

4.2 — Consequences & Sources of Power

ECON 306 • Microeconomic Analysis • Spring 2023

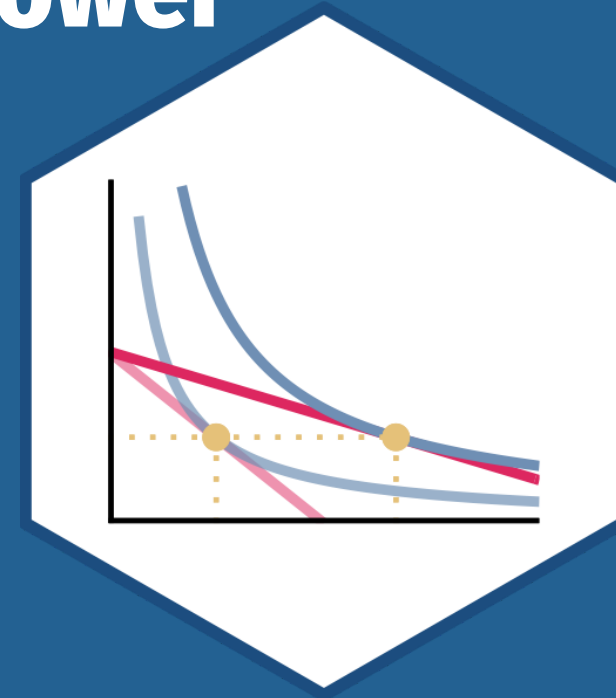
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Outline



The Social Harm of Market Power

What *Is* a Monopoly?

The *Dynamic* Benefits of Markets (with Market Power)

What If You're *Just Better*?

Barriers to Entry

The *Ugly* of Market Power: Rent-Seeking

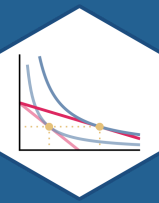
Antitrust

Market Power: The Good, the Bad, and the Ugly



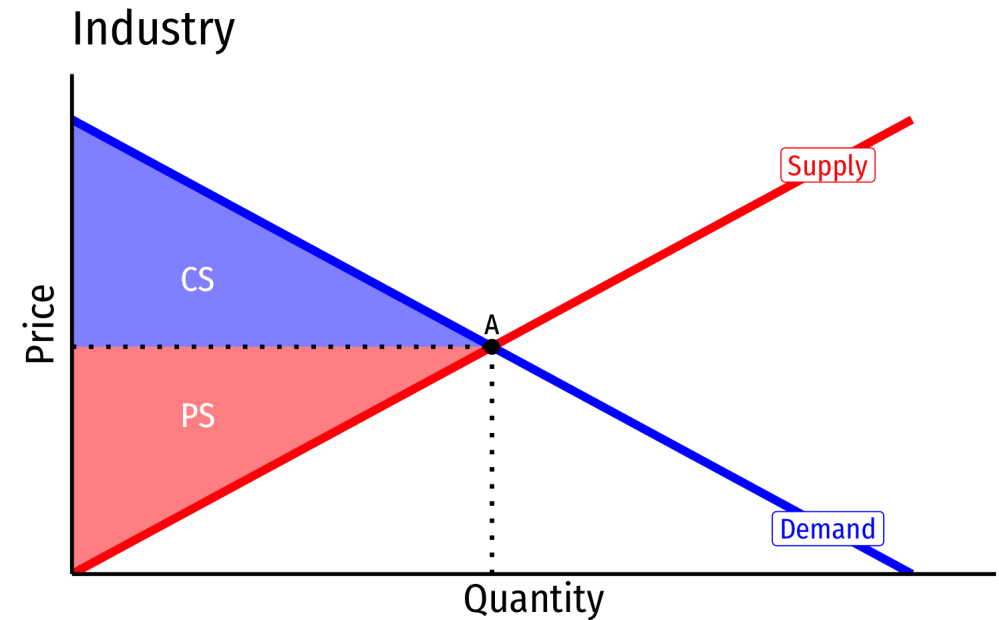
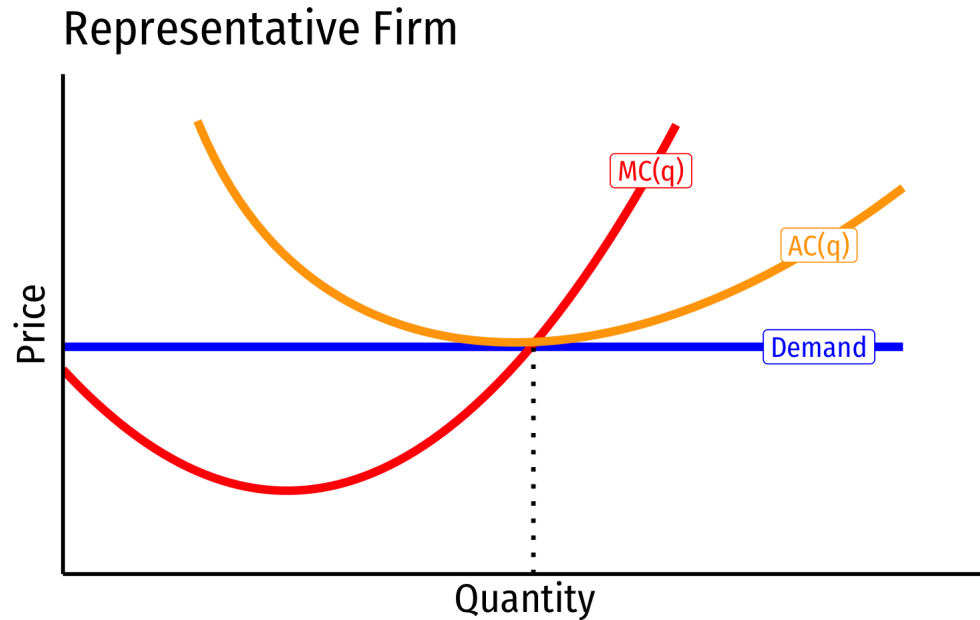
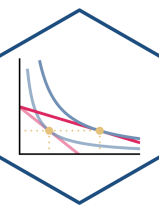
- No market is perfectly competitive, but **that does not necessarily imply market failure**
 - Static vs. dynamic benefits of markets
- Market power is *interesting*
 - Most firms clearly have *some* market power
 - Market power \neq bad, necessarily!
- Today, we'll examine what I call “**the good, the bad, and the ugly**” of market power
 - (but not necessarily in that order)





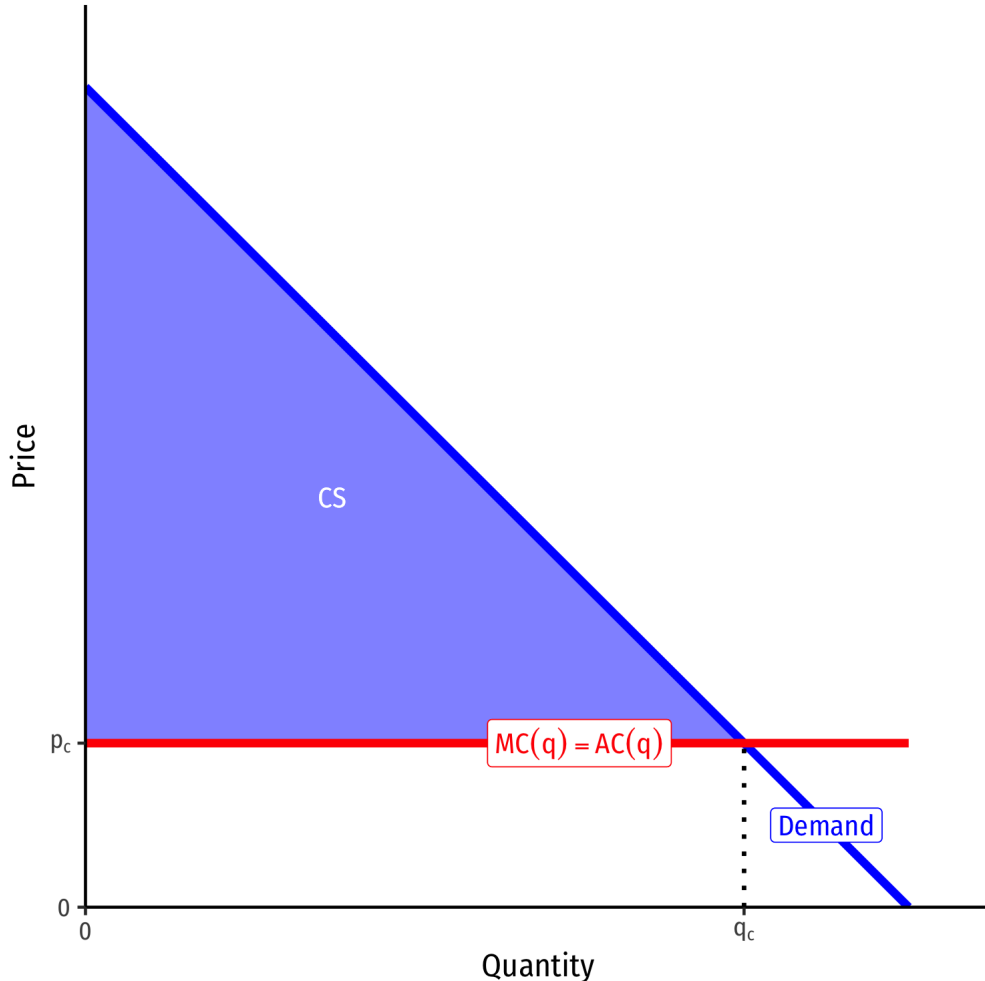
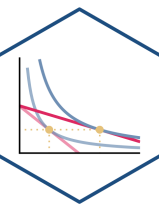
The Social Harm of Market Power

Perfectly Competitive Market



- In a **competitive market** in **long run equilibrium**:
 - **Economic profit** is driven to \$0; resources (factors of production) optimally allocated
 - **Allocatively efficient**: $p = MC(q)$, maximized $CS + PS$
 - **Productively efficient**: $p = AC(q)_{min}$ (otherwise firms would enter/exit)

