts quasi-rents eventually forces some input producers to exit the market. As time progresses and committed assets deteriorate or become obsolete, the monopsonist's success at extracting quasi-rents will cause suppliers to exit the input market rather than reinvest. At some point, the number of suppliers may shrink to the point that the remaining suppliers have sufficient market power to cause the input market to become a bilateral monopoly. If so, the remaining firms may then bargain for a sufficiently better deal that they have an incentive to make the investments that are necessary to stay in business. But in any case, consumers are affected because the exit of some firms leads to less product variety.

If the final goods market is segmented between two types of sellers that are imperfect substitutes—for example, big-box retailers with low service and amenities versus upscale boutiques—a permanent gap in final goods prices may be sustainable, in which case the number of input suppliers will shrink until the sales of each at high prices are sufficient to recover fixed costs. Although no generalization is possible—the answer depends on assumptions about own- and cross-elasticities of demand between upscale and big-box outlets—a plausible result is that big-box consumers are better off (lower prices), upscale consumers are worse off (higher prices and/or less variety), surviving input manufacturers are neither harmed nor benefited, but fewer input suppliers and fewer upscale producers survive.

One form of fixed cost that leads to product differentiation in the input supply market is research and development. That is, competition in the input market may take the form of costly effort to improve the product. In this case, monopsony can reduce technological progress because suppliers will anticipate that if their R&D efforts are successful, the monopsonist nevertheless will be able to extract the quasi-rents that recover the R&D costs. This effect parallels the observation that monopolists have less incentive to create product variety that takes away some business from one of their existing products. Consistent with this expectation, Weiss and Wittkopp provide empirical evidence that in some cases innovation in food products has been adversely affected in markets in which food retailers have oligopsony power.[43] This adverse effect is not affected by the extent of concentration among suppliers and thus supports the argument that, in many cases, the quasi-rents of suppliers offer at least as inviting a target as their excess profits.

III. POLICY TOWARDS BUYER POWER

Policy analysis of buyer power begins with identifying the social harms of monopoly and the counterparts to these harms under monopsony. The harms of monopoly are the efficiency loss arising from price above marginal cost and the transfer of wealth from consumers to producers. Although the point is controversial, antitrust policy regards this income transfer as an undesirable effect of monopoly,[44] as exemplified by the

---

[43] CRISTOPH R. WEISS & ANTJE WITTKOPP, BUYER POWER AND INNOVATION OF QUALITY PRODUCTS: EMPIRICAL EVIDENCE FROM THE GERMAN FOOD SECTOR (Working Paper FE 0307, Department of Food Economics and Consumption Studies, University of Kiel, 2003), *available at* http://www.food-econ.uni-kiel.de/Workingpaper/Fe0307.pdf.

[44] The classic work on efficiency and distributive justice in antitrust is Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968). For a collection of essays on this issue, including differing views about the implications

fact that damages in antitrust are the estimated magnitude of the over-charge (monopoly) or under-charge (monopsony) suffered by the harmed party, not the deadweight loss created by the anticompetitive action. As explained by Terry Calvani, the basis for this position is the belief that, generally speaking, monopoly profits concentrate wealth, and more concentrated wealth is normatively undesirable, holding total wealth constant.[45] Of course, this proposition is not always true. A cartel of household servants would extract excess returns from the wealthy, as would a monopsony cooperative of patients in a local market for physicians' services that contained mostly families in poverty.

In most cases, monopsony harms consumers because the distortions it creates in an input market reduce efficiency in final goods markets. Single-price monopsonists are especially harmful if the motivation for monopsonistic behavior is to capture Ricardian rents or quasi-rents. While discriminating monopsonists can extract Ricardian rents without creating distortions, perfect discrimination is unlikely.

If the monopsony is created to counteract monopoly power by suppliers, its creation theoretically can benefit consumers in some circumstances, but for reasons discussed in the previous section these circumstances are not common. In any event, the outcome of bilateral monopoly is unlikely to be as efficient as the outcome of competition or vertical integration.

