David Youngberg

Econ 301—Bethany College

**Lecture 24: Insiders, Outsiders, and Antitrust**

1. Combating Deadweight Loss
	1. If monopolies are to be avoided, how do we avoid them?
	2. Governments often rely on *antitrust laws*—rules and regulations prohibiting actions that restrain or are likely to restrain competition.
		1. The name “antitrust” comes from an old word for a cartel: a trust. As in, firms trusting one another to keep prices high.
	3. The key piece of legislation is the Sherman Antitrust Act (1890). Here’s Sections I and II:
		1. *“Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”*
		2. *“Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony [. . . ]”*
	4. The Act manifests many ways: breaking up cartels, prosecuting predatory pricing, and preventing mergers are common examples. It is generally enforced by the Federal Trade Commission and the Justice Department.
		1. Cartels—even with the incentive for cartel members to betray each other (as discussed in the advanced course), it’s possible cartels can persist. This extends to *parallel conduct*—a form of implicit collusion in which one firm consistently follows actions of another.
		2. Predatory pricing—*predatory pricing* is when a firm prices below cost to drive out competition and then raises prices when it’s the only firm left. This concern often appears in international trade where it is called “dumping.” It is also one of the most absurd reasons to regulate a company: if a firm drives out competition only to raise prices later, what will prevent new entrants from biding those prices back down? Remember, all monopolies rely on a barrier to entry.
		3. Mergers—when multiple companies become one, there’s a danger the result might have market share high enough to grant market power.
	5. What’s a market share that’s too high? The Justice Department uses the Herfindahl-Hirschman Index (HHI) to guide them.
		1. The HHI squares the market share of each firm in an industry and then adds them together. Mathematically, it looks like this:

$$\sum\_{i=1}^{n}s\_{i}^{2}$$

Where *si* is the market share of the *i*th company and *n* is the number of companies in the industry.

* + 1. The HHI can be expressed either as a number from 0 to 1, where 1 represents a single monopoly and the market share is expressed as a fraction, or from 0 to 10,000, where 10,000 represents a single monopoly and the market share is expressed as a percent.
		2. The Justice Department considers 1,000 to 1,800 (0.10 to 0.18) to be moderately concentrated and anything above 1,800 (0.18) to be concentrated.
		3. Any merger that increases the HHI by more than 100 (0.01) in a concentrated industry raising concerns by the Justice Department.[[1]](#footnote-1)
	1. While monopolies are in general undesirable, recall that they can be quite beneficial. Rents are a strong motivator for action, especially if you’re inventing something. The government recognizes this to some extent (if you have a monopoly thanks to a patent, you are exempt from antitrust laws), but some mergers, even if it results in a monopoly, might be better than several competing firms due to economies of scale.
1. Insiders and Outsiders
	1. As suggested, antitrust laws get fuzzy when companies get in bed with government (patents, of course, are a source of government-backed monopoly power).
		1. Recall firms often seek rent via government authority.
	2. Another motivation to be connected with government is that you become an *insider*, or a person who has direct influence on or secret information of an organization (for our purposes, we focus on insiders in government). An *outsider* lacks such influence/information.
	3. Insiders are in a good position to engage in *regulatory capture*—when a regulating agency starts acting on behalf the industry is supposed to regulate rather than act in the public interest
		1. The Minerals Management Service would approve drilling permits for BP (and other companies) without assessing threat to endangered species as required by law
		2. In 2004, the EPA described hydraulic fracturing as posing little to no danger to drinking water which we now know as false
		3. Mansanto’s growth hormone is banned in other countries but the FDA approved it; the FDA is accused of being more interested in supporting agribusiness rather than public interest
		4. Nuclear Regulatory Commission is accused of being too easy on safety inspection for nuclear power plants
		5. Ditto for the FAA on airplane safety
1. <http://www.justice.gov/atr/public/testimony/hhi.htm> [↑](#footnote-ref-1)