

# Managerial Economics in a Global Economy, 5th Edition by Dominick Salvatore

## Chapter 12

### Regulation and Antitrust: The Role of Government in the Economy

# Government Regulation Restriction of Competition

- Licensing
  - Ensure a minimum degree of competence
  - Restriction on entry
- Patent
  - Exclusive use of an invention for 17 years
  - Limited monopoly
- Robinson-Patman Act (1936)
  - Restrictions on price competition

# Government Regulation Consumer Protection

## Food and Drug Act of 1906

- Forbids adulteration and mislabeling of foods and drugs sold in interstate commerce
- Recently expanded to include cosmetics

# Government Regulation Consumer Protection

## Federal Trade Commission Act of 1914

- Protects firms against unfair methods of competition based on misrepresentation
- Price of products
- Country of origin
- Usefulness of product
- Quality of product
- Wheeler-Lea Act of 1938 prohibits false or deceptive advertising

# Government Regulation Consumer Protection

## 1990 Nutrition Labeling Act

- Food and Drug Administration (FDA)
- Labeling requirements on all foods sold in the United States

# Government Regulation

## Consumer Protection

- Consumer Credit Protection Act of 1968
  - Requires lenders to disclose credit terms to borrowers
- Consumer Product Safety Commission
  - Protect consumers from dangerous products
  - Provide product information to consumers
  - Set safety standards

# Government Regulation Consumer Protection

- Fair Credit Reporting Act of 1971
  - Right to examine credit file
  - Bans credit discrimination
- Warranty Act of 1975
  - Requires clear explanations of warranties
- National Highway Traffic Safety Administration (NHTSA)
  - Imposes safety standards on traffic

# Government Regulation Worker Protection

- Occupational Safety and Health Administration (OSHA)
  - Safety standards in the work place
- Equal Employment Opportunity Commission (EEOC)
  - Hiring and firing standards
- Minimum Wage Laws



# Government Regulation Protection of the Environment

- Environmental Protection Agency (EPA)
  - Regulates environmental usage
  - Enforces environmental legislation
- Clean Air Act of 1990
  - Requires reduction in overall pollution
  - Established a market for pollution permits

# Externalities

- Externalities are harmful or beneficial side effects of the production or consumption of some products
- Public Interest Theory of Regulation
  - Regulation is justified when it is undertaken to overcome market failures
  - Externalities can cause market failures

# Externalities

- External Diseconomies of Production or Consumption
  - Uncompensated costs
- External Economies of Production or Consumption
  - Uncompensated benefits

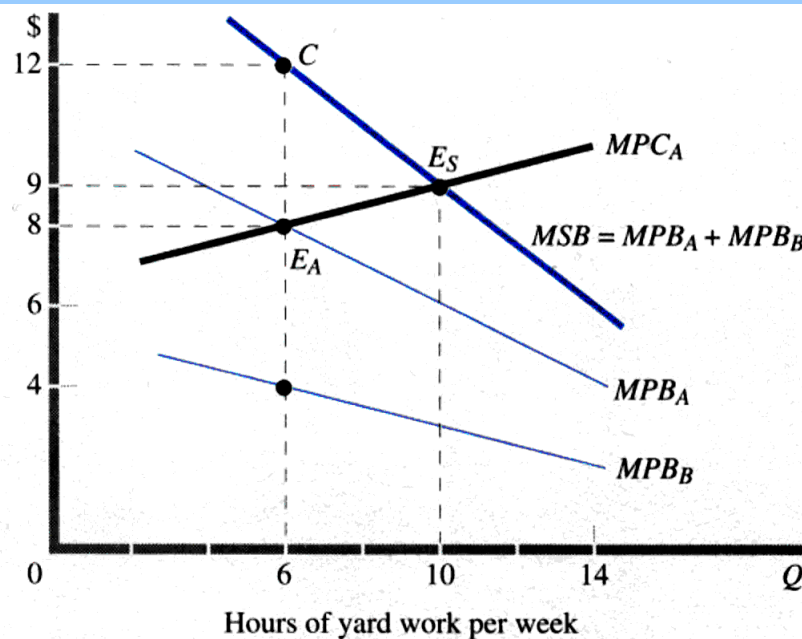
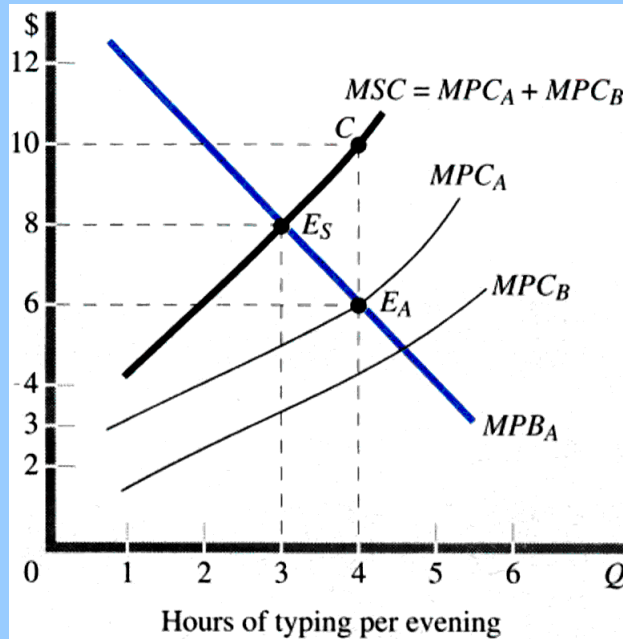
# Externalities