The Bad of Monopoly: DWL I



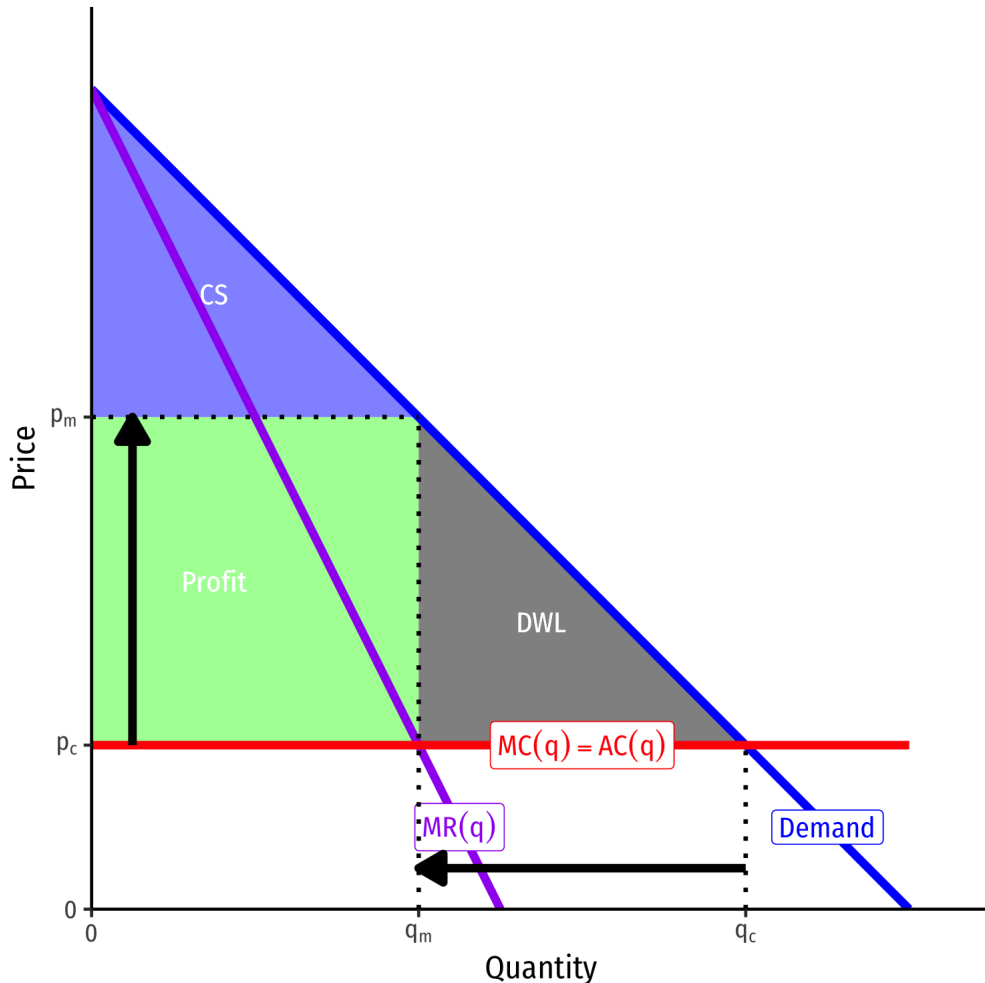
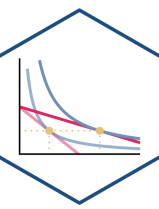
- Consider an industry with some simplified cost assumptions:

$$C(q) = cq$$

- No fixed cost; $MC(q) = AC(q) = c^\dagger$
- If this industry were **competitive**, firms would set $p_c = MC(q)$ and (collectively), industry would produce q_c
 - Max consumer surplus, $\pi = 0$

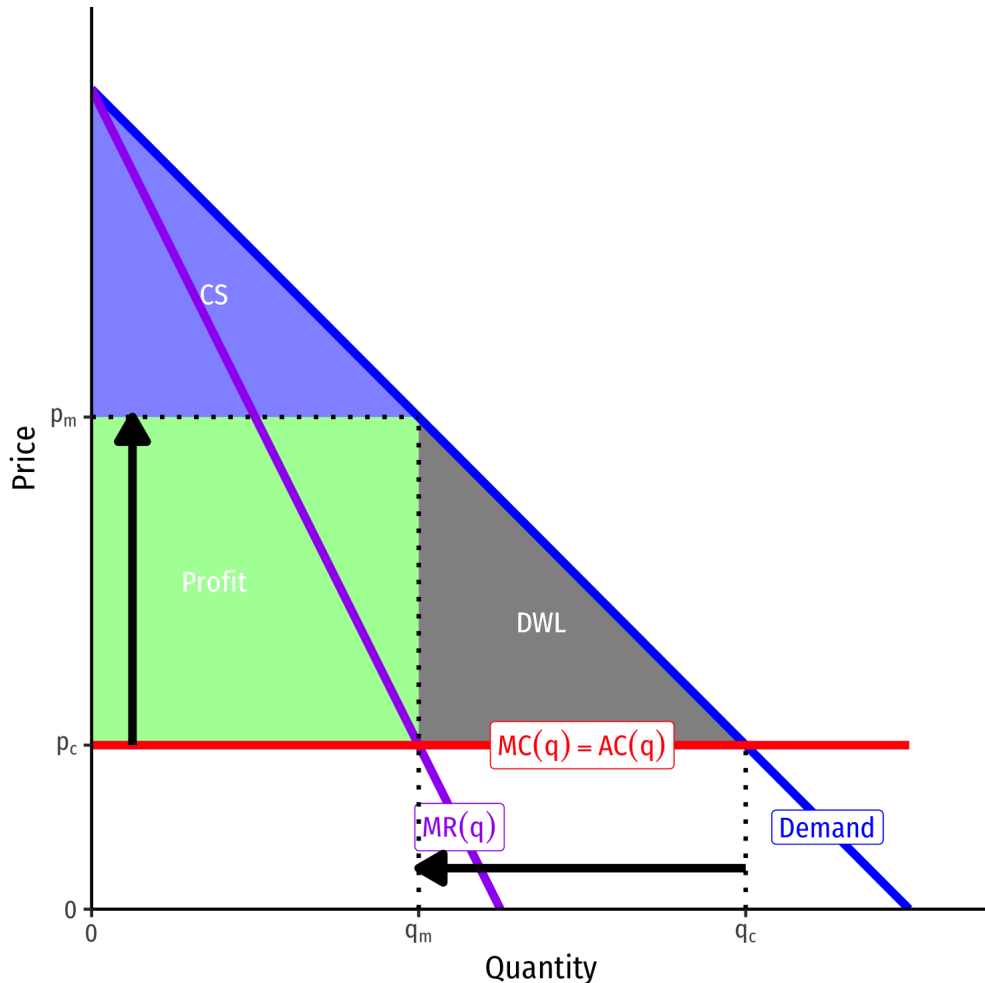
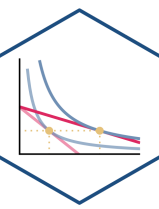
[†] Why? [See here](#) for a reminder.

The Bad of Monopoly: DWL II



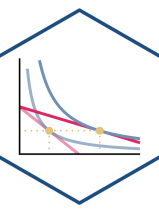
- A **monopolist** would face *entire* industry demand and set (q_m, p_m) :
 - Set $MR(q) = MC(q)$: q_m
 - Raise p to max. WTP (Demand): p_m
- **Restricts output and raises price**, compared to competitive market
- Earns **monopoly profits** ($p > AC$)
- Loss of **consumer surplus**

The Bad of Monopoly: DWL III



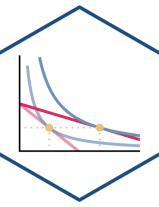
- **Deadweight loss** of surplus destroyed from lost gains from trade
 - Consumers willing to buy more than q_m , if the monopolist would lower prices!
 - Monopolist *would* benefit by accepting lower prices to sell more than q_m , but this would yield *less* than *maximum* profits
 - main problem is that monopolist must lower price on all units sold

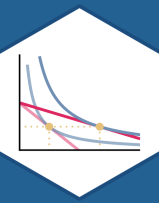
The Bad of Monopoly II



- **Deadweight loss** of surplus destroyed from lost gains from trade
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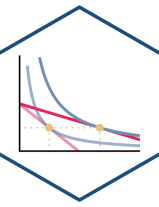
In General





What Is a Monopoly?

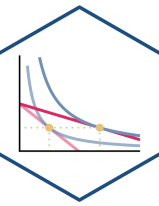
What Is a Monopoly?



- Everyone (economists & the public alike) generally agree that monopoly is bad
- **But what *is* a monopoly?**
- A surprisingly difficult question to answer!



In Ye Olde Days



Lord Edward Coke

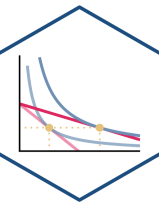
1552—1634

Chief Justice (King's Bench)

“A monopoly is an institution or allowance by the king, by his grant, commission, or otherwise...to any person or persons, bodies politic or corporate, for the sole buying, selling, making, working, or using of anything, whereby any person or persons, bodies politic or corporate, are sought to be restrained of any freedom or liberty that they had before, or hindered in their lawful trade,” (181).

Coke, Edward, 1648, *Institutes of the laws of England*, Part 3

In Ye Olde Days



"[A man lives] in a house built with monopoly bricks, with windows...of monopoly glass; heated by monopoly coal (in Ireland monopoly timber), burning in a grate made of monopoly iron...He washed himself in monopoly soap, his clothes in monopoly starch. He dressed in monopoly lace, monopoly linen, monopoly leather, monopoly gold thread...His clothes were dyed with monopoly dyes. He ate monopoly butter, monopoly currants, monopoly red herrings, monopoly salmon, and monopoly lobsters. His food was seasoned with monopoly salt, monopoly pepper, monopoly vinegar...He wrote with monopoly pens, on monopoly writing paper; read (through monopoly spectacles, by the light of monopoly candles) monopoly printed books," (quoted in Acemoglu and Robinson 2011, pp.187-188).

Hill, Christopher, (1961), *The Century of Revolution*

Acemoglu, Daron and James A Robinson, 2013, *Why Nations Fail*

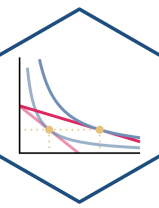
Isn't a Single Seller a Monopolist?



- Isn't the only seller of something a monopolist?
 - A new inventor?
 - An artist?
 - LeBron James?
 - First-mover?
 - The only hardware store in town?
 - The only seafood restaurant?

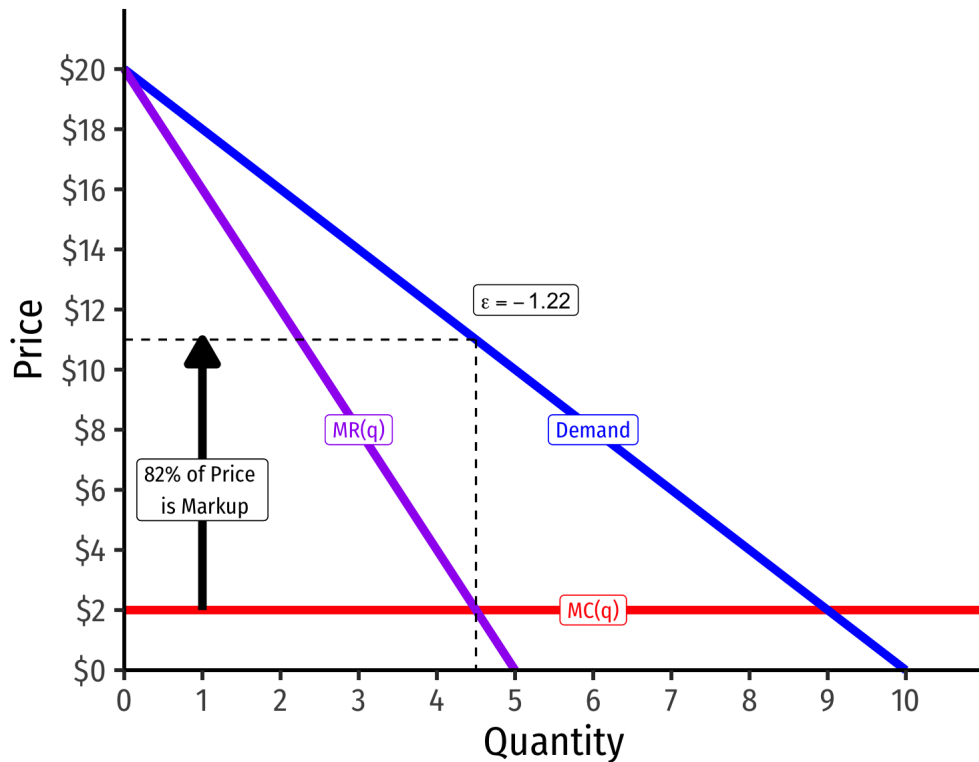


Maybe...Depends on the Price Elasticity!