A. SUPERIOR EFFICIENCY AND MONOPSONY

Despite the undesirable economic consequences of all forms of monopsony, antitrust is not always the appropriate policy response. An important feature of antitrust policy is that it does not find all exercise of monopoly power illegal. In general, monopolies that are acquired through "superior skill, foresight and industry" are legal.[46] Such monopolies can set monopoly prices, although in the past they usually have not been permitted to refuse to sell to competitors in downstream markets for which their product is an essential input.[47] The rationale for this policy

---

of theories of distributive justice for antitrust policy, see ECONOMIC ANALYSIS AND ANTITRUST LAW (Terry Calvani & John J. Siegfried eds., 1988).

[45] Terry Calvani, *What Is the Objective of Antitrust?*, *in* ECONOMIC ANALYSIS AND ANTITRUST LAW, *supra* note 44, at 7, 8–9.

[46] United States v. Aluminum Co. of Am., 148 F.2d 416, 430 (2d Cir. 1945).

[47] Although monopolists are free to set monopoly prices for "essential facilities," in most cases they have not been permitted to leverage their monopoly into downstream markets by refusing to sell at any price to their downstream competitors. *See* United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912) (a case involving concerted action among horizontal competitors); United States v. Otter Tail Power Co., 410 U.S. 366 (1973) (a case involving unilateral action). Recently, however, a strongly worded Supreme Court

is that society is better off if entrepreneurs have a financial incentive to invent ways to produce better products at lower costs, even if doing so creates a monopoly. Thus, the first major issue in analyzing monopoly behavior is to determine whether the monopoly is the result of superior efficiency or anticompetitive acts.

Monopsony, too, can arise from superior efficiency. Two examples can be inferred from the preceding discussion: economies of scale of food processors in local markets for primary products, and an innovation that creates a downstream monopoly and, as a result, an upstream monopsony for an input that has no other use except for making the monopolized product. The monopsony counterpart to the essential facilities doctrine is that a monopsonist would bear some obligation to treat sellers on a nondiscriminatory basis, and specifically would not be permitted to leverage its monopsony power into creating a monopoly in the upstream input.

1. *Primary Products*

For primary products, local monopsony arises when economies of scale produce only one or a very few local firms that acquire the product as an input. If primary product markets are local but final goods markets are not, local monopsonists may compete in a larger market. Thus, a single pipeline may be the most efficient market structure for delivering oil or natural gas from many wells to a final consumption market that is served by several pipelines, or a single plant may be the most efficient local market structure for meat packers. The symmetric policy to monopoly antitrust doctrine is that in these cases monopsony is legal, despite the fact that it may harm consumers by creating national production inefficiencies. If policy is to seek to correct this problem, the appropriate response is economic regulation, not antitrust.

In *Standard Oil*[48] some of Standard's monopsony power arose from ownership of pipelines that were the only method of transporting crude oil from a particular field. Thus, Standard could exercise monopsony power in buying oil from wells. Because this monopsony was natural (arising from economies of scale in pipelines and Standard's first-in advantage), sellers of oil did not have a valid antitrust claim; however, policy could intervene to regulate field prices. In addition, Standard enjoyed monopsony power because of its monopolization of national refining. Thus, Standard could extract monopsony rents from indepen-

---

opinion all but abandoned the essential facilities doctrine. *See* Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, 124 S. Ct. 872, 879 (2004).

[48] Standard Oil Co. v. United States, 221 U.S. 1 (1911).

dent pipelines from other fields. Because Standard's monopoly and monopsony in refining were due to mergers and acquisitions, not superior foresight and efficiency, independent pipelines did have a valid antitrust claim.

In the *American Tobacco* case[49] the ability to control raw tobacco prices arose from an agreement among tobacco companies to fix prices in local tobacco markets. Again, this monopsony power was illegally acquired, so that sellers in raw tobacco markets had a valid antitrust claim.

