VERTICAL INTEGRATION AND SABOTAGE:
EVIDENCE AND REGULATION

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ABSTRACT

Many network industries have an upstream monopolist that sells an essential input to downstream firms. When price of access is regulated the integrated monopolist may have incentives to degrade the quality of access if it is integrated with one of the downstream firms. The goal of this dissertation is: 1) to study the US natural gas, electricity and telecommunications industries to document instances of sabotage; 2) to derive study the welfare optimal access charge and vertical control policies under two different downstream market structures, differentiated goods Bertrand duopoly and the dominant firm competitive fringe model.

We find that concerns for sabotage are real as it does occur in these regulated industries. We also find that the regulator faces a trade-off between reducing the double markup problem by pricing access low, versus pricing access high in order to deter non-price discrimination. Also, the optimal vertical control policy is chosen to balance a trade-off between achieving an efficient downstream production mix and sabotage deterrence.