13 Market Power and Government Regulations

NEWS UPDATE

- We know that market power can often translate into political power, and that political power can have negative implications for society. We recently learned that the two major West Virginia coal miners' unions strongly endorsed President Biden's Build Back Better legislation that their own Senator Joe Manchin had just voted against. The coal miners understand that coal is on the way out, and they want the support embodied in Build Back Better that would help them transition to other types of economic activity and jobs. Even more to the point, they wanted the clause that would have continued the excise tax paid by coal companies into a trust fund for miners afflicted with black lung disease. Instead, the tax was cut in half after the bill failed to pass the Senate. The issue? The Manchin family is linked to the coal companies, and Senator Manchin has received more campaign contributions from the oil, gas, and coal companies than any other senators in the current election cycle. So, money talks, and in this case, coal companies and their money literally prevented legislation that would have radically transformed the U.S. safety net into one providing for the socio-economic needs of American families (Jonathan Weisman, *The New York Times*, January 11, 2022).
- Corporations are not the only ones who collude when they can get away with it. A lawsuit was recently filed against the nation's top colleges and universities, charging them with colluding on the level of financial awards they would give out. The lawsuit alleges that an estimated 170,000 students eligible for financial aid ended up overpaying their college tuition ("Suit Alleges Colleges Conspired on Aid," *Minneapolis Star Tribune*, January 11, 2022).

PURPOSE

This is the first of four chapters in the section titled Efficiency and Stability Issues. Clearly, government failure to address market power leads to inefficiency; and government failure to regulate leads to instability (as in the case of the 2007–2008 financial crisis), inequity (as in the failure to ensure racial equity), and exploitation (of labor, consumers, and the environment). This chapter first addresses market power with the use of the demand and supply model to compare behavior and outcomes of monopoly with those of competition. Next, we look at government regulations more broadly (and more globally) than in previous editions. Additional material on monopoly, price elasticity of demand, and price discrimination is presented in the appendices to the chapter.

WHAT'S NEW?

1. This edition provides new material on government regulations, the Google antitrust case, and the contrast between former President Donald Trump and President Biden on antitrust and regulatory behavior. Trump's association with Fox News is examined, as are other examples of policy and behavior.
2. There is new material on the exploitation of labor, including slave labor in the palm oil industry in Indonesia and Malaysia and the exploitation of the Uighur people in Jinjiang Province in Western China. Students are encouraged to educate themselves about the issues involved and to be aware of organizations seeking to end this kind of exploitation.

TEACHING SUGGESTIONS

➢ *Student Interest*

- Normally, we don't expect a lot of student interest in market power and antitrust policy. It is helpful to bring it down to the student's level. You might start by asking students where they shop. Where do they buy their schoolbooks and supplies, their clothes, their food, and their gasoline? Where do they buy their electricity and where do they do their banking? Are these businesses competitive or do they exhibit market power?
- Students may be interested in cases that affect them. This is true of the cases against Ticketmaster and Google. Many students use Ticketmaster to purchase concert tickets, and most of them probably use one or more of Google's platforms.
- Once the following terminology is explained to students, they can probably provide more examples pertaining to franchises, licenses, patents, product differentiation, and barriers to entry than consumer-challenged instructors such as me.
- Students are interested in the topics of climate change and racial equity, as well as the exploitation of labor and consumers. This means students are interested in government regulatory activity as well.

➢ *Controversy*

- Students will differ in their views toward antitrust policy (once you explain it to them and literally drag out their nascent opinions). They are probably more opinionated about government regulations, with some of them aligned with the populist Trumpian ideology opposed to government regulations, and others more welcoming of regulations, especially on climate change.
- The greatest controversy may involve government regulation in the context of the coronavirus pandemic. Any right-wing students in your class may insist that government regulations violate their liberty. Don't allow any misinformation in your classroom!
- Students are also interested in regulations that protect workers and consumers and that foster greater racial equity. You may be able to dredge up some interest in the 2007–2008 financial crisis and the differing views toward financial regulations by the Obama, Trump, and Biden administrations.

➢ *Economic Theory and Models*

- A demand and supply model is used to represent a competitive market and its outcomes. Next, a graph of demand (but no supply) is used to represent a monopolist and its outcomes. Oligopoly is also described.
- Another demand (absent supply) graph is presented in Appendix 13–1 to describe a hypothetical monopoly in terms of numerical values. The elasticity conditions necessary for a monopoly to increase profits by restricting output are addressed in Appendix 13–2, along with the role of the price elasticity of demand in relation to price discrimination.
- The theory of economies of scale is presented and discussed as a form of barrier to entry.