2. *Labor Markets: Sports*

Labor markets present a somewhat different set of problems because of the legality of unions as a means for monopolizing labor markets. For professional athletes, the source of the monopsony power they face is the horizontal agreement not to compete by teams in a league. Leagues are a means of coordinating schedules and playing rules for the purpose of organizing a championship season in a particular sport. Effectively performing this function does not require collusion in either a product market (e.g., collective sale of broadcast rights[50] and collective decisions about team locations[51]) or an input market (players, stadiums). Leagues have defended rules that limit competition among teams in two ways: that restrictions on competition are necessary to achieve competitive balance, and that for purposes of antitrust leagues are "single entities" in the sense of *Copperweld.*[52]

The competitive balance defense is based on the argument that in order for a league to be attractive to consumers, teams must be similar in quality so that the outcome of a game is uncertain and that all teams are perceived as having a real chance at becoming champion. Leagues have argued that to assure competitive balance, leagues must adopt rules that prevent teams with more potential revenues from dominating teams with less potential revenues. In particular, league rules that create monopsony in player markets by assigning the exclusive right to negotiate with all or most players to only one team are asserted to contribute to competitive balance and hence enhance the welfare of fans. This argument amounts to the claim that collusion by teams in sports leagues is justified because it is efficient and improves the welfare of consumers.

---

[49] *See* American Tobacco Co. v. United States, 328 U.S. 781 (1946).

[50] *See* Ira Horowitz, *Sports Broadcasting, in* GOVERNMENT AND THE SPORTS BUSINESS (Roger G. Noll ed., 1974).

[51] *See* JAMES QUIRK & RODNEY D. FORT, PAY DIRT: THE BUSINESS OF PROFESSIONAL TEAM SPORTS 298–301 (1992); Roger G. Noll, *The Economics of Promotion and Relegation in Sports Leagues: The Case of English Football*, 3 J. SPORTS ECON. 169 (2002).

[52] Copperweld Corp. v. Independence Tube Co., 467 U.S. 752 (1984).

This line of argument is rejected by virtually all economic studies of professional sport.[53] The structure of the player market does not affect competitive balance under the following conditions: (1) teams can buy, sell, and trade player contracts; (2) the transactions cost of a competitive player market and in a monopsonized market of negotiating contracts and trading players do not differ appreciably; (3) the number of teams is large enough to make markets for players and player contracts structurally competitive; and (4) teams are business oriented in the sense that either teams maximize profits or maximize wins subject to a budget constraint that is determinjed by owner wealth plus team revenues.[54] Under these conditions, the Coase Theorem applies: the assignment of ownership of an asset (here, a player's human capital) will not affect the ultimate allocation of that asset in a competitive market. In fact, transactions costs probably are higher under the player reservation system, with its two separate negotiations—between a player and a team, and then between teams to trade player contracts. Thus, there is no basis for the claim that anticompetitive restrictions in the player market enhance efficiency by promoting competitive balance.

The single-entity argument asserts that teams in a league should be regarded as divisions of the same business entity for purposes of antitrust analysis. The essence of this argument is that team sports differ from other businesses in that the welfare of each team depends on the operation of the other. Games require coordination between the two teams that are playing, and the production of a league product—a championship season—requires coordination by all teams. Hence, efficient operation of a league requires a degree of coordination among member teams that is not consistent with competitive behavior.[55] The single-entity argument has both a formal and a substantive weakness.[56] Formally, in all