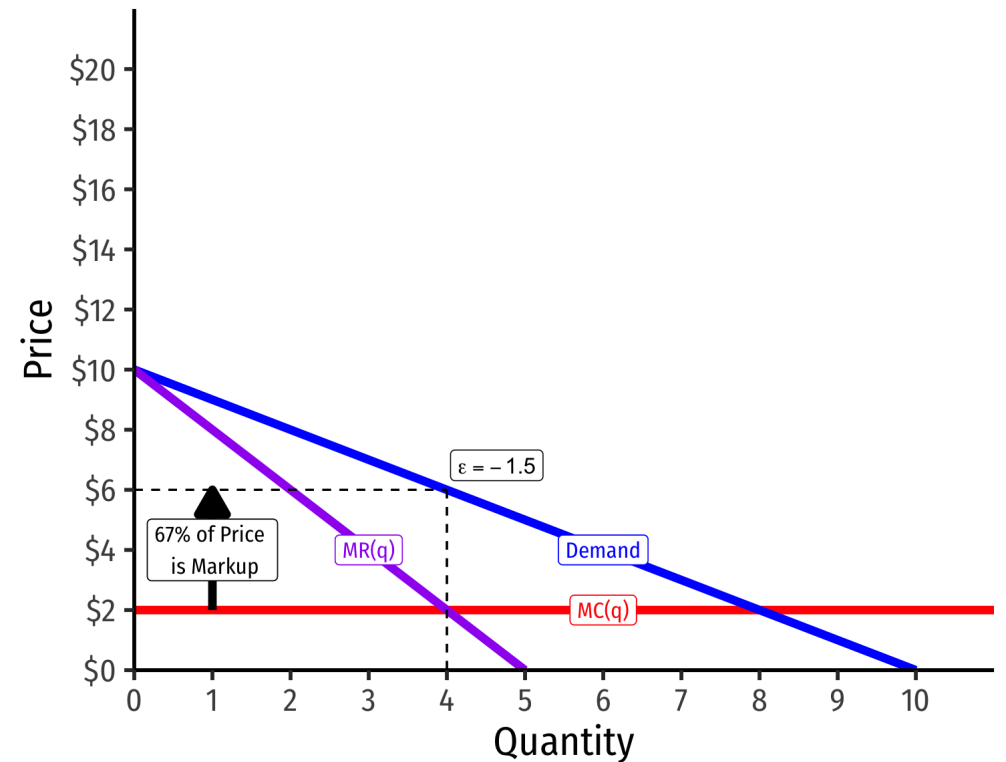


The more (less) price elastically a good, the less (more) market power: $L = \frac{p - MC(q)}{p} = -\frac{1}{\epsilon}$

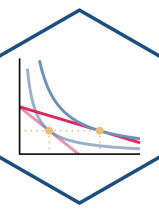
Demand *Less* Elastic at p^*



Demand *More* Elastic at p^*



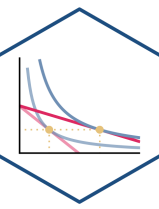
And Recall What Determines Price Elasticity!



- A main determinant of price elasticity is the **availability of substitutes!**
 - More substitutes → higher elasticity → less market power
 - Universal substitute: not buying!
- So again, it's **Consumer Demand** all the way down!
- Aside: courts in **antitrust** cases often also focus on the **cross-price elasticities** between goods!
 - helps determine substitutability of a good, where/whether customers will go in response to price hike



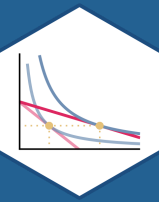
And Cross-Price Elasticity!



“For every product substitutes exist. But a relevant market cannot meaningfully encompass that infinite a range. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose 'cross-elasticities of demand' are small,” *Times-Picayune Publishing v. United States*, 345 U.S. 594 at 621 n. 31 (1953)

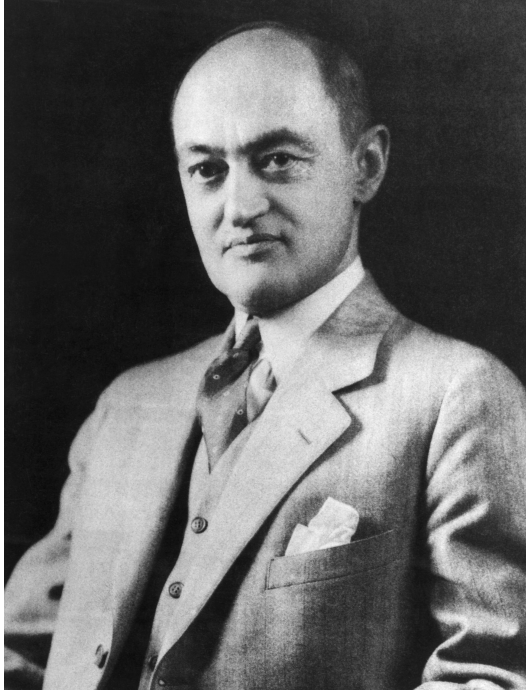
“Every manufacturer is the sole producer of the particular commodity it makes but its control in the above sense of the relevant market depends on the availability of alternative commodities for buyers: i.e., whether there is a cross-elasticity of demand between cellophane and the other wrappings,” *U.S. v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956)

“Cross-price elasticity is a more useful tool than own-price elasticity in defining a relevant antitrust market. Cross-price elasticity estimates tell one where the lost sales will go when the price is raised, while own-price elasticity estimates simply tell one that a price increase would cause a decline in volume,” *New York v. Kraft General Foods*, 926 F. Supp. 321 (1995)



The Dynamic Benefits of Markets (with Market Power)

Markets as an Evolutionary Process



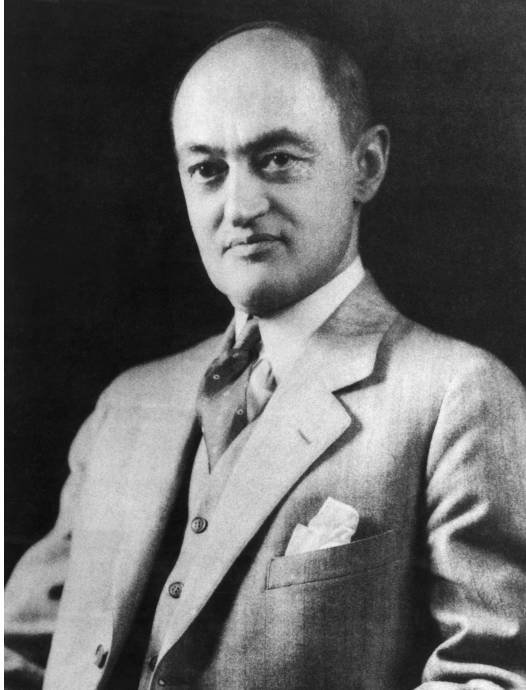
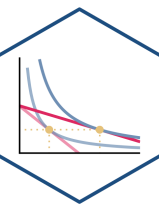
Joseph Schumpeter

1883-1950

“Capitalism...is by nature a form of economic change and not only never is but never can be stationary...The essential point to grasp is that in dealing with capitalism we are dealing with an **evolutionary process**,” (pp.82).

“[I]n capitalist reality as distinguished from its textbook picture, it is...that kind of competition...from the new commodity, the new technology, the new source of supply, the new type of organization...**competition** which commands a decisive cost or quality advantage **which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives**,” (p.132).

Creative Destruction



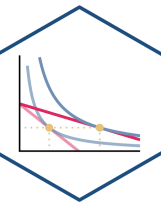
Joseph Schumpeter

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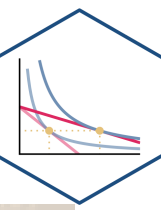
“Industrial mutation—if I may use that biological term—that **incessantly revolutionizes the economic structure from within**, incessantly destroying the old one, incessantly creating a new one. This **process of Creative Destruction is the essential fact about capitalism**. It is what capitalism consists in and what every capitalist concern has got to live in,” (p.83).

Schumpeter, Joseph A, (1947), *Capitalism, Socialism, and Democracy*

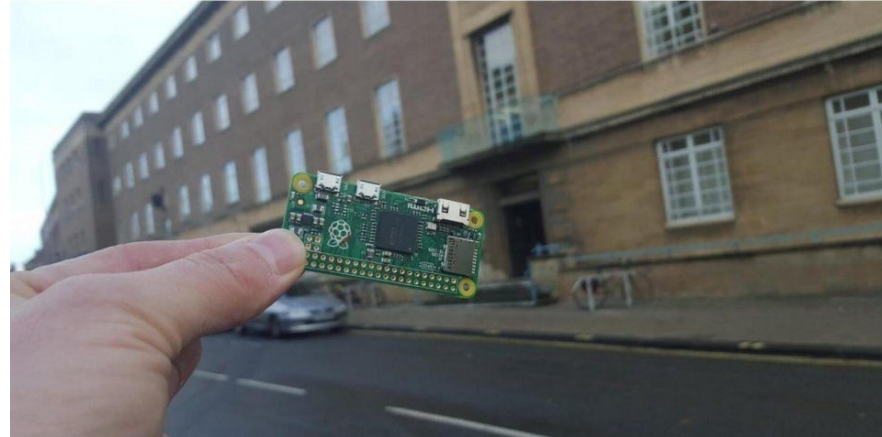
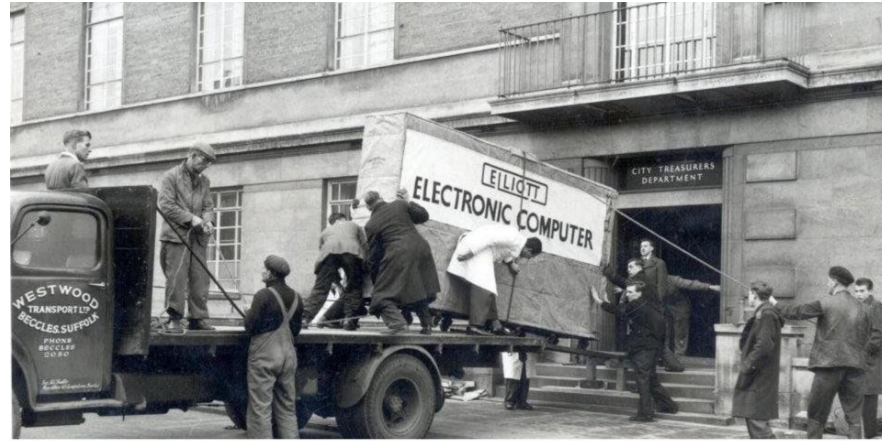
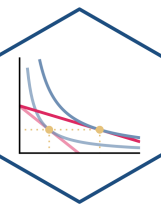
Creative Destruction: Examples



Creative Destruction: Example II

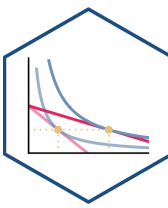


Creative Destruction: Example III



59 years of progress

No Corporate Monolith Lasts Forever (On Its Own)



Guardian

News Opinion Sport Culture Lifestyle

Will MySpace ever lose its monopoly?

Victor Keegan

Thu 8 Feb 2007 07:41 EST

Nokia

**ONE BILLION CUSTOMERS—
CAN ANYONE
CATCH THE
CELL PHONE KING?**

HOW **YAHOO!** WON THE SEARCH WARS

BY RANDALL E. STROSS

Once upon a time, Yahoo! was an internet search site with mediocre technology. Now it has a market cap of \$2.8 billion. Some people say it's the next America Online.

