



May 8, 2014

## Cross-Border Price Regulation: Anti-Competition Policy?

Report of the C.D. Howe Institute Competition Policy Council

A recent federal proposal to legislate against cross-border price discrimination is profoundly wrong-headed in approach and should not proceed. This is the consensus view of the C.D. Howe Institute's Competition Policy Council, which held its seventh meeting on April 25, 2014.

The proposed federal legislation would address price differences across borders that are not "justified by higher operating costs in Canada," and give the Commissioner of Competition power to enforce the new framework. Such an approach would be deeply impractical to implement, prove ineffective in achieving its aims, harm consumers, and be costly to government and to business, concluded the Council.

The Competition Policy Council comprises top-ranked academics and practitioners active in the field of competition policy. The Council, chaired by Finn Poschmann, Vice President, Research, at the C.D. Howe Institute, provides analysis of emerging competition policy issues. Professor Edward Iacobucci, Osler Chair in Business Law at the University of Toronto and Competition Policy Scholar at the Institute, advises the program, along with Benjamin Dachis, Senior Policy Analyst. The Council, whose members participate in their personal capacities, convenes a neutral forum to test competing visions and to share views on competition policy with practitioners, policymakers and the public.

**At Issue** The February 2014 federal budget stated, on page 182, that it "... intends to introduce legislation to address price discrimination that is not justified by higher operating costs in Canada, and to empower the Commissioner of Competition to enforce the new framework."

At the April 25 meeting, the Council addressed the following questions: When is price discrimination economically efficient? when is it not? and when should law and policy seek to prevent it? Is there an economic rationale for preventing price discrimination across borders? If so, is there a way to revise the *Competition Act* so that it effectively and efficiently addresses cross-border price discrimination?

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The Council would like to thank Nicholas Li, Assistant Professor of Economics at the University of Toronto, for providing his C.D. Howe Institute *Commentary* (Li 2014) as a briefing note to the group and for participating in this meeting of the Council.

## The Economics and Policy of Price Discrimination Legislation

Recent plans to introduce legislation to address cross-border price discrimination come only five years after the federal government repealed criminal prohibitions against price discrimination, as previously contained in the *Competition Act*, among a broader package of 2009 amendments to the *Act*.

***What is Price Discrimination?*** Price discrimination occurs when a firm, reacting to predictable differences among buyers in their demand for its products, charges a significantly different price to two or more customers while costs to the seller are not significantly different (Trebilcock et al. 2002).<sup>1</sup> Price discrimination had until 2009 been a criminal offence, although rarely enforced, and 2009 amendments to the *Competition Act* removed the related language.

***When is Price Discrimination Economically Justified?*** Price discrimination is common throughout the economy, typified in the practice of charging different ticket prices, at movie theatres for example, depending on the time of day and age of customer. The Council agreed that the original removal of prohibitions against price discrimination measures was appropriate, in part because such practices often are economically efficient. When producers are able to segment consumers, based on consumers' ability or willingness to pay, they may be able to sell more and serve more customers than if they were required to set a single price. This makes moviegoers, or consumers generally, producers, and the economy as a whole better off. Moreover, while price discrimination may also lower welfare by reducing output, there is no practical way to ban only inefficient price discrimination, while allowing efficient price discrimination. Society, and the law, is better off by allowing it.

***Is Preventing Cross-Border Price Discrimination Economically Justified?*** The government is concerned with country-specific price discrimination (called country-pricing) by wholesalers and manufacturers. Cross-border price differences allow firms to pursue country-specific marketing strategies that suit supply and demand conditions and account for costs of serving markets that vary from place to place. Price differences could reflect practical and efficient price discrimination motivations, with sellers seeking higher prices in countries with greater demand for the firm's products, perhaps because of intrinsic differences in preferences, perhaps because of differences in competitive conditions.

To achieve equivalent prices across countries would require routine price changes to reflect changes in exchange rates. When prices do not adjust in this fashion, differences can arise when measured in terms of the purchasing power of the underlying currencies. Such price differences can reflect the mechanical costs of changing prices – menu costs, in economics literature. In addition, sellers may desire to keep nominal prices to customers relatively constant for other reasons, even as exchange rates fluctuate. In either case, sellers typically do not post new daily prices to reflect changes in costs caused by exchange rate movements.

There was consensus among the Council, therefore, that such factors militate strongly against an effort to enforce internationally uniform prices. The purpose of the *Competition Act* “is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada . . . and in order to provide consumers with competitive prices and product

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1 Trebilcock, Michael, Ralph A. Winter, Paul Collins, and Edward M. Iacobucci. 2002. *The Law and Economics of Canadian Competition Policy*. University of Toronto Press. Price differences that result from different selling costs in different places are not in this sense discriminatory.

choices.”<sup>2</sup> When distributors or retailers set prices to reflect local demand or cost conditions, or to keep posted prices steady in the face of exchange rate movements, that is consistent with competition. Hence, amendments that would prohibit cross-border price discrimination would not be in the spirit of the *Act*, and would contravene the letter of the *Act*'s stated purpose.

## The Problems with Regulating Cross-Border Price Differences

The group pointed to numerous potential unintended consequences if the government enacts legislation to address cross-border price differences.