MSC = Marginal Social Cost

MSB = Marginal Social Benefit

Activity of A imposes external cost on B. Socially optimal output is 3.

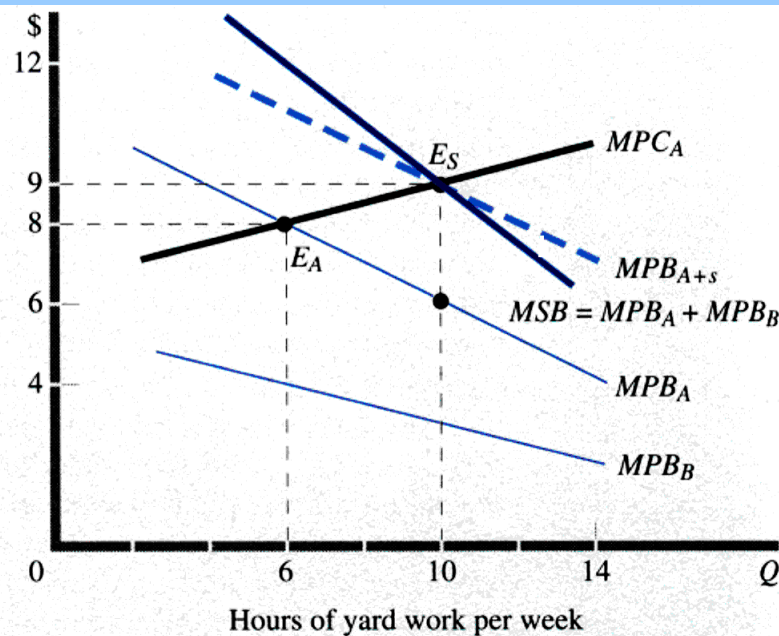
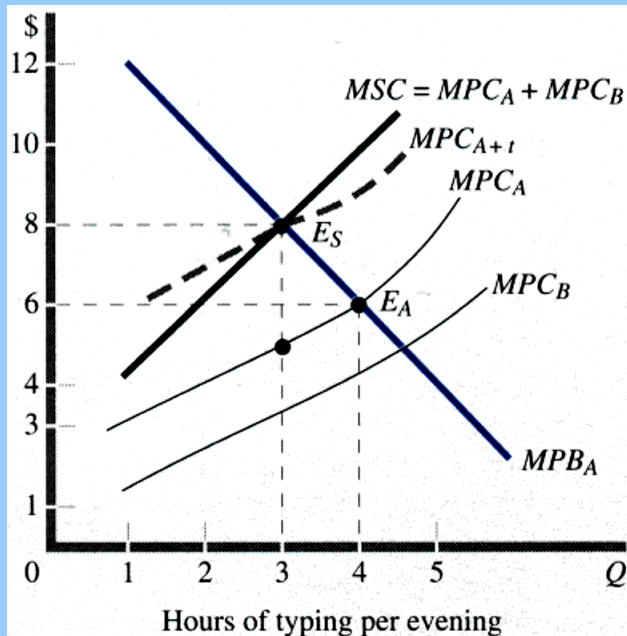
Activity of A causes external benefit for B. Socially optimal output is 10.