TECHNEWSWORLD

OPINION

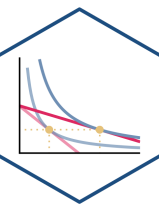
MySpace Is a Natural Monopoly

By John Barrett
Jan 17, 2007 4:00 AM PT

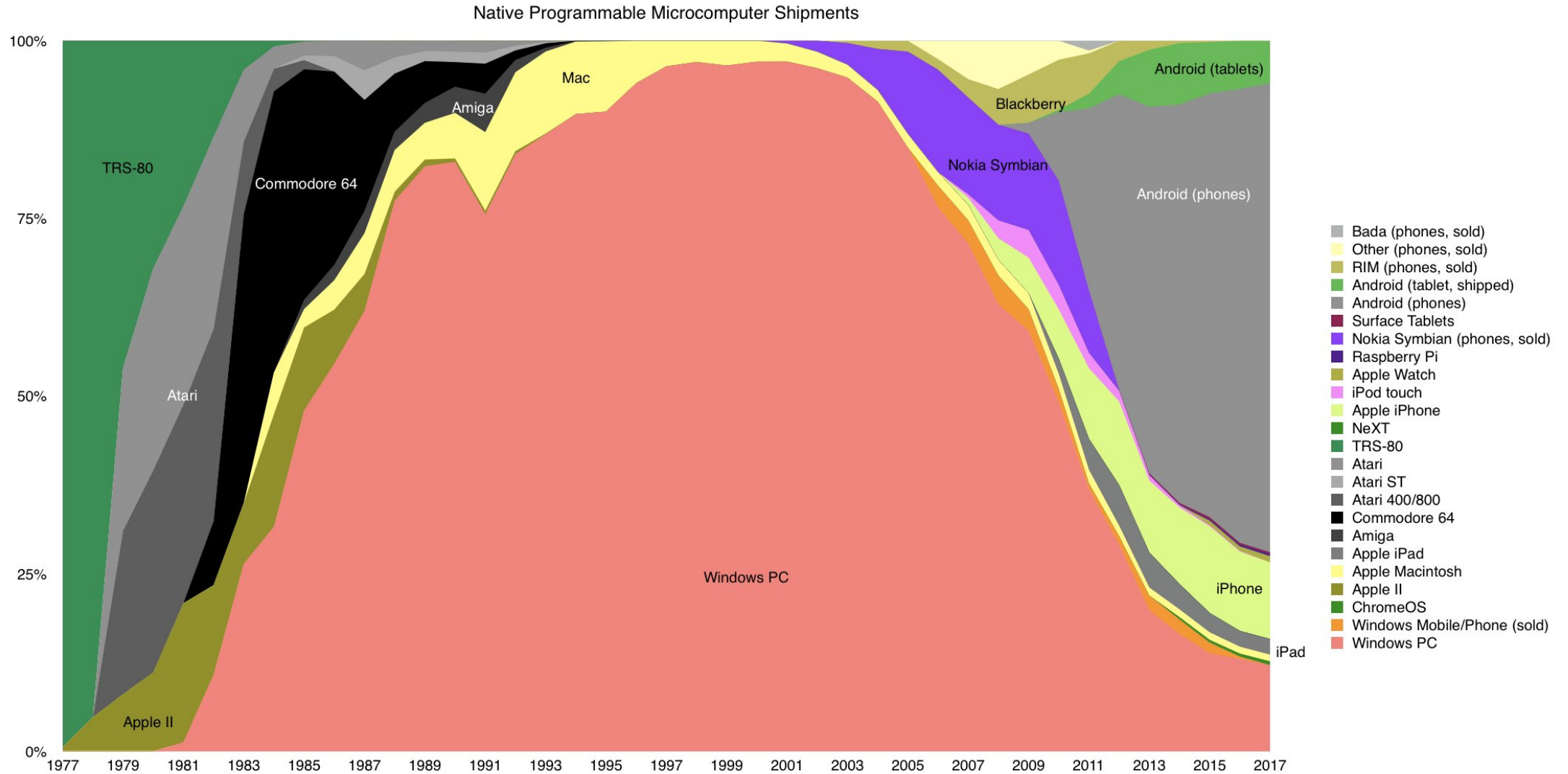
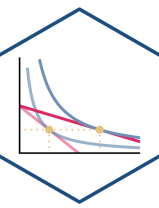
Economics teaches that the market for some goods and services are "natural" monopolies.

Take telephone service, for example. A telephone service is only really valuable if any person with a phone can be connected to any other person with a phone. For this reason, the market will "naturally" coalesce around a single, monopoly provider unless the government

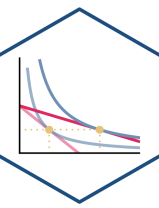
No Corporate Monolith Lasts Forever (On Its Own)



No Corporate Monolith Lasts Forever (On Its Own)



No Corporate Monolith Lasts Forever (On Its Own)



ZDNet Q MENU US

AOL quietly linking AIM, ICQ

It is now possible for many to use Instant Messenger to communicate with ICQ users -- creating a potential 138 million member network.

By [Julia Angwin](#) | September 26, 2000 -- 00:00 GMT

QUARTZ

GOODBYE

AOL Instant Messenger is dead

By [Mike Murphy](#) · October 6, 2017

WIRED SUBSCRIBE

WIRED STAFF BUSINESS 12.26.00 02:00 AM

AOL'S INSTANT MESSAGING MONOPOLY?

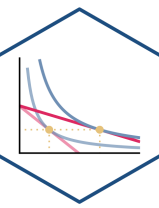
WASHINGTON - All else being equal, Duane Roelands would prefer to dash off short instant text messages to co-workers and friends with the

The New York Times

PLAY THE CROSSWORD

Zuckerberg Plans to Integrate WhatsApp, Instagram and Facebook Messenger

No Corporate Monolith Lasts Forever (On Its Own)

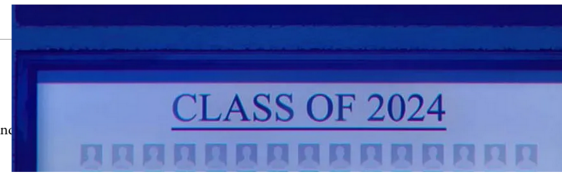
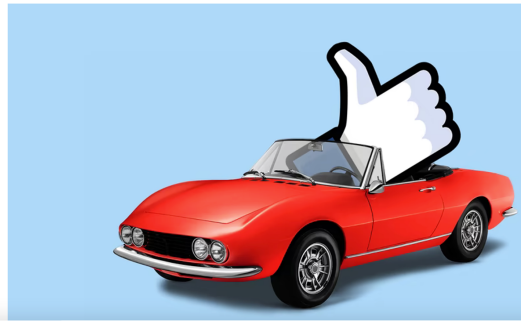


Popular Latest *The Atlantic*

What Happened When Facebook Became Boomerbook

Leaked documents reveal that a company that was once rebellious and optimistic is now bloated, regretful, and uncool.

By Helen Lewis



FACEBOOK'S LOST GENERATION

The world's largest social network is internally grappling with an existential crisis: an aging user base

By [Alex Heath](#) | [@alexheath](#) | Oct 25, 2021, 7:00am EDT
Illustration by [Alex Castro](#)

f t SHARE

Earlier this year, a researcher at Facebook shared some alarming statistics with colleagues.

Teenage users of the Facebook app in the US had declined by 13 percent since 2019 and were projected to drop 45 percent over the next two years, driving an overall decline in daily users in the company's most lucrative ad market. Young adults between the ages of 20 and 30 were expected to decline by 4 percent during the same timeframe.

The New York Times



THE SHIFT
Facebook Is Weaker Than We Knew
A trove of leaked documents, published by The Wall Street Journal, hints at a company whose best days are behind it.

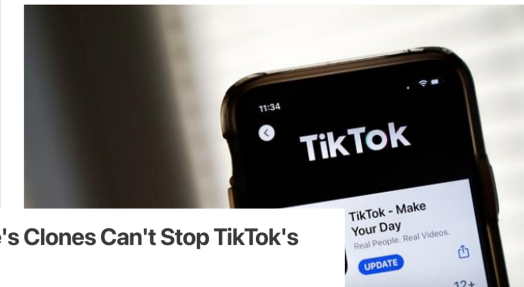
TikTok overtakes FB as most world's most downloaded social media app

Chinese short-video platform TikTok has overtaken Facebook as the most downloaded social media app in the world, the media reported.

Topics
TikTok | Facebook | Social media apps

IAN5 | Beijing
Last Updated at August 10, 2021 13:09 IST

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Facebook and Google's Clones Can't Stop TikTok's Growth

TikTok just hit 1 billion users.

Adam Levy (TMF+Coffee)
@adamlevy · Author Bio

Follow @admlv

Key Points

- TikTok has grown despite efforts to clone its product by competitors.
- The service has shrugged off challenges from Facebook and Google's previous efforts to squash it.
- TikTok is becoming very attractive for valuable e-commerce ad spending.

Since launching globally four years ago, TikTok's user growth has been insane. It started 2018 with about 55 million monthly users, and now it has over 1 billion. Growth has barely slowed over the last 14 months, with the short-form video app adding over 300 million new users in that time.

Meanwhile, the digital ad duopoly of [Facebook \(NASDAQ:FB\)](#) and [Alphabet's \(NASDAQ:GOOGL\)](#) Google has taken steps to combat the rise of TikTok, which poses a threat to engagement on their platforms. The young video-sharing platform's rapid growth may be the biggest threat either company has seen in the social media space.

Motley Fool Returns
STOCK ADVISOR S&P 500
689% ▲ **146%** ▲
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DISCLOSURE: OFFERS ARE ONLY AVAILABLE TO NEW MEMBERS. STOCK ADVISOR WILL REVIEW AT THE THEN-CURRENT NET PRICE. STOCK ADVISOR NET PRICE IS \$199 PER YEAR.
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Don't miss out. Market closes in...
01 : 48 : 54
Hours Minutes Seconds

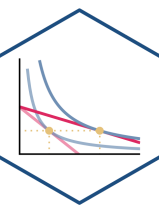
Monopoly *Persists* Because of Entry Barriers



- Monopoly exists, and persists, because of **barriers to entry**
 - otherwise, profits would get competed away by new entrants
 - markets become competitive over time as entrepreneurs enter & produce substitutes
- **How easy is it to enter and compete with existing firm?**

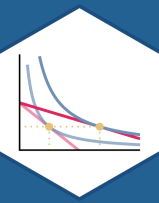


Monopoly *Persists* Because of Entry Barriers



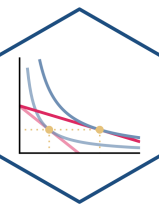
- (Some) possible types of entry barriers:
 - **Control over key resource**
 - **Technological superiority:** Name/brand recognition, high fixed/sunk costs, economies of scale, network externalities
 - **Government regulation:** Intellectual property rights, occupational licensing, public franchises, burdensome compliance, rent-seeking
- “Natural” vs. “artificial” barriers to entry
 - “open” vs. “closed” monopoly





What If You're Just *Better*?