➢ *Data and Terminology*

- Concentration ratios are updated and used as a means of addressing and measuring concentration. The flaws of concentration ratios are also discussed.

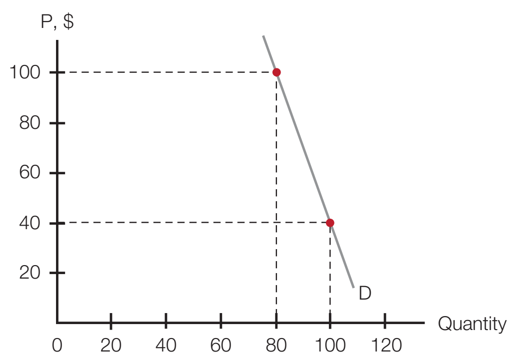
- It is important to discuss the cautions regarding concentration ratios, such as how their significance depends on the breadth of the category is (e.g., food versus breakfast cereal) and the relevance of the local versus national market (e.g., local newspapers are relevant for local markets).
- There is updated data on the share of senior management time spent complying with government regulations across many countries of the world. Certainly, very large shares of time spent on compliance would suggest the government is overdoing it. On the other hand, the regulations may be necessary.

➢ *Fundamentals*

- It is often the case that when there is a crisis (such as the financial crisis just referenced), low-income people suffer the most. The same is true when we consider the exploitation of labor and consumers that takes place when the government doesn't adequately protect them. And, of course, failure to regulate against climate change tends to hurt the poor more than the rich. National and global income inequality are the outcomes of so many aspects of our economy.
- Racial inequities continue when the government refuses to use regulations, executive orders, and legislation to prevent discrimination. Regulations pertaining to immigrants are often based on and perpetuate racism.

CLASSROOM EXERCISES

1. A market demand curve is shown below. If the only firm in the market sells 100 units, what price can it charge? [$40] If it wants to raise the price to $100, what would it do? [Reduce its output to 80.] Show numerically with the graph.



2. Suppose the widget industry consists of six firms, each producing the following shares of total widget output. What is the concentration ratio for the widget industry? [95, calculated as 50+30+10+5]

Firm	Share of Total Output
1	50
2	30
3	10
4	5
5	3
6	2

SAMPLE TEST QUESTIONS

Multiple Choice Questions

1. A monopoly will not only charge a higher price, it will also produce __________ output than a competitive market would produce.
   a. more
   b. less
   c. better
   d. poorer

2. The United States automobile industry is a good example of:
   a. a monopoly.
   b. a competitive market.
   c. an oligopoly.
   d. an unconcentrated industry.

3. A monopoly:
   a. charges higher prices than competitive firms, all other things equal.
   b. produces more output than competitive markets, all other things equal.
   c. is one of several firms in a market.
   d. all of the above

4. Compared to competitive markets, monopolies charge:
   a. higher prices, produce more output, but make lower profits.
   b. higher prices, produce more output, and make higher profits.
   c. higher prices, produce less output, and make higher profits.
   d. lower prices, produce more output, and make higher profits.

5. What do patents, economies of scale, and exclusive franchises have in common?
   a. They are all barriers to entry.
   b. They are all granted by the government to monopoly firms.
   c. They all guarantee that a market will be competitive.
   d. All of the above

6. If, shortly after Kellogg's Company announces price increases on its cereals, the other cereal manufacturers announce identical price increases on their products, this is likely to be:
   a. the essence of competition.
   b. a cartel.
   c. price leadership.
   d. a coincidence.

7. All other things equal, compared to a competitive market, a monopoly will have:
   a. higher profits and greater efficiency.
   b. lower profits and greater efficiency.
   c. lower profits and lower efficiency.
   d. higher profits and lower efficiency.

8. Compared to a firm in a competitive market, a monopoly has:
   a. more pressure to reduce costs.
   b. less pressure to reduce costs.
   c. lower profits.
   d. greater output.

9. Which of the following serves to limit market power?
   a. Patents
   b. Economies of scale
   c. Import competition
   d. Limit pricing

10. Price discrimination is:
    a. charging different prices to different customers because it costs the firm more to serve some customers than others.
    b. changing the firm's price frequently to respond to market conditions.
    c. charging different prices to different customers when the price differences are not based on cost differences.
    d. charging different prices to different customers based on their race or ethnicity.

