Amazon and Antitrust Law

An Economic Analysis of Amazon's Monopolistic Traits

Anthony DiCioccio

I. Introduction

Since 1890 U.S. antitrust policy has continually evolved. The foundational legislation related to such policy was set forth in the Sherman Antitrust Act. Following this legislation, there have been numerous acts as it relates to the antitrust policy, e.g., The Clayton Act (1914) the Robinson-Patman Act (1936), the Federal Trade Commission Act (1914). In addition to legislative actions, the federal judiciary has interpreted the application of these policy pronouncements. More recently, regulatory agency actions, legislative pronouncements, and judicial decisions have significantly impacted antitrust policy enforcement. In fact, since the 1980's. In a recent article written by Adam Levine Weinberg, Weinberg asserts that Amazon has violated U.S. Antitrust law[1]. Others have suggested the same, including a 2017 article published by Bloomberg.com, and the Trump administration[2]. This paper suggests that the findings of Adam Weinberg are flawed; Amazon is not a monopoly.

This paper proceeds as follows. Section II provides background information and context for purposes of examining Amazon in the marketplace from a legal and economic perspective. Section III analyzes from an economic perspective Amazon's position in the marketplace. Section IV concludes that Amazon, while a large company, is not a monopoly.

II. Background

[1] See, Adam Levine – Weinberg. *Amazon Could Have a Very Real Antitrust Problem*. The Motley Fool. 10/14/2018
[2] See, Barry Ritholtz. *Amazon, Monopoly and Lame-Duck Presidents. Bloomberg*. 07/31/2017

Antitrust laws originated in the U.S. in the late 19th and early 20th century and have had a massive impact on the way corporate America conducts business. The U.S. Antitrust laws prohibit price-fixing and attempts to monopolize markets. Of particular note and the foundation for all U.S. Antitrust laws is the Sherman Act of 1890.[3] "An act to protect trade and commerce against unlawful restraints and monopolies" (Transcript from Sherman Act). The act was named after Senator John Sherman of Ohio who was also the Chairman of the Senate finance committee and Secretary of the Treasury under President Hayes. The bill passed the Senate with a 51-1 vote and a unanimous 242-0 vote in June of 1890. In 1914, the Clayton Act[4] was signed into law, which imposed criminal and civil sanctions on corporations caught, among other things, conspiring, attempting to monopolize or throttle trading. Overall, these acts and other related antitrust legislation were designed to foster competition and prohibit unfair trade, which the government deems damaging to the marketplace.

While antitrust laws were successful in their task of preventing the perversion of the free market, early sanctions for violations we relatively weak. As weak as the sanctions were, they served as a highly visible example and deterred cartels and tacit collusion. However, courts would on occasion misinterpret economic evidence such as the U.S. Steel monopoly case[5]. The Supreme Court did not acknowledge U.S. Steel Corporations monopolistic pricing because its competitors were silent in its shadow. The Supreme Court decision effectively crushed any opportunity for new sellers to gain entry into the steel market for some time.

[3] Sherman Act, 26 Stat. 209, 15 U.S.C. §§ 1-7
[4] Clayton Act, 15 U.S.C. §§ 12-27, U.S.C. §§ 52-53
[5] United States v. United States Steel Corp., 251 U.S. 417 (1920)