Economies of Scale and Natural Monopoly I



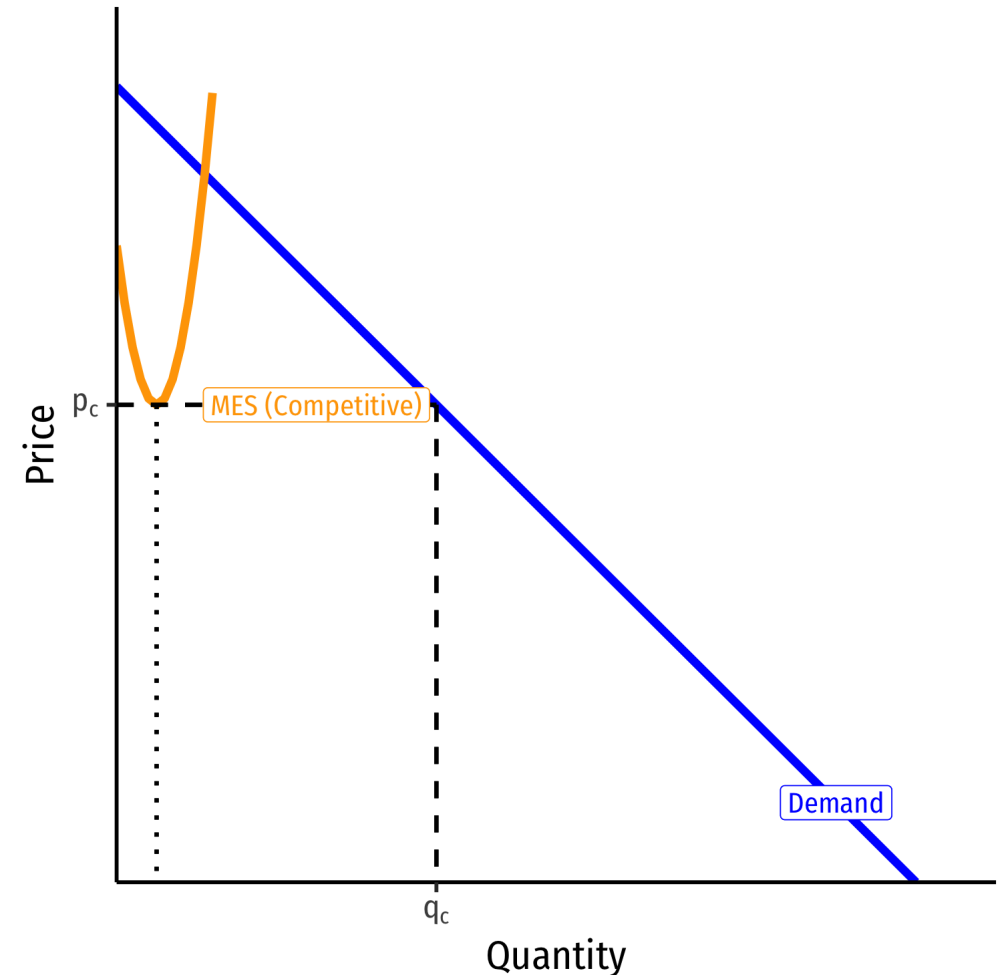
- Recall: **economies of scale**: as $\uparrow q$,
 $\downarrow AC(q)$
- **Minimum Efficient Scale (MES)**: q with the
lowest $AC(q)$



Economies of Scale and Natural Monopoly I



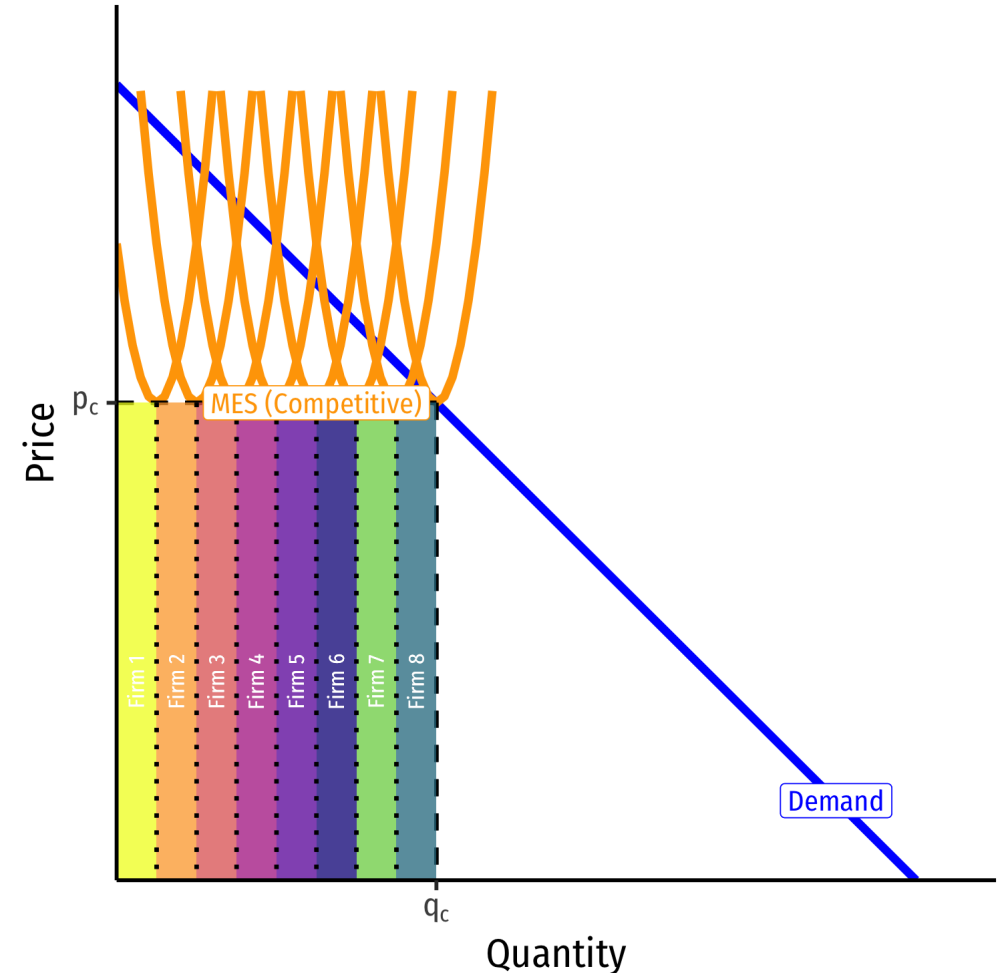
- Recall: **economies of scale**: as $\uparrow q$,
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- **Minimum Efficient Scale (MES)**: q with the lowest $AC(q)$
- If MES is small relative to market demand...
 - **AC** hits **Market demand** during **diseconomies of scale**...



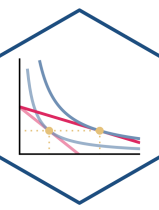
Economies of Scale and Natural Monopoly I



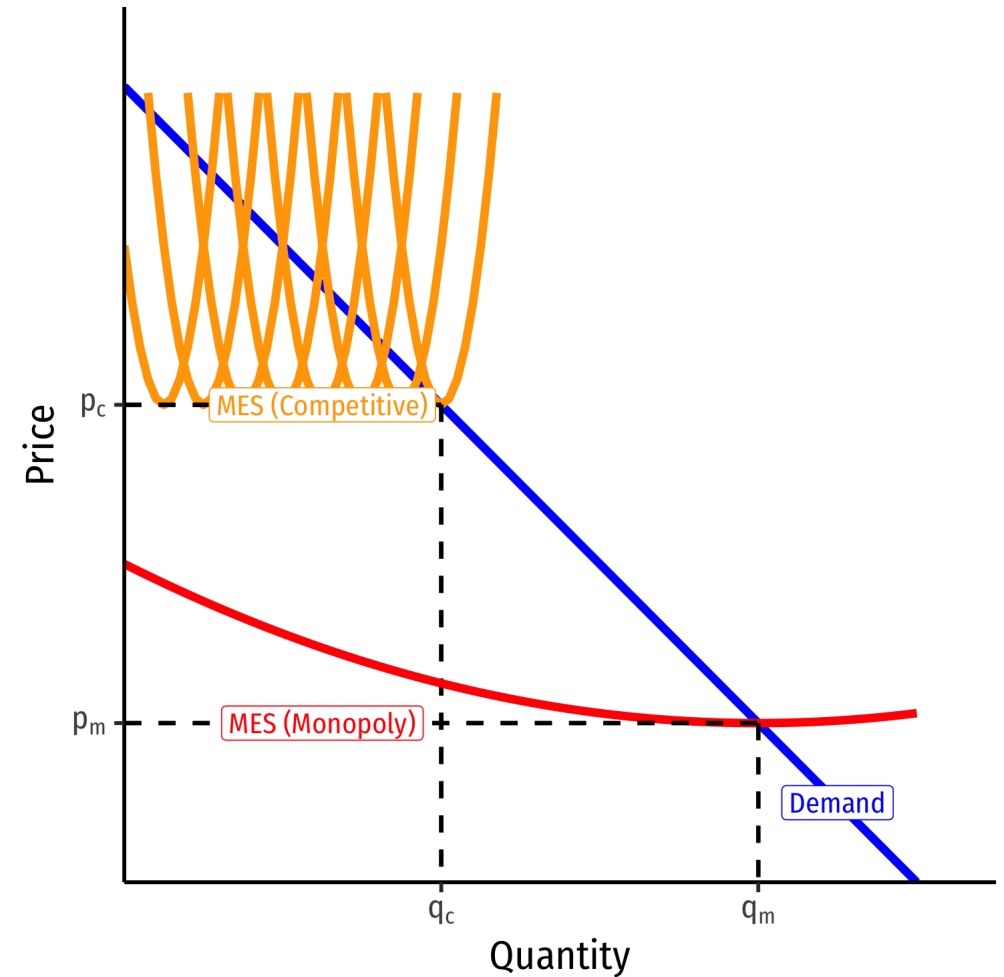
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 $\downarrow AC(q)$
- **Minimum Efficient Scale (MES)**: q with the lowest $AC(q)$
- If MES is small relative to market demand...
 - **AC** hits **Market demand** during **diseconomies of scale**...
 - ...can fit more identical firms into the **industry!**



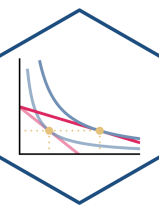
Economies of Scale and Natural Monopoly I



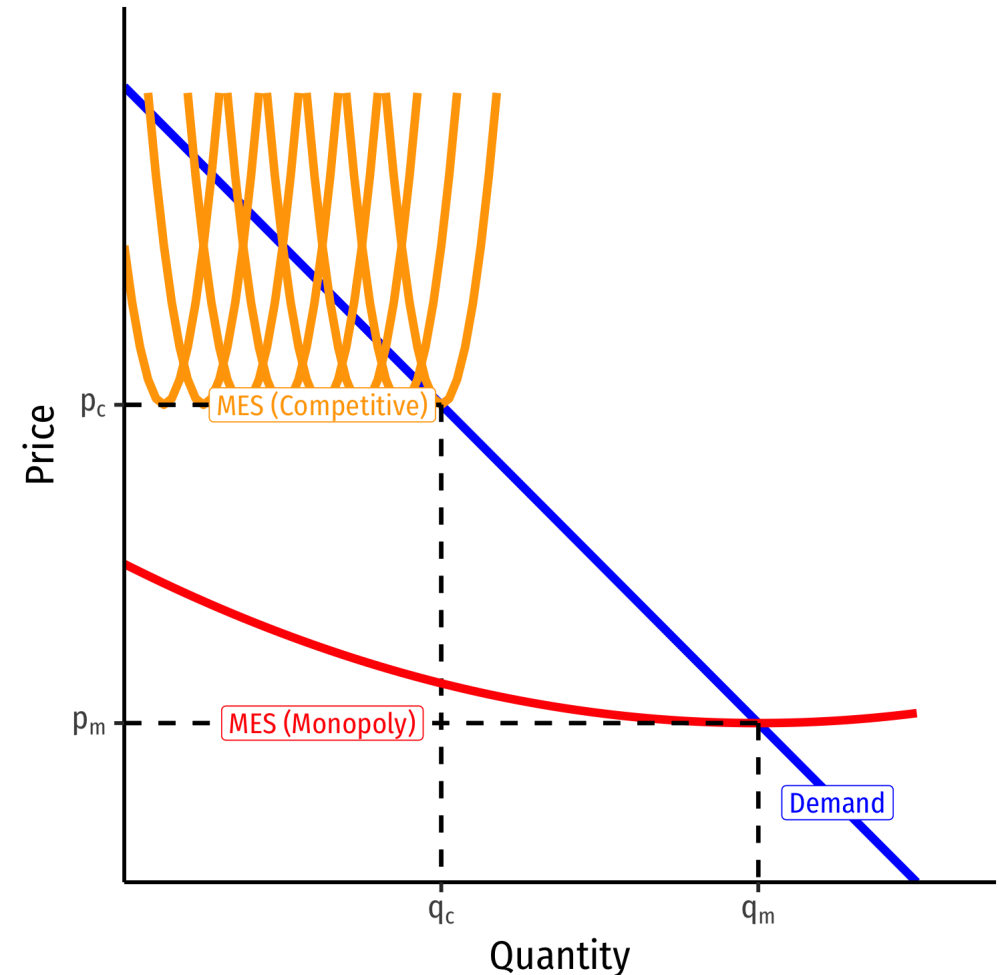
- If MES is *large* relative to market demand...
 - AC hits Market demand during **economies of scale...**
 - **likely to be a single firm in the industry!**



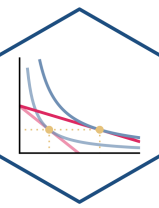
Economies of Scale and Natural Monopoly I



- If MES is *large* relative to market demand...
 - AC hits Market demand during **economies of scale...**
 - **likely to be a single firm in the industry!**
- A **natural monopoly** that can produce higher q^* and lower p^* than a competitive industry!