---

[53] For the seminal theoretical contributions, see Simon Rottenberg, *The Baseball Players' Labor Market,* 64 J. POL. ECON. 242 (1956); Mohamed El-Hodiri & James Quirk, *An Economic Model of a Professional Sports League,* 79 J. POL. ECON. 1302 (1971). For empirical studies showing that changes in the extent of competition in player markets have no effect on competitive balance, see QUIRK & FORT, *supra* note 51, at 240; Roger G. Noll, *Professional Basketball: Economic and Business Perspectives, in* THE BUSINESS OF PROFESSIONAL SPORTS 18 (Paul D. Staudohar & James A. Mangan eds., 1991); Daniel Sutter & Stephen Winkler, *NCAA Scholarship Limits and Competitive Balance in College Football,* 4 J. SPORTS ECON. 3 (2003); Stefan Szymanski, *Income Inequality, Competitive Balance, and the Attractiveness of Team Sports: Some Evidence and a Natural Experiment from English Soccer,* 111 ECON. J. F69 (2002). For a compendium of articles on competitive balance, see 3 J. SPORTS ECON. 111 (2001). For a recent survey of the research literature, see Allen R. Sanderson & John J. Siegfried, *Thinking about Competitive Balance,* 4 J. SPORTS ECON. 255 (2003).

[54] For an analysis of the relevance of owner objectives to competitive balance, see Rodney Fort & James Quirk, *Owner Objectives and Competitive Balance,* 5 J. SPORTS ECON. 20 (2004).

[55] For a comprehensive statement of this argument, see Gary R. Roberts, *The Case for Baseball's Special Antitrust Immunity,* 4 J. SPORTS ECON. 302 (2003). For a partial endorsement

successful leagues, teams are independently owned, although some unsuccessful leagues own the teams. Successful leagues are joint ventures of independent teams. Substantively, while organization into a league adds value to team sports, this value arises from creating common playing rules and schedules. One also can argue that forms of revenue sharing that reduce the inequality among teams in their incentive to acquire star players also contributes to competitive balance and so improves the welfare of at least some consumers and thus is a legitimate restriction to be imposed by leagues. But the added value arising from cooperation in buying inputs and selling outputs, because it does not improve competitive balance or otherwise increase the value of the sport to fans, arises purely from eliminating competition.

Because both the competitive-balance and single-entity arguments depend on an efficiency claim that is not supported by economic analysis, collusion among teams in sports leagues to create monopsony power in the player market should be regarded as an anticompetitive abuse. Notwithstanding that sports leagues have managed to procure antitrust exemptions for some of their collusive behavior, nearly all scholarly analysis of sports labor markets conclude that restrictions on competition in markets for professional athletes are anticompetitive abuses.[57]

Until fairly recently, except for the anomalous case of baseball,[58] courts have agreed with the preceding analysis, holding that rules that prevent players from offering their services in an unfettered market are anticompetitive.[59] Nevertheless, recently the nonstatutory labor exemption to antitrust has been applied by the courts largely to remove player markets from antitrust supervision as long as the players are unionized. Regardless of the legal merit of these decisions, insisting that players choose either unionization or antitrust, but not both, as their sole weapon to combat monopsonization of sports leagues is likely to be a bad policy outcome.

---

but partial rejection of this argument by economists, see Michael A. Flynn & Richard J. Gilbert, *The Analysis of Professional Sports Leagues as Joint Ventures,* 111 ECON. J. F27.

[56] For a more complete discussion of the problems with the single-entity argument, see Roger G. Noll, *The Organization of Sports Leagues,* 19 OXFORD REV. ECON. POL. 530 (2003). The courts also thus far have rejected the single entity argument. *See* Los Angeles Mem. Coliseum Comm'n v. Nat'l Football League, 726 F. 2d 1381, 1388 (9th Cir. 1984).

[57] For a recent summary of the arguments that restrictions against competition by sports leagues are anticompetitive and references to other articles on the topic, see Stephen F. Ross, *Competition Law as a Constraint on Monopolistic Exploitation by Sports Clubs and Leagues,* 19 OXFORD REV. ECON. POL. 569 (2003).

[58] *See* Flood v. Kuhn, 407 U.S. 258 (1972); Federal Baseball Club of Baltimore v. Nat'l League of Prof'l Baseball Clubs, 259 U.S. 200 (1922).