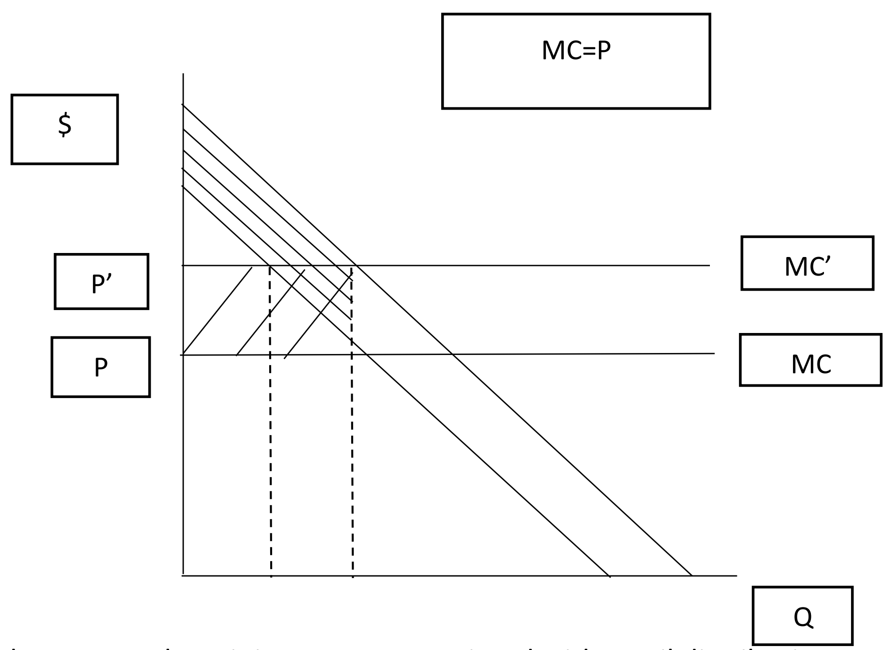
Monopolies are dominance over the supply of a good either through exclusive physical or legal ownership. The effect of a monopolistic corporation can be profound and have an adverse effect on trade and commerce within a free market. As a true profit maximizing seller, they will continue expanding their output so long as an additional unit sold adds more to their total revenue than to their total cost, however, the true profit maximizing output is where the quantity at which marginal revenue is equal to that of marginal cost. As we will examine shortly, monopolies rely heavily on market elasticity in order to maximize output and profit.

While monopolies are provocative and the origin of much economic antitrust analysis, they are rare. Much more common and applicable to our study are oligopolies, which are markets in which few firms account for the majority of sales. Often, we see oligopolies maintaining striking similarities to cartels without the obvious facilitation of collusion and the like.

A cartel can be defined as a group of sellers of a similar (or the same) product limiting their output under a contractual agreement. The contract is expected to make the group of producers better off by creating monopoly profits at the expense of the consumer. However, it is important to note, cartels are highly unstable organizations that fall perfectly into game theory. If the agreement between the producers is unenforceable cartel members have an incentive to cheat or form a single firm to achieve monopoly pricing without being obligated to contractual agreements.

As it relates to retail it can be proven that economic welfare is strengthened by resale price maintenance. This is where a manufacturer will contract retailers and resellers of their goods in order to prevent them from underselling the corporation, while this is illegal per se as per the Supreme Court. This model of price fixing does leave some consumers better off namely those who are first time buyers because retailers and resellers will provide services and incentives to outclass the manufacturer however, consumers who wait end up paying a higher price because they value services at less than the price they are paying. Another benefit to the consumer albeit a marginal benefit, is the increase in quality of the product being offered and is often enhanced by presale services and bundles offered by retailers. To provide a visual depiction reference figure 1-1 below.

Figure 1-1



While MC=P can be seen as the minimum cost associated with retail distribution. We see P’ and MC’ is the new cost of distribution which provides presale services, D’ is the new demand for the good with the incorporation of the new services. As the demand curve shifts to the right the consumer will be worse off because the price will increase in order to match the marginal cost of manufacturing the product.

Firms on the other hand produce aim to produce to the point where marginal revenue is equal to that of marginal cost being as the competitive price is equal to marginal cost as we previously established in figure 1-1. However, more relative to the firm in relation to monopolistic price is the measure of the elasticity of demand as it relates to profit maximization. A useful formula that can accurately measure the power a monopoly has is the elasticity of demand facing a firm. This equation can be calculated by dividing the elasticity of demand facing the market by the market share of the firm plus elasticity of supply of the other firms in the market multiplied by the product of one minus the market share of the firm divided by the market share of the firm.

$$edf=edm/S+es(1-S)/S$$

Relative to monopolies, if the firm has one hundred percent of the market elasticity of demand facing the firm is equal to elasticity of demand facing the market.

