Chapter 13: Limiting Market Power - Regulation And Antitrust

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Lecture

Economists have long argued whether bigness is good or bad. Opponents contend that the flow of wealth to firms with significant market power is socially undesirable and should be restrained. Proponents maintain that big firms, because of economies of scale, can yield benefits to society in the form of lower per unit cost. To break up these firms would increase costs. The United States has chosen to deal with potential monopolies through the use of regulation and antitrust policy.

Government regulation of industry consists of two types: limiting market power and promoting consumer and worker protection and safety. The purposes of regulation include control of market power resulting form economies of scale and scope. Economies of scale are savings that are obtained through increases in quantities produced, whereas economies of scope are savings that are obtained through simultaneous production of many different products. Another source of monopoly power can arise when a single firm has possession of a facility that other rival firms must use if they are to compete. A facility owned by a single firm and needed by rival firms is called bottleneck facility. A third problem is the analysis of regulation of "universal service," which means the availability of service to everyone for "reasonable prices." For example, airlines and telecommunications are two industries it was feared that without regulation of entry and rates, or subsidies, less populous communities would lose their airline services and pay high rates for telephone service.

Governments want to regulate prices to prevent those prices from being so high that they bring monopoly profits to the firm. But at the same time, prices must be sufficiently high to enable the firms to cover their costs and to survive.

Bigness can at times benefit society. The most important advantage of bigness is found in industries where technology makes small-scale operation inefficient. Some economists argue that only large firms have the resources and the motivation for really significant innovation. Although individuals create innovations, they may not have the resources to put a new invention into commercial production.

In the mid 1970's Congress deregulated several industries, including airlines and trucking, and eliminating most of the powers of the regulatory agencies. Deregulations has had many effects in the U.S. Generally, prices are lower. In terms of local service, some communities have been hurt and others have benefited. Deregulation has reduced the barriers of entry, creating many new competitors. Labor unions have been hurt as can be seen in the airline industry with wage concessions. Mergers have increased the concentration within industries. Price competition created "no frills" service, like that offered by many airlines. Deregulation has not affected safety in the airline industry. And lastly, profits and wages have been depressed since deregulation.

The U.S. has five basic antitrust laws: The Sherman Act (1890); The Clayton Act (1914); The Federal Trade Commission Act (1914); The Robinson-Patman Act (1936); and the Celler-Kefauver Antimerger Act (1950).

One of the measures that the U.S. Department of Justice and the Federal Trade Commission use to test whether a firm is likely to possess monopoly power is the concentration of the markets in which the firm operates. A market or an industry is highly concentrated if it contains only a few firms, and a market is considered "unconcentrated" if it has many small firms. One measure is the concentration ratio is the percentage of an industry's output produced by its four largest firm. Another measure is the Herfindahl-Hirschman Index (HHI), which is calculated by determining the market share of each of the firms in the industry, squaring each of these numbers, and adding them. The HHI ranges from 10,000 (100 percent market share squared) to a number approaching zero.

The main purpose of the antitrust laws is to prevent anticompetitive practices, actions by a powerful firm that threaten to destroy competitors, to force them to compete less vigorously, or to prevent the entry of new rivals. A typical accusation is predatory pricing, in which the defendant implements an unjustifiably low pricing policy that forces the competitors to lose money and go out of business. Another example is bundling, referring to a pricing policy under which the supplier offers substantial discounts to customers if they buy several of the firm's products, so that the price of the bundle of products is less than the sum of the pieces of the products if they were bought separately. This was the question with Microsoft.

Mergers have been regarded as antitrust. This is particularly true if it is a horizontal merger, whereby the merger is of competitors. Many economists agree that mergers sometimes reduce competition. Others believe that mergers will not reduce competition.