[59] *See* Radovich v. NFL, 352 U.S. 445 (1957); Philadelphia World Hockey Club v. Philadelphia Hockey Club, Inc., 351 F. Supp. 462 (E.D. Pa. 1972); Mackey v. NFL, 543 F.2d 606 (8th Cir. 1976); Robertson v. NBA, 566 F.2d 682 (2d Cir. 1977).

In the normal unionized industry, a union is a means for creating market power and negotiating wage agreements that produce superior results for labor compared with markets. Whereas some unions arose because local labor markets were monopsonized, the more common examples of unionization arose in competitive labor markets. The labor exemption for collective bargaining is most properly viewed as a mechanism to facilitate a process that, whether rightly or wrongly, seeks to give an advantage to labor in comparison with a competitive market, not as a mechanism to protect market rules that were designed through horizontal collusion among competing firms to the disadvantage of labor.

Labor markets in which workers are heterogeneous and typically negotiate individual contracts are rarely effectively unionized, and as a result sports labor unions were difficult to organize. Historically, sports labor unions were created largely in response to monopsonistic policies of leagues.[60] In sports the purpose of unions is to create countervailing power against monopsony sports leagues, and the result is to reduce (never to eliminate) monopsonistic practices, thereby producing an outcome that is less beneficial to labor than a competitive market outcome.

Historically, player unions have financed and managed antitrust cases against leagues and then used victories in antitrust litigation as the basis for negotiating more relaxed player market rules. In all cases the ex post rules have restricted competition in ways that, in the absence of the nonstatutory labor antitrust exemption, would be anticompetitive horizontal agreements.

In the 1980s the courts grew increasingly unwilling to hear antitrust cases involving sports labor markets, ruling that the nonstatutory labor exemption applied to all labor market practices by management as long as a collective bargaining relationship existed, regardless of whether these practices had been negotiated or were part of the collective bargaining agreement.[61] These rulings created the requirement to abandon

---

[60] See PAUL D. STAUDOHAR, THE SPORTS INDUSTRY AND COLLECTIVE BARGAINING (1986), for complete histories of the formation of unions in professional team sports.

[61] The scope of the labor exemption has two parts: which matters are shielded from antitrust by the presence of a collective bargaining agreement, and when the antitrust exemption applies. Initially courts answered the first question by asking whether the issue genuinely was negotiated, and the second by allowing antitrust suits if the issue had not been negotiated, even if a collective bargaining agreement was in force. In *Powell v. NFL,* 930 F.2d 1293 (8th Cir. 1989), the court rejected this approach. Instead, the court ruled that non-negotiated terms that are imposed jointly by owners after bargaining has reached impasse are still protected by the non-statutory labor exemption as long as the terms are "conceived in an ongoing collective bargaining relationship." *Id.* at 303. The dissent argued that this standard amounted to requiring that a union decertify. *Id.* at 1306 (Heaney, J., dissenting), and in fact the National Football League Players Association promptly decerti-

unionization in order to pursue an antitrust complaint against employers. This requirement is a costly one because unions in professional sports perform many functions other than collective bargaining about player market rules, including group licensing for product endorsements and participation in disciplinary proceedings involving players. Players are unlikely to abandon unions unless player market rules become quite Draconian. Thus, after a long string of successful cases by player plaintiffs, antitrust is all but dead as a means of attacking a player market monopsony.

3. *Labor Markets: Physicians*

Physicians face an even more confining constraint, as discussed extensively by Blair and Herndon.[62] The physicians' nemesis is managed care organizations that have sufficient monopsony power to force physicians to lower their fees. Because these monopsonists generally have not attained monopsony power by illegal means, antitrust is unavailable to physicians as a means to create more competition and hence higher fees. But likewise, neither is unionization available, because organizations of professionals are ineligible for collective bargaining because they are not employees of insurers.