***The Legislation Would Be Unenforceable:*** The Council's consensus view is that the legislation would be unenforceable. For example, it would be extraordinarily difficult to define unjustified price differences. Differences between the US and Canada are largely determined by the Canada-US exchange rate (Li 2014), and day-to-day fluctuations in that rate make it difficult to determine an obvious comparable price. Moreover, the Council members were concerned that the government has not considered the practicalities of enforcement. An enforceable law would require the Competition Bureau to identify a particular firm that was at fault for a specific set of activities, and bring a case that would meet a minimal burden of proof, which would eventually arrive at the Competition Tribunal, which would hear evidence. The likelihood of success would be extraordinarily low and fraught with risk of error.

For example, potential actions aimed at retailers would have to account for retail distribution costs, the prices charged to them by distributors or wholesalers, the latter's distribution costs, and prices charged to them by domestic and international goods producers, which would be contingent, among many other things, on exchange rates. Establishing the occurrence of malign actions on the part of a particular seller, to a credible evidentiary standard, therefore would be difficult to impossible. If a case were to be brought against a particular wholesaler or retailer, perhaps because prices for one product line were higher in Canada than in the US, the Bureau would have to ponder how to deal with a situation where the same company charged lower prices, for a different product line, than in the US. In turn, the Bureau would have to establish whether the product or products were indeed identical, perhaps through the use of Universal Product Codes. Yet, were the Bureau to do so, it would inescapably find itself in the position of seeking to regulate prices product-by-product, which would be wholly impractical and wrong-headed.

***Chilling Competition:*** The Council also felt that prohibiting cross-border price differences could have the unintended consequence of limiting choice and increasing costs for Canadian consumers. As Li (2014) demonstrates, competition among brands leads to lower prices for consumers. A move to regulate lower prices in Canada, and its corresponding risk of regulatory overreach and error, could create incentives for foreign suppliers to abandon the Canadian market, or decline to enter competitively, were enforcement action to be threatened over their pricing strategies. The potential requirement to provide cost and sales data, even in the absence of action, would create a barrier to entry by firms hesitant to share commercially sensitive information. Moreover, to require firms to charge the same price in different markets could make prices more rigid, impeding competition, and lead to higher prices everywhere.

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2 The *Competition Act*, R.S.C., 1985, c. C-34 (Section 1.1).

**Harming Canadian Export Growth:** Another potential unintended consequence is the risk to Canadian firms looking to expand abroad. If a Canadian firm that was domestically successful sought entry to an aggressively competitive foreign market such as the US or Brazil, where prevailing prices might be lower but nonetheless profitable, it might find itself at risk of legal action in Canada.

**Increased Risk of Trade Disputes:** Some members of the Council felt that the proposed legislation amounted to regulating international trade. Singling out one country – such as the US – against which to compare Canadian prices could violate international trade agreements. The alternative, to compare Canadian prices to comparable goods sold anywhere around the world – would be an impossible task. The Bureau would find itself seeking, for example, financial details of Volkswagen AG's retail distribution costs in Germany versus those elsewhere and in Canada.

**Diversion of Resources:** Lastly, Council members were concerned that creating an imperative within the Competition Bureau to investigate and enforce cross-border price differences would be an unproductive use of Bureau resources and staff, which instead could be deployed in activities that supported competitive markets. Likewise, to pursue the initiative would require businesses to respond to exhaustive information requests from the Bureau, and to develop financial data that would not otherwise be generated in the course of business. The Council in previous statements has expressed serious concern over such diversions of productive resources.

## Policy Recommendations

The Council's view was that the 2014 federal budget proposal should be abandoned forthwith, on the view that it was on its face wrongheaded and destined for costly failure.

More productive potential moves to promote competitive markets, specifically aimed at improving consumer choice and prices, are clear. The federal government could lower or eliminate import tariffs, liberalize the producer cartels that are maintained through agricultural supply management and dairy quotas in particular, lower other regulatory barriers to internal and external trade in goods and services, and facilitate cross-border price arbitrage, by increasing duty-free limits for returning Canadian travelers.

In addressing the possibility that the federal government were to proceed with its misguided proposal, the Council had different recommendations for legislation that could minimize the damage.

One possibility would be to permit or require the Competition Bureau to conduct market studies that could provide the basis for legal action regarding cross-border price differences, or could justify enacting the proposed legislation, should it in fact proceed through Parliament, while stopping short of immediate legal intervention. Another possibility would be to include a requirement to establish that country pricing was conducted by a seller with significant market power, globally and domestically, and that the differential pricing, to be legally vulnerable, would be shown to protect or enhance this market power. Such a focus on competition would be more consistent with the *Act*, and would help minimize the costs of the legislation.

There was consensus, however, that such alternatives, while perhaps better than other possible amendments to the law that could implement the budget proposal, would nevertheless be costly and worse than the status quo. The Council was clear that the government should not proceed in its misguided initiative.

## Members of the C.D. Howe Institute Competition Policy Council

*Members of the Council participate in their personal capacities, and the views collectively expressed do not represent those of any individual, institution or client.*

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\* Not in attendance, April 25, 2014.