In an October 2018 article Levine-Weinberg argue that, Amazon violates the antitrust laws, given its sheer size in on-line retail vis-à-vis other on-line retailers. In addition, Amazon is able to cross-subsidize its activities in other markets.[6] Levine-Weinberg position is further supported by statements from retail analysts such as Mark May arguing “Amazon’s $1 trillion valuation (which has fallen back to $850 billion) makes it a target”. The article goes on to state that while “Amazon is an essential sales channel for many small companies that develop unique products. No other internet retail platform has equivalent reach”. The company does this while

[6] See, Appendix, Infographic of Amazon, depicted on pg. 9 of this thesis.

also advertising its own private label alternatives to some products listed on its website. The main argument the article makes is that "Amazon is just driving prices down by competing with third-party sellers on its platform". Mr. Weinberg argues that this limits consumer options and in turn drives competition out of business and goes on to compare the issue to Microsoft's Internet Explorer browser option in the late 1990s.

III. Economic Analysis

While Mr. Weinberg makes valid points, these statements need to be evaluated with the due diligence that can only be provided through economic analysis complimented by monopoly characteristics and theory. Like any company Amazon's goal is profit maximization, in order to accomplish this a profit-maximizing seller will continue to expand their output as long as an additional unit sold adds more to their total revenue than to their total cost[7], it's also worth noting the profit-maximizing output itself is the quantity at which marginal revenue is equal to that of marginal cost. Simply because a corporation is successful at applying the profit maximization theorem does not qualify it as a monopoly. We need to look at the barriers to entry to the online retail market which consist of purchasing a domain name, producing and shipping product and several other small tasks. This pales in comparison to breaking into the airline industry or automobile manufacturing where there are monstrous fees, licensing, and securing of patents and intellectual property before being able to even consider beginning operations. Supplementing this is the high cross-elasticity of demand for products offered by the company, if the corporation were monopolistic it would always sell in the elastic region of its demand curve, selling in the inelastic demand would mean that raising price would not cause

[7] See, Richard A. Posner. *Economic Analysis of Law 9th Edition*. Ch. 9.1 (pg. 332)

a fall in output. Simply put, Amazon cannot raise prices to extremes without losing a substantial amount of output to substitutes and competitors in the online retail industry. Similar to what the cellophane market went through in the 20^{th} century[8].

So, it's safe to say becoming an online retailer of goods has relatively low barriers to entry and ease of entering the market. One could argue that because of Amazon's size it can be considered a natural monopoly which is where the seller can supply the entire market at a lower cost than multiple sellers. Economically speaking we know that under monopolistic constraints output is smaller because often monopoly price pushes consumers towards substitutes also driving competition from the market. However, Amazon does not always have the lowest price for all its goods offered, nor does it offer a product for all goods listed on its website, thus eliminating it from this category.

Later in the article, we find our author, Mr. Weinberg, calling for the dismantling of Amazon, effectively separating the company into two or more divisions; retail division and advertising division. He argues that this would cause "dis-synergies" within the company and provide competitors with an opportunity for growth. In a direct quote from the article, "Amazon's revenue from sponsored product ads more than doubled last year. One analyst thinks the ad business could be generating $22 billion of revenue and $16 billion of operating profit annually by 2021"[9]. The separation of advertising from the retail aspect of the company would undoubtedly cause a ruckus. However, the opportunity to collude and form a cartel with