# Externalities

Activity of A imposes external cost on B. Socially optimal output is 3. Tax yields this result

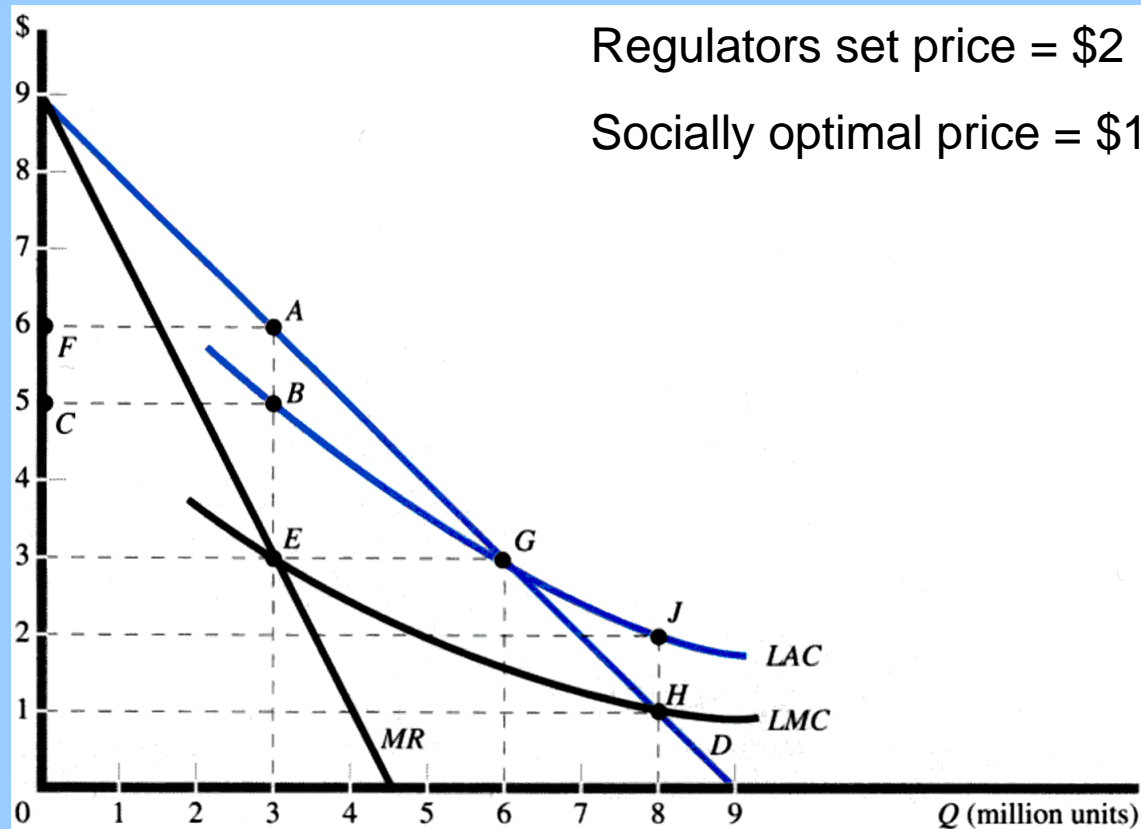
Activity of A causes external benefit for B. Socially optimal output is 10. Subsidy yields this result.



# Public Utility Regulation

- Natural Monopolies
- Long-Run Average Cost (LAC) has a negative slope
- Long-Run Marginal Cost (LMC) is below LAC
- Regulators Set Price = LAC

# Public Utility Regulation



# Public Utility Regulation

- Rate regulation is difficult in practice
- Guaranteed return gives little incentive to control costs
- Averch-Johnson Effect
  - Rates that are set too high or too low can lead to over- or under-investment by in plant and equipment by utility
- Regulatory Lag or 9-12 Months



# Antitrust

## Sherman Act (1890)

- Made any contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade illegal
- Made monopolization or conspiracies to monopolize markets illegal

# Antitrust

## Clayton Act (1914)

- Made it illegal to engage in any of the following if the effect was to lessen competition or create a monopoly
  - Price discrimination
  - Exclusive or tying contracts
  - Acquisition of competitors stocks
  - Interlocking directorates among competitors

# Antitrust

## Clayton Act (1914)

- Federal Trade Commission Act (1914)
  - Prohibited “unfair methods of competition”
- Robinson-Patman Act (1936)
  - Prohibited “unreasonable low prices”
- Wheeler-Lea Act (1938)
  - Prohibited false or deceptive advertising to protect consumers
- Celler-Kefauver Antimerger Act (195)