As a general matter, the physician's plight probably is the result of a proper antitrust policy, and the present application of the nonstatutory labor exemption to professional sports is a poor precedent to extend to other occupations. A right to exercise market power, whether statutory as in the case of labor, or through superior foresight and efficiency in the case of an insurer, should not create a right to use otherwise anticompetitive means to exercise countervailing market power without an explicit political decision to do so in the form of special legislation. Most likely, the best solution to the problem of a durable monopoly or monopsony will be a form of regulation, rather than an antitrust exemption for the other side of the market. Converting monopoly or

---

fied and filed an identical suit that it eventually won. *See* McNeil v. NFL, 790 F. Supp. 871 (D. Minn. 1992). The union then recertified to renew negotiations from the baseline of the court's decision, and the resulting agreement included unrestricted free agency for most veteran players. In *Brown v. Pro Football, Inc.*, 518 U.S. 231 (1996), the Supreme Court ruled that the absence of bargaining about some aspect of player market rules was irrelevant but fell short of requiring decertification. The court rejected lifting the exemption at "impasse" in the bargaining relationship, *id.* at 244–45, but refrained from adopting a bright-line test for termination of the exemption. *Id.* at 250. It stated that the nonstatutory labor exemption was in force until the bargaining relationship ceased to exist, although the union might still exist. *Id.* Thus, the upshot of *Powell* and *Brown* is that players must choose one of two mutually exclusive routes to overcome monopsony in the player market: antitrust or collective bargaining.

[62] Blair & Herndon, *supra* note 36.

monopsony into bilateral monopoly does not so clearly improve efficiency in a wide spectrum of cases that it should be a valid "efficiency defense" against antitrust complaints. Likewise, whereas participants in multi-unit bargaining have an efficiency rationale for joining together for industrywide bargaining, no such rationale exists for using joint industrywide bargaining as a mechanism for converting a competitive labor market into a monopsony.

B. Big-Box Retailers and Price Discrimination

The source of market power for big-box retailers is a series of technological innovations in the physical layout of retail stores, services provided to customers, and management systems used to control inventories. Big-box retailers have lower costs (regardless of the presence of monopsony power) and lower prices. Although they generally are less conveniently located, provide less in-store service, and have less selection within a product category, they nevertheless appeal to a large number of consumers because of their low prices. The monopsony power of the most successful big-box retailers arises primarily because their way of doing business has given them a large market share in some product lines.

One aspect of the policy debate about big-box retailers, which is similar to the issues in the original *A&P* case,[63] is whether a big-box retailer violates the antitrust law when it extracts a lower price from a supplier than the supplier charges to other retailers, or when big-box retailers manage to extract lower prices from some suppliers than from others, due to differences in market power among sellers. Symmetry with policy towards monopolists would lead to a policy in which big-box retailers can exercise monopsony power over input prices without creating antitrust liability. On the other hand, some producers of consumer products that supply big-box retailers would like to see symmetrical application to buyers of the principles of the Robinson-Patman Act, which prohibits price discrimination by sellers. According to their argument, symmetrical application of these principles would prohibit big-box retailers from extracting more favorable prices than those charged to other buyers or paying different prices to different suppliers of the same product. The effect of this policy would be to eliminate the all-or-nothing contracts that big-box retailers now offer to their suppliers. Typically, these contracts produce an average price that is below the price that the same supplier charges others, and typically the magnitude of the price reduction increases with the size of the contract, causing average prices to big-box retailers to differ among sellers of the same product.

----

[63] United States v. New York Great Atl. & Pac. Tea Co., 173 F.2d 79 (7th Cir. 1949).

Because "meeting competition" is a defense against Robinson-Patman liability for price discrimination by a seller, the all-or-nothing contracts offered by big-box retailers are now protected because these contracts emerge from competition among sellers to be part of the retailer's inventory.[64] This exception to Robinson-Patman creates an asymmetrical policy. Symmetry in the treatment of price discrimination would require repealing the "meeting competition" defense but placing liability on the buyer, not the seller. Such a policy change would be virtually certain to harm consumers.