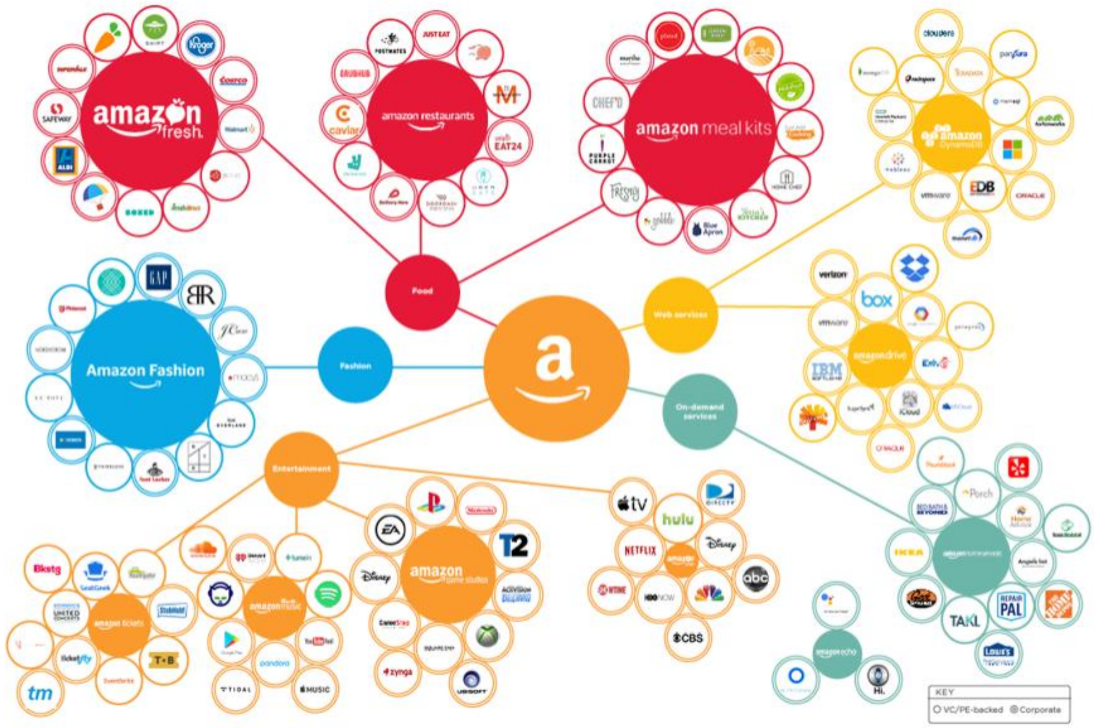
---

[8] See, Richard A. Posner. *Economic Analysis of Law 9th Edition*. Ch 10.7. (pg. 369)
[9] See, Adam Levine – Weinberg. *Amazon Could Have a Very Real Antitrust Problem*. The Motley Fool. 10/14/2018

other online retailers would then present itself, which may indeed be the stronger of the two evils.

As we all know, cartelization leads to unavoidable price fixing within the market, there are a number of factors that would act as the “canary in the coal mine” if this were to occur. The first would be the number of sellers, the fewer the number of sellers in the market the lower the cost of coordinating the cartel. The second piece would be a bit more complex in nature, determining the percentage of profits kept by each colluder depending on the size and contribution to the activities. Next, the homogeneity of the product then comes into question, because the more homogeneous the product the more difficult it is to cheat and any alterations in quality, quantity, or price between colluders would be noticed by consumers and producers alike. The elasticity of demand as it pertains to price would then come to question, the less elastic the product at a competitive price the greater profit will be in the cartel. The condition of entry is also a significant factor because it has a drastic effect on the elasticity of demand, the more rapidly competitors can enter the market the greater the loss of profit for those colluding. State of the market weighs heavily on profits as well, if the market is growing, cartelization is difficult whereas a declining or stagnant market is preferable, entry during a declining market has little threat to a cartel. High ratios of fixed and variable costs, changes in price and frequency of changes, and the structure of the market all weigh heavily on the buying market during a cartel. Interestingly enough, there are several other symptoms of cartelization as it would relate to international corporations such as Amazon. It’s also worth noting antitrust cases against intricate and well-planned collusion depends entirely on economic evidence which would is likely to be misunderstood or misinterpreted by the court due to the economic

Fig 1-2



sophistication of the topic. To ensure the proper amount of regulation to a market court should seek council in well-established economists for analyzation of empirically related evidence.

IV. Conclusion

If Amazon were to be dismantled and broken up in order to allow smaller online retailers to “grow” or take advantage of the power vacuum opportunity presented it would also cause massive losses for its affiliate retailers. As we can see in figure 1-2, the ripple effect of breaking up the company would be felt throughout multiple regions of the country and in various industries. So, if the Supreme Court were to dismantle one corporation it would ultimately put multiple in jeopardy.

In conclusion, the purpose of this paper is to perform an economic analysis on the issue of U.S. antitrust law as it relates to online retailing, specifically Amazon.com, Inc. our findings show after conducting a thorough analysis of Amazon and contrasting it to the theory of monopoly and antitrust doctrine as interpreted by Dr. Posner, Amazon cannot be considered a monopoly merely because of its size and profits. The monopolist as we find it is determined by a corporation's hold on the market (in this case online retail) and control of the quality, quantity, and demand of a product.