

Unregulated upstream monopolist in vertical structure: Vertical integration versus legal unbundling

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Abstract

There is a problem under discussion about reforming industries with vertically integrated upstream monopolist, for example telecommunication, electricity or gas sectors. This paper compares vertical integration to legal unbundling as an alternative vertical form. Legal unbundling, the upstream monopolist is legally independent of the downstream incumbent, is proposed or introduced in practice to tackle anti-competitive concerns about the vertically integrated upstream monopolist. As anti-competitive concerns, we consider margin squeeze and sabotage (non-price discrimination) in the model. If the upstream monopolist is unregulated, margin squeeze do happens but sabotage would not be taken when the downstream rival is more efficient, and then the rival can be active under vertical integration. Vertical integration outperforms legal unbundling in terms of total output and consumer surplus. Moreover, even when the downstream rival is foreclosed from the market, the result is maintained. Result obtained in this paper is opposite to current studies assuming regulated upstream monopolist. Under unregulated upstream environment for the vertical integration, mitigating effect of double marginalization is superior to potential effect of raising rival's cost by sabotage.

Keywords

Upstream monopolist, Exclusive behavior, Vertical integration, Legal unbundling

JEL Classification

K2; L43; L5: L9