Economies of Scale and Natural Monopoly II

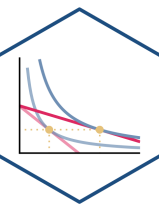


Example: Imagine a single isolated condo complex with 1,000 units far from any other buildings or telco infrastructure

- **Fixed costs:** laying fiber optics to the complex is \$100,000
- **Marginal costs:** connecting each unit: \$0



Economies of Scale and Natural Monopoly II

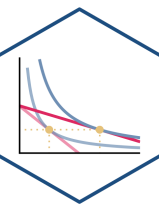


- Suppose **10 providers** split the complex, each laying down their own cables, and each serving 100 units:

$$AC(100) = \frac{\$100,000}{100} = \$1,000/\text{subscriber}$$



Economies of Scale and Natural Monopoly II



- Suppose **1 provider** serves the complex serving all 1,000 units:

$$AC(1,000) = \frac{\$100,000}{1000} = \$100/\text{subscriber}$$



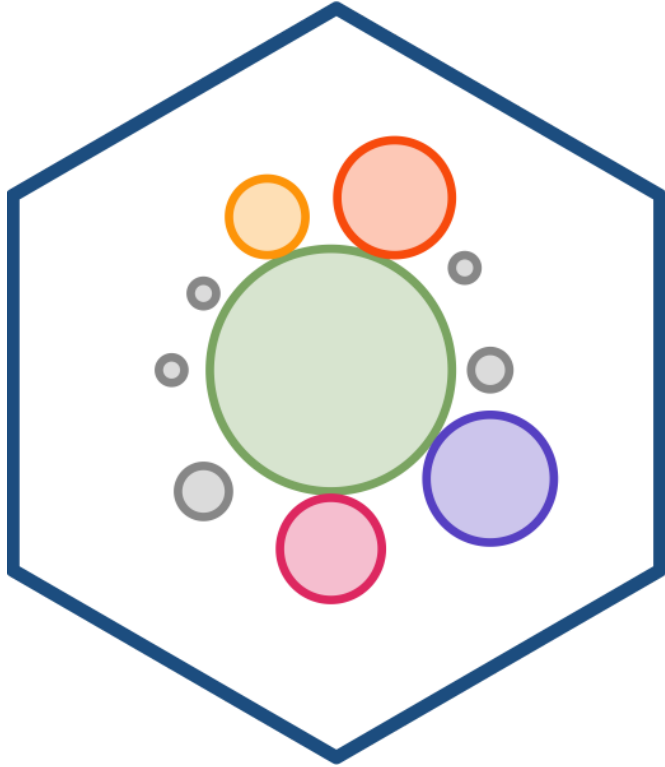
Regulating Natural Monopolies



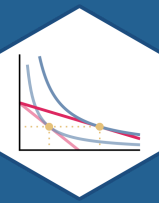
- Governments avoid “wasteful duplication” of competition by granting **exclusive franchises**: a single monopolist allowed in geographic region
- Provider made a **common carrier**: monopolist must provide universal service to all
- **Rate of return regulation**: gov’t and monopolist agree on a price to guarantee a “modest return on capital” (i.e. some $\pi > 0$)
 - Attempting to $\uparrow q$ and $\downarrow p$
 - Prohibition on price discrimination, enforced subsidies



Regulating Natural Monopoly

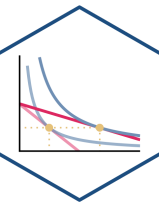


- Are big tech firms monopolies? Should they be broken up? How should they be regulated?
- We tackle some of these questions more in my Industrial Organization course:
 - [Lecture 4.4: Antitrust III: Big Tech & Hipster Antitrust](#)
 - [Lecture 4.5: Natural Monopoly Regulation](#)

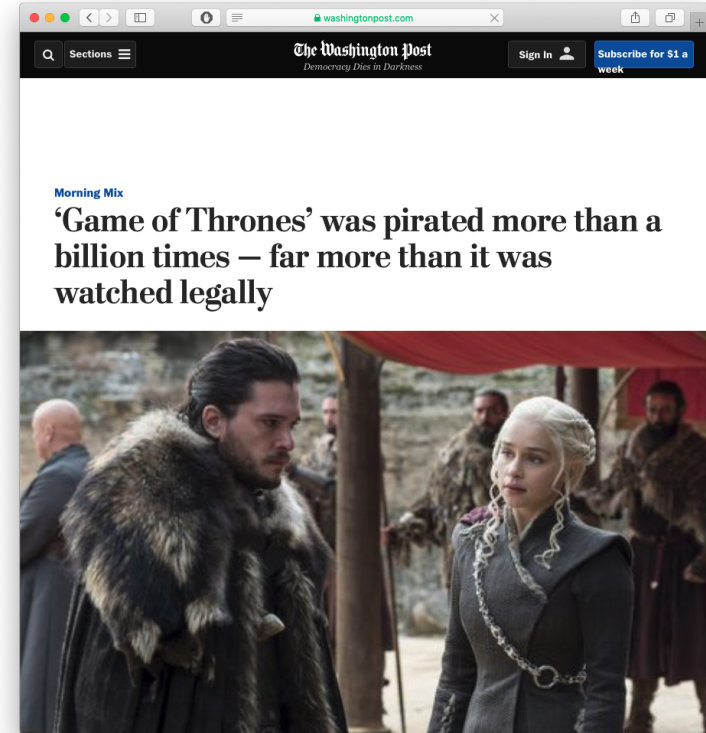
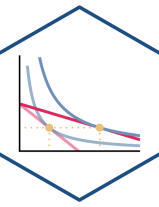


Barriers to Entry

Intellectual Property I

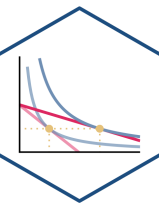


Intellectual Property II

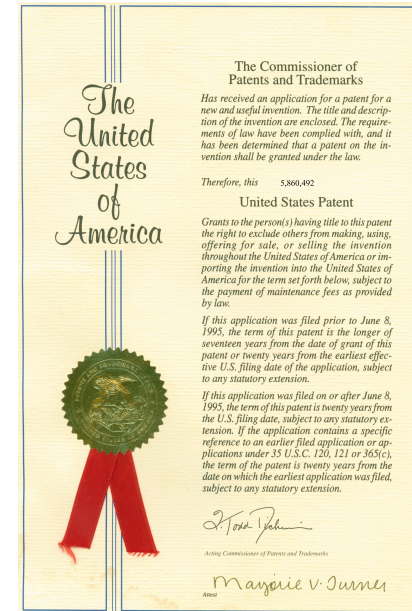


Source: [Washington Post \(Sept 8, 2017\)](#)

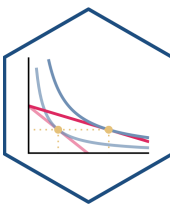
Intellectual Property III



- For these economic reasons, **patent** (for ideas and inventions) and **copyright** (for expressions) laws exist
- Grant *temporary* monopoly to recover fixed costs & provide incentive to undertake (risky and expensive) research/creativity
- A *tradeoff* between incentives & access
- See my intellectual property **lecture** from Economics of the Law for more



Intellectual Property IV



United States Patent [19] **Patent Number:** **6,004,596**
Kretchman et al. [45] **Date of Patent:** **Dec. 21, 1999**

[54] **SEALED CRUSTLESS SANDWICH** 5,853,778 12/1998 Mayfield 426/89

[75] Inventors: **Len C. Kretchman**, Fergus Falls, Minn.; **David Geske**, Fargo, N. Dak.

[73] Assignee: **Menusaver, Inc.**, Orrville, Ohio

[21] Appl. No.: **08/986,581**

[22] Filed: **Dec. 8, 1997**

[51] Int. Cl.⁶ **A21D 13/00**

[52] U.S. Cl. **426/94; 426/274; 426/275; 426/297**

[58] Field of Search **426/94, 274, 275, 426/297, 138**

[56] **References Cited**

U.S. PATENT DOCUMENTS

3,083,651	4/1963	Cooper	426/275
3,690,898	9/1972	Partyka	426/275
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3,862,344	1/1975	Zobel	426/244
4,382,768	5/1983	Lifshitz et al.	426/275

10 Claims, 4 Drawing Sheets

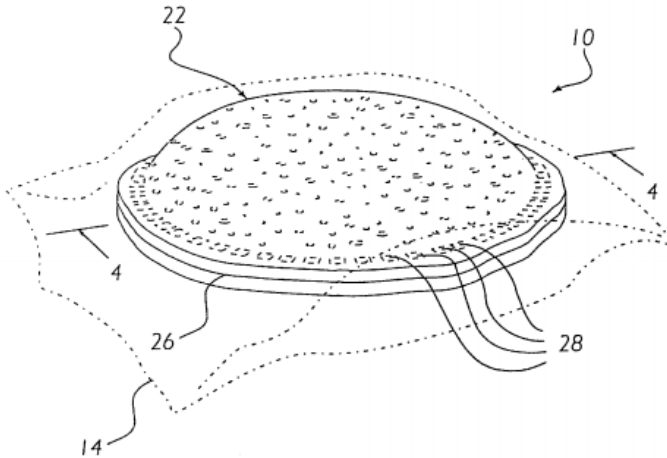
OTHER PUBLICATIONS

"50 Great Sandwiches", Carole Handslip, pp. 81-84, 86, 95, 1994.

Primary Examiner—Lien Tran
Attorney, Agent, or Firm—Vickers, Daniels & Young

[57] **ABSTRACT**

A sealed crustless sandwich for providing a convenient sandwich without an outer crust which can be stored for long periods of time without a central filling from leaking outwardly. The sandwich includes a lower bread portion, an upper bread portion, an upper filling and a lower filling between the lower and upper bread portions, a center filling sealed between the upper and lower fillings, and a crimped edge along an outer perimeter of the bread portions for sealing the fillings therebetween. The upper and lower fillings are preferably comprised of peanut butter and the center filling is comprised of at least jelly. The center filling is prevented from radiating outwardly into and through the bread portions from the surrounding peanut butter.



