Beat the competition.
Get more customers.
Learning Objectives:

1) Analyze differing opinions as to what the proper role of government should be.

2) How do economists and governments analyze when mergers of large companies should be allowed or should be blocked?

3) What criteria do economists and governments use to regulate natural monopolies?

4) Explain why the trend of the federal government has been to deregulate markets in recent years.
I) Corporate Mergers

A) Merging two large firms into one may reduce market competition.

1- Must notify the FTC if sales of one company is at least $63 million.

   A- There are other guidelines, such as the size of the market.

2- FTC may approve or block proposed merger.

   a- antitrust laws, gives government power to break up large firms into smaller firms.
Exhibit 13-1  Mergers and Acquisitions: Number and Size
In the early 2000s, the number of mergers and acquisitions declined from the levels at the tail end of the 1990s.

(a) Number of mergers submitted for review by the Federal Trade Commission, 1999–2008
(b) Size of transaction for mergers submitted for review in 2008 (in millions of dollars)
C) Guidelines to approve or block mergers

1- The challenge for the Department of Justice is to decide when a merger may actually hinder competition.

2- The Four-Firm Concentration Ratio:
   a- If four largest firms have market share combined exceeding 50%, then DOJ may block merger of the market’s largest firms.
3- Herfindahl-Hirshman Index:

   a- formula that takes the market share of each firm in the industry, square each one, and add them.

1- If HHI < 1000, FTC approves.

2- If HHI > 1800, FTC challenges the merger.

3- If HHI between 1000 and 1800, FTC scrutinizes case-by-case.
Exhibit 13-2
Calculating Concentration Ratios from Market Shares

If the market shares in the market for replacing automobile windshields are:

Smooth as Glass Repair Company  16% of the market
The Auto Glass Doctor Company  10% of the market
Your Car Shield Company  8% of the market
Seven firms that each have 6% of the market  42% of the market, combined
Eight firms that each have 3% of the market  24% of the market, combined
Then the four-firm concentration ratio is \( 16 + 10 + 8 + 6 = 40 \).
Exhibit 13-3  Some Herfindahl-Hirschman Index Calculations

- HHI for a monopoly: $100^2 = 10,000$
- HHI for an industry with 100 firms that each have 1% of the market: $100(1^2) = 100$
- HHI for the industry market share in Exhibit 13-2: $16^2 + 10^2 + 8^2 + 7(6^2) + 8(3^2) = 744$
Examples of Concentration Ratios and HHI’s in the U.S. Economy, 2009:

<table>
<thead>
<tr>
<th>Industry</th>
<th>4-Firm Ratio</th>
<th>HHI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wireless</td>
<td>90</td>
<td>2243</td>
</tr>
<tr>
<td>Largest five: Verizon, Cingular, Sprint Nextel, T-Mobile, Alltel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alcoholic Beverages</td>
<td>81</td>
<td>2887</td>
</tr>
<tr>
<td>Largest five: Anheuser-Busch, Miller, Coors, Heineken, Pabst</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Worldwide Volume Servers</td>
<td>79</td>
<td>2002</td>
</tr>
<tr>
<td>Largest five: Hewlett Packard, Dell, IBM, Sun MicroSystems, Fujitsu Siemens</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Airlines</td>
<td>55</td>
<td>1060</td>
</tr>
<tr>
<td>Largest carriers: American, United, Delta, Continental, Northwest</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Examples of Market Share in the Cellphone Market, 2012:

- Verizon: 31.3%
- AT&T: 26.6%
- T-Mobile: 12.2%
- Sprint: 16.1%
- MetroPCS: 2.8%
- U.S. Cellular: 2.2%
- Leap Wireless (Cricket): 1.8%
- TracFone: 6%
- Other: 1%
4- In last 10 – 20 years, the FTC only uses the Concentration Ratio and the HHI as two tools to consider antitrust action.

   a- now rely on case-by-case analysis of different industries.

   b- *Two steps:*

1) Use statistical analysis (CR’s and HHI’s) to determine the S & D curves faced by the firms proposing the merger.

2) Specify how competition occurs in the specific industry: competing to cut prices and raise to output, to build a brand name, advertising ability, build a reputation for good service or high quality.

1- Two largest companies in the “premium natural and organic supermarket chains”.

2- Could also argue that they are two relatively small companies in the broader market for all stores that sell groceries.

* Finally allowed in in 2009

* But Whole Foods must sell off the Wild Oats brand name and a number of stores – to preserve competition in certain local markets.
II) Regulating Anticompetitive Behavior

A- The FTC and The DOJ supervise the markets to eliminate *restrictive practices*:

1. minimum resale price agreements
2. exclusive dealing
3. tie-in sales
4. bundling
5. predatory pricing
6. fixing of price and/or output levels (collusion)

**Ex:** Int’l cartel of vitamin producers (Hoffman-LaRoche, BASF, Rhone-Poulenc) 1999, MicroSoft 2000

**Ex:** U.S. v Apple (April 2012, e-book price fixing)
III) Regulating a natural monopoly

A- Leave the natural monopoly alone.

1- But end up with high prices and economic/monopoly profits. (Monopolist produces where MR = MC.)
B- Break up the company.

1- But will two or three companies be more efficient than one large company?

2- One company produces at point A: 4 items @ price of $9.30. Two companies produce at point B: 2 items @ cost of $9.75
Competition & Public Policy: Chapter 13

C- Regulators set prices and output levels. Possible choices:

1- **Point C** (allocative efficiency, \( P=MC \)), but firm suffers an economic loss as \( P < ATC \).

2- **Point F** is better choice. \( P=ATC \). Monopolist earns a only a normal profit.
D- How do regulators set prices and output levels?

1- Cost-plus regulation (firm permitted to cover its costs and make a “normal” level of profit)
   a- but no incentive to reduce costs, just ↑ price.

2- price-cap regulation (the regulator sets a price that a firm cannot exceed over a set time period.)
   a- but what if energy prices ↑?

3- A major problem is *regulatory capture*:
   the regulators are taken over by those they are supposed to oversee.

Ex: SEC and Wall Street
IV) The Great Deregulation Experiment


1- Removed government controls over prices and output in airlines, railroads, trucking, natural gas, intercity bus travel, bank interest rates, and financial markets.

B- Mixed bag of effects of Deregulation

1- Increased pressure of competition led to entry and exit, i.e., many companies went bankrupt.

2- But it did increase efficiency and lowered prices to consumers by $50 billion per year by 2000.

3- Did less regulation of financial markets lead to the economic crash and financial crisis of 2008 – 2009?
C- Nationalization vs. Privatization

1- Nationalization has been very rare in the U.S.

**Ex:** AMTRAK


2- Britain sold off gov’t owned industries in 1980’s, from 10% of GDP to 2%.
D- “Governments should steer, not row.”

1- Gov’t should set conditions and general conditions of competition, but not micromanage the economy.

Ex: Why advocates of privatization dislike the Affordable Health Care Act of 2010.

2- BUTT, all market-based economies operate against a backdrop of laws and regulations, including contract enforcement, taxes, and protecting health and the environment.
The End!

Time to analyze a market case study!