# Antitrust Enforcement

- Remedies
  - Dissolution and divestiture
  - Injunction
  - Consent decree
  - Fines and jail sentences
- Anticompetitive Conduct
  - Conscious parallelism
  - Predatory pricing

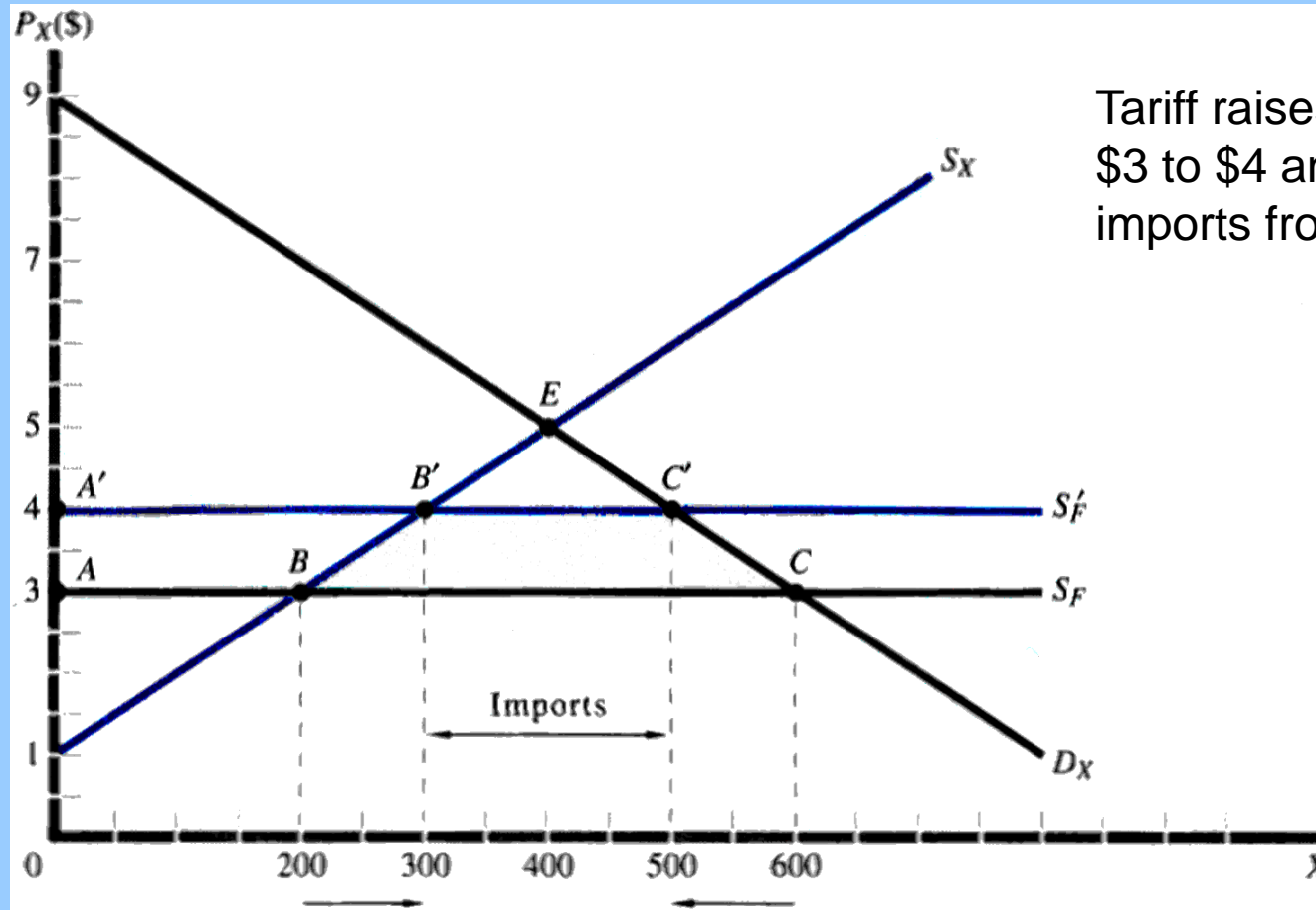
# Regulation

## International Competition

- Tariff
  - Tax on imports
- Import Quota
  - Restricts quantity of imports
- Voluntary Export Restraint
  - Exporter restricts quantity of exports
- Antidumping Complaints

# Regulation

## International Competition



Tariff raises price from \$3 to \$4 and reduces imports from 400 to 200.