United States Patent [19] **Patent Number:** **5,443,036**
Amiss et al. [45] **Date of Patent:** **Aug. 22, 1995**

[54] **METHOD OF EXERCISING A CAT**

[76] Inventors: **Kevin T. Amiss**, 255 S. Fickett St., #301, Alexandria, Va. 22304; **Martin H. Abbott**, 10549 Assembly Dr., Fairfax, Va. 22030

[21] Appl. No.: **144,473**

[22] Filed: **Nov. 2, 1993**

[51] Int. Cl.⁴ **A01K 29/00**

[52] U.S. Cl. **119/707**

[58] Field of Search **119/702, 707, 174, 905; 446/485**

[56] **References Cited**

U.S. PATENT DOCUMENTS

3,877,171	4/1975	Sloop et al.	446/485
4,208,701	6/1980	Schock	
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5,194,007 3/1993 Marshall et al.

OTHER PUBLICATIONS

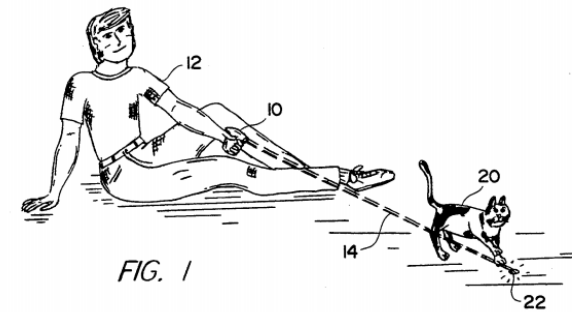
Carayan et al., "Effects of tianeptine on the Performance of a reaching movement in a cat", *Psychopharmacology*, vol. 104, Issue 3, Berlin, 1991, pp. 328-336.
 Levesque et al., "Visual 'cortical-recipient' and tectal-recipient pontine zones play distinct roles in cat visuomotor performance", *Behavioral Brain Research*, vol. 39, Netherlands, 1990, pp. 157-166.

Primary Examiner—Todd E. Manahan

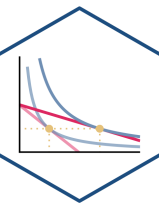
[57] **ABSTRACT**

A method for inducing cats to exercise consists of directing a beam of invisible light produced by a hand-held laser apparatus onto the floor or wall or other opaque surface in the vicinity of the cat, then moving the laser so as to cause the bright pattern of light to move in an irregular way fascinating to cats, and to any other animal with a chase instinct.

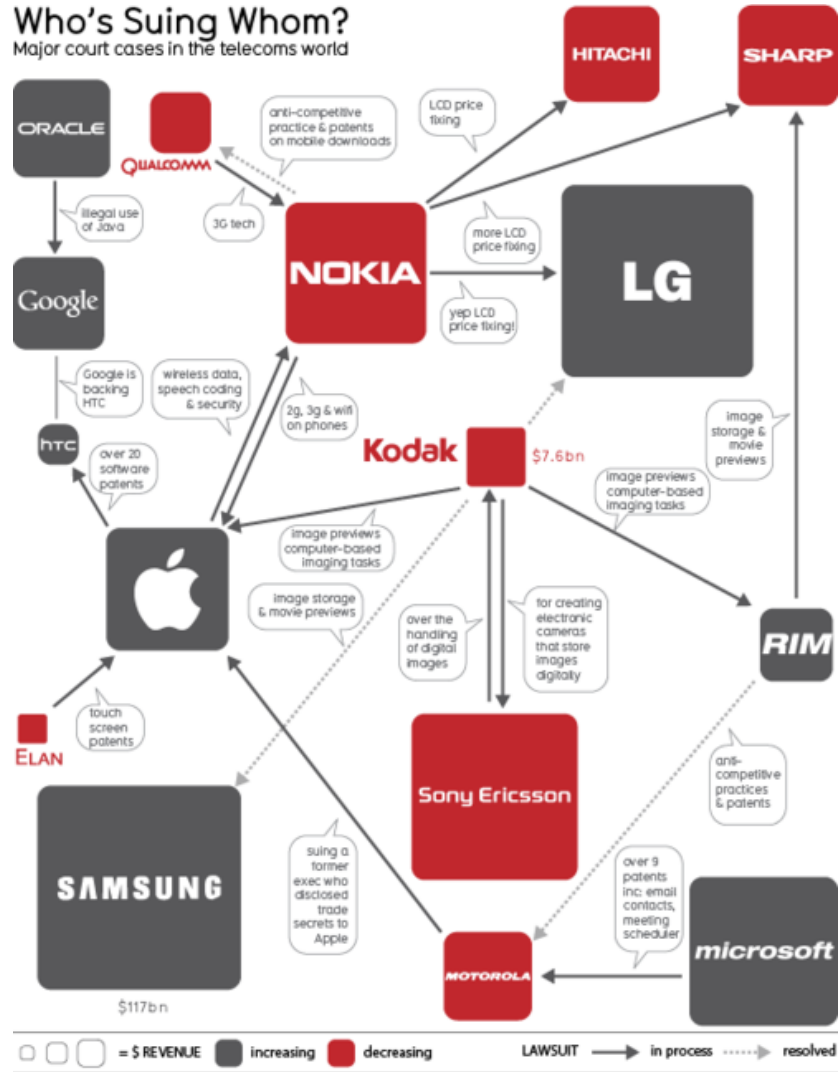
4 Claims, 1 Drawing Sheet



Intellectual Property V

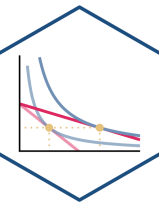


Who's Suing Whom? Major court cases in the telecoms world



- Apple, Inc. vs. Samsung Electronics Co., Ltd.
- Freakonomics: Apple vs. Samsung: Who Owns the Rectangle?

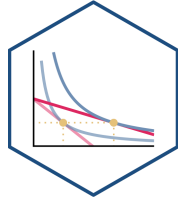
Legal Prohibitions



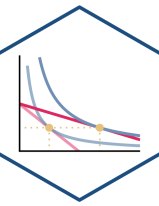
- The United States Postal Service is the only provider of first class mail allowed by order of the government
- Starting another business that delivers mail is **illegal**

“Whoever establishes any private express for the conveyance of letters or packets, or in any manner causes or provides for the conveyance of the same by regular trips or at stated periods over any post route which is or may be established by law...shall be fined...or imprisoned...or both.” ([18 U.S.C. § 1696](#))

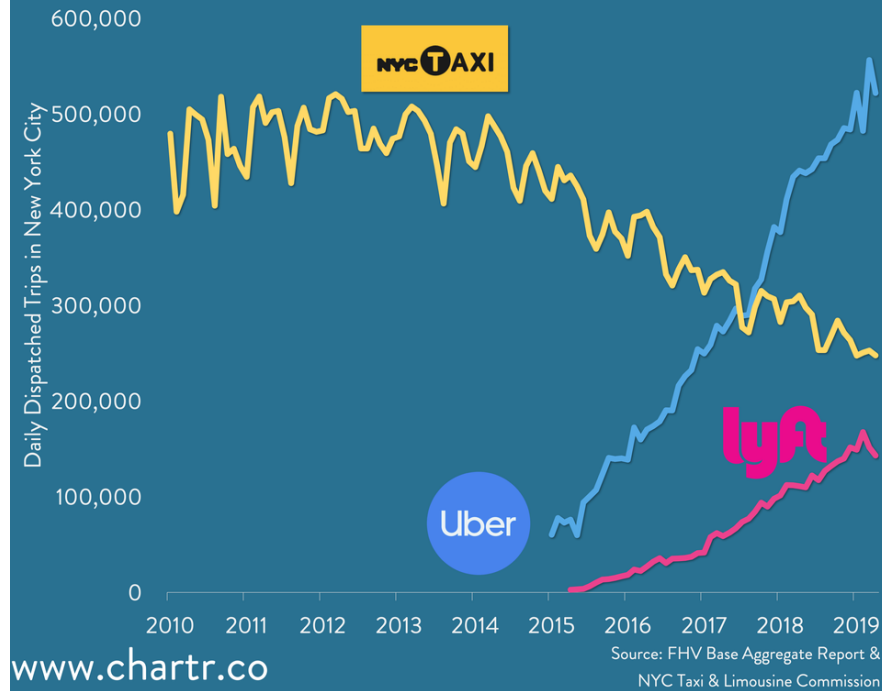
Taxis I



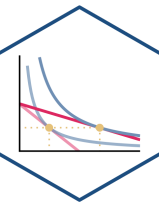
Taxis II



Uber & Lyft Have Decimated New York's Yellow Taxis



Taxis III



Occupational Licensing I

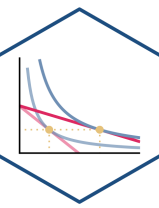


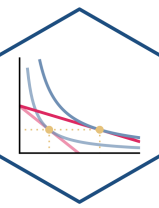
Figure 2: Share of Workers with a State Occupational License



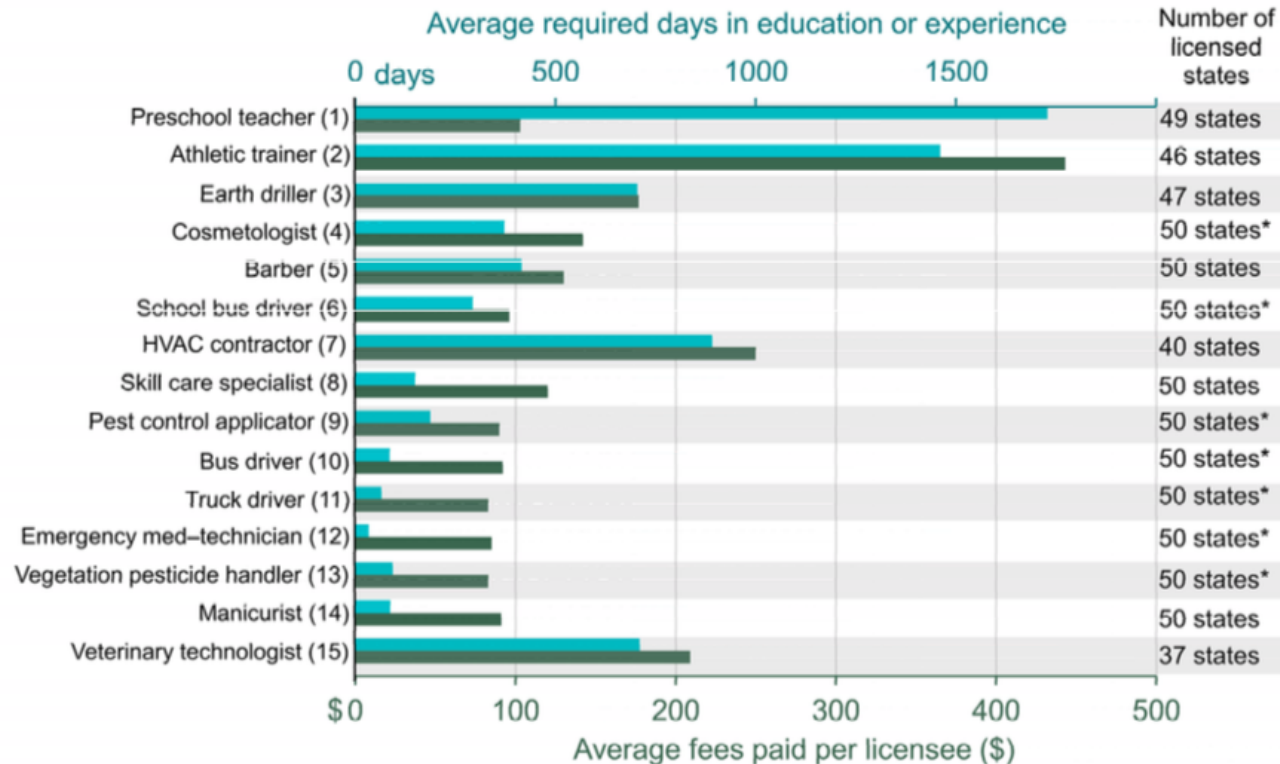
Sources: The Council of State Governments (1952); Greene (1969); Kleiner (1990); Kleiner (2006); and Kleiner and Krueger (2013), Westat data; CEA Calculations.