From the standpoint of consumer welfare, all-or-nothing contracts generally are preferable to single-price monopsony because, unlike the latter, the former cause some of the monopsony price reduction to be passed on to final consumers. Thus, interpreting or extending the Robinson-Patman Act to prohibit monopsonists from offering all-or-nothing contracts is likely to be harmful to consumers. The forms of price discrimination by suppliers that the Robinson-Patman Act prohibits are controversial because their effect on consumers is ambiguous. Standard price discrimination benefits some consumers and increases efficiency, but it harms other consumers, transfers more wealth to the monopolist, and can be used against downstream competitors to leverage monopoly into other markets.

The goal of monopsonistic price discrimination is to extract different amounts of Ricardian rents or quasi-rents from different sellers. Distributive justice provides no basis on which to conclude that society should care very much whether buyers or sellers capture Ricardian rent. Although long-run economic efficiency implies protecting quasi-rents, in the long run monopsonists have a positive incentive to keep suppliers in business, and so will find it in their interest to make certain that purchase contracts enable suppliers to recover their costs. Thus, only if one accords the same normative status to the transfer of Ricardian rents that one accords to the wealth that monopolists acquire from consumers can monopsonistic price discrimination be as ambiguous in its welfare consequences as monopoly price discrimination. Otherwise, the price discrimination that arises from all-or-nothing contracts is welfare-enhancing. The danger of policies that assign greater weight to producers' rent than to buyers' surplus is that it leads to policies that stifle competition and innovation on the supply side of the market. No

---

[64] Thus, "a buyer who has done no more than accept the lower of two prices competitively offered does not violate § 2(f) provided the seller has a meeting competition defense." Great Atl. & Pac. Tea Co. v. FTC, 440 U.S. 69, 81 (1979).

corresponding danger arises in the case of monopoly extraction of wealth from consumers.

In the *A&P* case the government alleged that A&P and its officers were guilty of a criminal violation of the antitrust laws "by oppressing competitors through the abuse of the defendants' mass buying and selling power."[65] A&P was found to have violated the antitrust laws because its lower input prices enabled it to charge lower retail prices, and its lower retail prices put some competitors out of business and thereby increased A&P's market share in final product markets. Thus, the fact that A&P induced suppliers to practice price discrimination in its favor was regarded as harmful because it allegedly reduced competition in the retail market.

Most antitrust scholars have concluded that the *A&P* case was wrongly decided. Like big-box retailers, A&P, as the first grocery chain, realized efficiency gains that enabled it to offer greater product variety and lower prices, which in turn gave it sufficient market share that it could exercise monopsony power in some wholesale food markets. The ultimate source of A&P's market power was superior technology that later was copied successfully by others. The A&P innovation did not cause the retail grocery store market to be monopolized, but it did cause a dramatic change in the identities and characteristics of the successful suppliers. Now that the *A&P* decision is a dead letter and private label foods are a common feature of grocery chains, any claim that consumers are worse off because grocery chains successfully acquire low-priced private-label foods justifiably would be greeted with great skepticism.

The concerns about Wal-Mart parallel the thinking that gave rise to the *A&P* case. While the ultimate outcome of the big-box retail sales innovation has yet to be played out, Wal-Mart hardly is the only firm that has adopted this strategy. Thus far, Wal-Mart is simply the most successful. At this point, a plausible long-run consequence of the Wal-Mart innovation is that several chains of big-box retailers will displace a variety of existing retail stores, including, perhaps, some chain grocery stores and department stores, as well as small, independent shops. At the local level, one can imagine a community legitimately deciding that a big-box retailer imposes a sufficiently large external cost on downtown retail districts to be unacceptable, but this argument is distinct from the competition policy issue and so does not support a national policy to curtail the exercise of monopsony power by big-box stores.

---

[65] *A&P,* 173 F.2d at 82.