11. Economies of scale over a wide range of output:
    a. can be a barrier to entry.
    b. mean that cost per unit of output is lower at high levels of output.
    c. mean that cost per unit of output is higher at low levels of output.
    d. all of the above

12. The essence of market power is:
    a. product differentiation.
    b. lack of pressure to raise prices.
    c. the firm's ability to influence the market price of its product.
    d. the existence of an exclusive franchise.

13. When we say that the competitive firm is a price taker, we mean that:
    a. the output of the firm is too small to influence the market price of the product.
    b. the firm's management doesn't know what price to set it charges what other firms charge.
    c. the firm is following a price leader.
    d. the firm produces less output to set a higher price.

14. An industry has a concentration ratio of 85. We would call this industry a(n):
    a. competitive industry.
    b. monopoly.
    c. oligopoly.
    d. very competitive industry.

15. If the concentration ratio for an industry is 80, the:
    a. four largest firms account for 20 percent of total output of the product.
    b. four largest firms account for 80 percent of total output of the product.
    c. industry is a monopoly.
    d. industry is competitive.

16. Concentration ratios may:
    a. overstate the extent of competition because they ignore imported products.
    b. understate the extent of competition because they ignore imported products.
    c. either overstate or understate the extent of competition because they ignore imported products.
    d. none of the above

17. Which of the following has market power?
    a. Google
    b. Apple
    c. Amazon
    d. all of the above

18. (*Appendix 13–1*) The example used to demonstrate monopoly behavior in this appendix is:
    a. water.
    b. dishwashers.
    c. "anti-age."
    d. opioids.

19. (*Appendix 13–2*) To successfully reduce output to raise both price and profits, the monopolist must have an:
    a. inelastic demand curve.
    b. inelastic supply curve.
    c. elastic demand curve.
    d. elastic supply curve.

20. (*Appendix 13–2*) In order to successfully use price discrimination to increase its profits, a monopolist must:
    a. be able to segment groups of consumers from one another
    b. have groups of consumers with different elasticities of demand.
    c. have market power
    d. all of the above

True / False Questions

1. Monopolies can charge any price they want and still be highly profitable because they have no competition. **(F)**
2. Monopolies produce more output than competitive markets. **(F)**
3. The monopolist's demand curve is the market demand curve. **(T)**
4. In order to receive a higher price, the monopolist reduces output. **(T)**
5. Monopolies are more efficient than competitive markets. **(F)**
6. Economies of scale occur when cost per unit of output is lower for higher levels of output. **(T)**
7. Whenever a firm charges different prices for its products, it is practicing price discrimination (you caution as you think this through). **(F)**

8. When a group of producers get together to discuss the output levels and prices that would maximize profits to the group, the group is called a cartel. **(T)**
9. Technological change serves to limit market power. **(T)**
10. A natural monopoly does not have economies of scale. **(F)**
11. Concentration ratios understate the extent of industry competition because they do not consider imports. **(T)**
12. Concentration ratios understate the extent of market power if the appropriate market is local instead of national. **(T)**
13. An oligopoly is a market with only a few dominant firms. **(T)**
14. Import competition limits the market power of domestic firms. **(T)**
15. The actions of existing firms in the industry can never act as a barrier to entry for new firms. **(F)**
16. The monopolist can increase output and price simultaneously. **(F)**
17. The first antitrust law passed was the Clayton Act of 1914. **(F)**
18. U.S. tariffs and import quotas increase the market power of domestic producers. **(T)**
19. When the government grants a public utility an exclusive franchise, it usually regulates the firm's prices and services. **(T)**
20. An exclusive franchise is a monopoly grant from the government. **(T)**
21. Cigarettes and breweries have relatively high concentration ratios. **(T)**
22. Conservatives generally view antitrust activity and economic regulations as creating inefficiency. **(T)**
23. Some countries listed in the text have a percent of senior management time spent on complying with government regulations as high as 80. **(F)**
24. Donald Trump made it his mission to increase the number of government regulations that protect workers, consumers, and the environment. **(F)**
25. (*Appendix 13–2*) The responsiveness of consumers to changes in the price of a product is measured by the elasticity of demand. **(T)**

Critical Thinking Questions

1. Describe the various barriers to entry discussed in the text. How do these serve to maintain the market power of existing monopolies?
2. Being a large, profitable company is not the same as being a company with considerable market power. What is the impact of each on its market? What is the impact of each on politics (e.g., money for campaigning and lobbying)?
3. What are some examples of workers being exploited in foreign countries? Are you interested in doing something about it, such as checking the sources in the text?