Here the history of Toys "R" Us (TRU) is instructive. TRU is a form of specialized big-box retailer, featuring a very large inventory of toys, a warehouse-like atmosphere, and minimal customer service, but low prices. The success of TRU in acquiring a large share of toy retailing enabled it to exercise buyer power, acquiring toys from major suppliers at less than the prices paid by others. Toys generally are not homogeneous products, so to the extent that TRU extracted greater price concessions than were justified by cost, the effect was to extract the quasi-rents of product-differentiated toy suppliers.

With the rise of membership warehouse stores, such as Costco and Sam's Club, TRU apparently feared that its market position was threatened, and sought to choke off the threat by forcing toy manufacturers to forgo selling to either TRU or membership discount stores. The Federal Trade Commission successfully challenged this practice, which went beyond extracting price concessions to actually obtaining an agreement not to do business with competitors.[66] Here the FTC was probably correct to create a parallel between monopsony and monopoly in cases where market power is not obtained by anticompetitive means. As in *Terminal Railroad*,[67] TRU could exercise market power to earn greater profits, but it could not engage in collusion to preserve its power. Meanwhile, TRU has faced increasingly intense competition from both membership discount stores and other big-box retailers. Over the last few years it has closed 25 TRU and 42 Imaginarium retail toy stores, and its profits have fallen by about 80 percent.[68] The monopsony power enjoyed by TRU was relatively quickly eroded by competition.

IV. CONCLUSION

Monopsony is an important area of antitrust for precisely the same reason that monopoly is important. The exercise of monopoly power almost always causes inefficiency and always harms at least some consumers; the effects of monopsony are basically the same. Consequently, policy should be symmetrical. Whereas one can imagine circumstances in which the existence of either monopoly or monopsony is a valid excuse for creating the other, in general, bilateral monopoly is unlikely to maximize welfare and, in any event, is likely to be regarded as inferior

---

[66] Toys "R" Us v. FTC, 221 F.3d 928 (7th Cir. 2000). One court distinguished *A&P* because A&P (like TRU) "was also found to exert pressure on suppliers either not to deal or to alter their dealings with A&P's competitors." Travelers Ins. Co. v. Blue Cross of W. Pa., 481 F.2d 80, 85 (3d Cir. 1973).

[67] United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912).

[68] Toys "R" Us, 2003 Annual Report, *available at* http://media.corporate-ir.net/media_files/irol/12/120622/reports/2003AR_low-res.pdf.

to merger by both parties, and as inferior to competition on both sides of the market by consumers. Thus, prohibiting the acquisition of monopsony power through anticompetitive means, regardless of the state of competition on the supply side of the market, is consistent with the general purposes of antitrust law.

The argument that antitrust law should look more favorably upon buyer cartels is unambiguously correct in only one case: when supply is monopolized, and the technology of the supplier exhibits constant returns to scale with no significant sunk costs. Moreover, even in this case, bilateral monopoly is unlikely to be efficient, or even stable, because both sides of a bilateral monopoly are likely to prefer vertical integration. The view that buyer cartels benefit consumers by passing-on lower input prices is simply wrong as a general proposition, notwithstanding the court opinions that express this view.

Perhaps the most difficult policy challenge arises when localized natural monopsonies seek to extract Ricardian rents, such as in agriculture and other resource-based industries. Local monopsony when market power is not present in a national or regional final product market causes harm to consumers by misallocating production among localities. Thus, policy should firmly oppose mergers or cartels for extracting Ricardian rents, as is consistent with antitrust precedent since the early 20th century.

Notwithstanding the efficiency losses and wealth transfers that accompany monopsony, a Robinson-Patman-like prohibition against monopsonistic price discrimination is unwarranted. Prohibiting a legally acquired monopsony from obtaining lower prices than other buyers, or from buying the same product from different producers at different prices, worsens the distortions arising from monopsony in both the input and final goods markets. The objective that such a prohibition would serve—reducing the transfer of Ricardian rent from suppliers to the monopsonist—has no generally applicable normative justification (unlike the normative justification for transferring monopoly profits back to consumers).