In 1950, 1 in 20 jobs required a license. Today it's 1 in 4. Source: [Obama White House \(2015\): Occupational Licensing: A Framework for Policymakers](#)

Occupational Licensing II

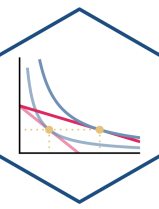


Low-Income Occupations Ranked by Number and Burden of Licensing



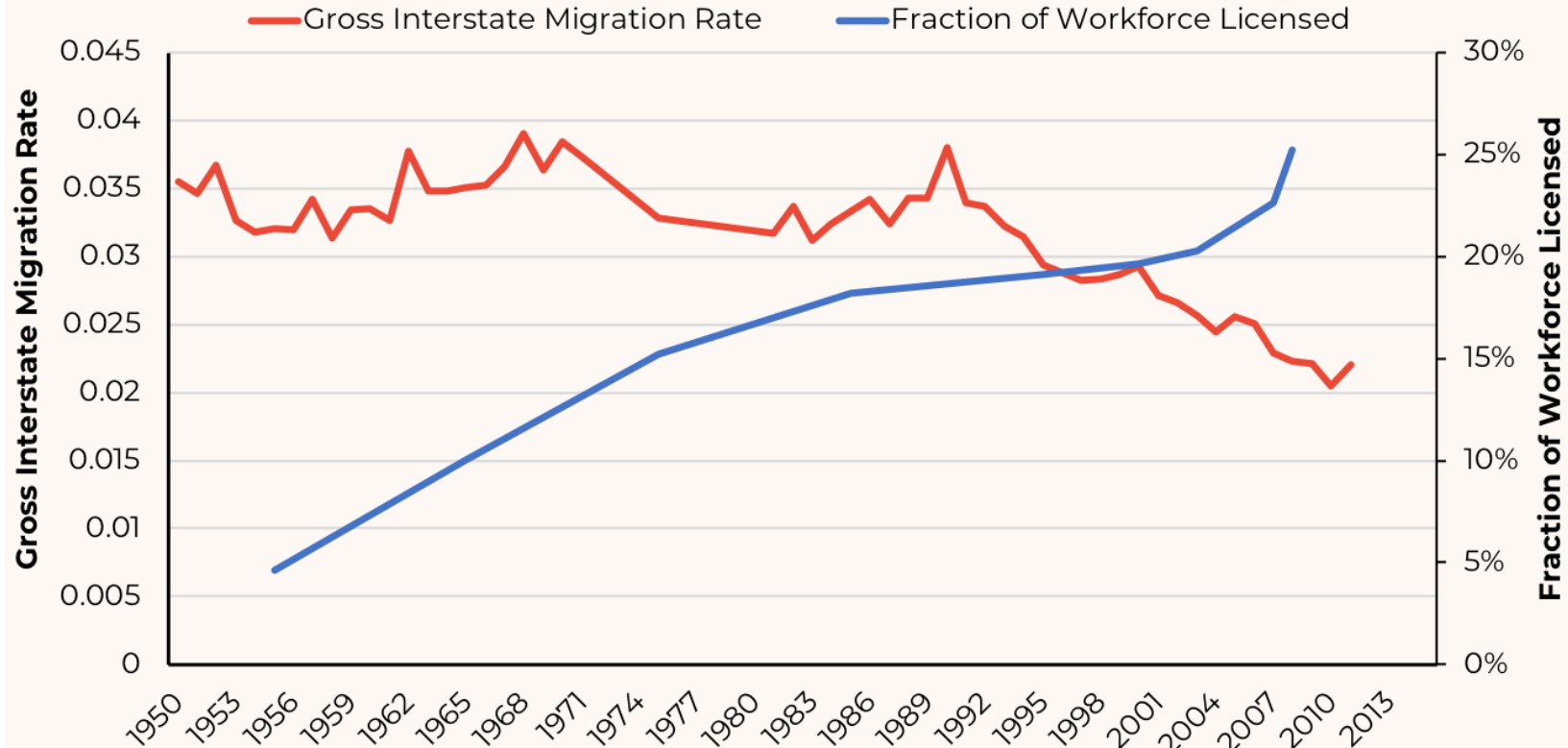
*Also includes the District of Columbia.
 Note: Rankings based on average fees combined with education or experience requirements.
 Source: Dick Carpenter et al., "License to Work: A National Study of Burdens from Occupational Licensing,"
 Institute for Justice Research Report (2012), <http://ij.org/licensetowork>.
 Produced by Veronique de Rugy and Rizqi Rachmat, Mercatus Center at George Mason University.

Occupational Licensing III



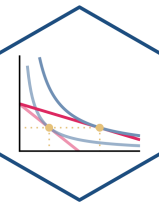
Interstate Migration Rates and Occupational Licensure

Interstate migration has declined as a greater share of the workforce became licensed.



Source: Janna E. Johnson and Morris M. Kleiner, "Is Occupational Licensing a Barrier to Interstate Migration," National Bureau of Economic Research Working Paper no. 24107, December 2017.

Occupational Licensing IV

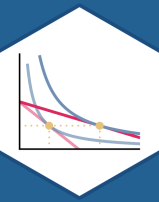


The screenshot shows a web browser displaying the NPR Planet Money website. At the top, there are logos for NPR, WAMU 88.5, and a 'DONATE' button. Below that is the Planet Money logo with the tagline 'THE ECONOMY EXPLAINED'. The main content area features the title 'Episode 381: Why It's Illegal To Braid Hair Without A License' under the 'TRADE' category. It includes a 'SUBSCRIBE' button, a '12-Minute Listen' button, and a '+ PLAYLIST' button. A social media sharing bar is visible on the left. The bottom portion of the image shows a close-up of a woman's face as she braids her hair.

“It is illegal in the state of Utah to do any form of extensions without a valid cosmetology license,’ the e-mail read. ‘Please delete your ad, or you will be reported.’

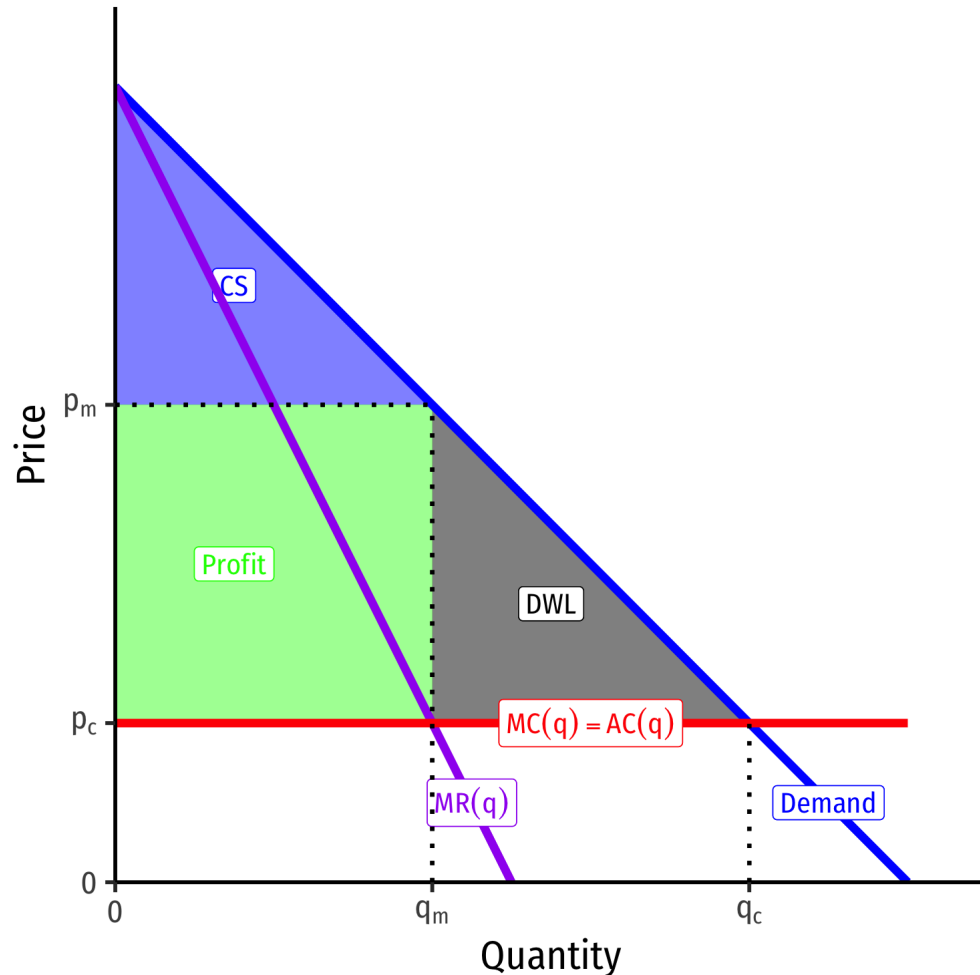
To get a license, Jestina would have to spend more than a year in cosmetology school. Tuition would cost \$16,000 dollars or more.”

Source: [NPR Planet Money](#).



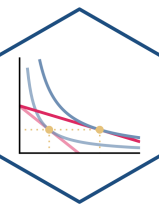
The *Ugly* of Market Power: Rent-Seeking

The *Ugly* of Market Power: Rent-Seeking I



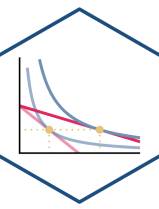
- The **monopoly profits** earned with market power are an **economic rent**
 - A windfall return above opportunity cost (MC)
 - Creates an artificial scarcity from restricting entry & competition
- This is the “**prize**” of market power

The *Ugly* of Market Power: Rent-Seeking II



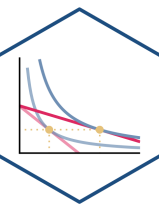
- Think of an **economic rent** as a “prize,” the payment a person receives for a good above its opportunity cost
- Creating rents creates competition for the rents, causing people to invest resources in **rent-seeking**
- The social cost of the rent is all of the resources invested in rent-seeking!

Government Intervention Creates Rents I



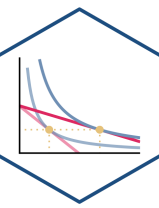
- Political authorities intervene in markets in various ways that benefit some groups at the expense of everyone else
 - subsidies to groups (often producers)
 - regulation of industries
 - tariffs, quotas, and special exemptions from these
 - tax breaks and loopholes
 - conferring monopoly and other privileges
- See Mitchell (2013) in [today's readings](#) for examples

Government Intervention Creates Rents I



- These interventions create **economic rents** for their beneficiaries by restricting competition
- This is a transfer of wealth from consumers/taxpayers to politically-favored groups
- The problem in politics **is you cannot give away money for free even if you tried!**
- The promise of earning a rent breeds **competition over the rents (rent-seeking)**
 - investments of resources to lobby political officials

Rent-Seeking

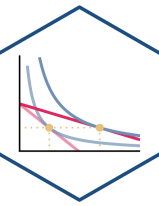


Gordon Tullock

1922-2014

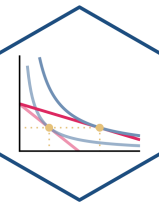
“The rectangle to the left of the [Deadweight loss] triangle is the income transfer that a successful monopolist can extort from the customers. **Surely we should expect that with a prize of this size dangling before our eyes, potential monopolists would be willing to invest large resources in the activity of monopolizing. ... Entrepreneurs should be willing to invest resources in attempts to form a monopoly** until the marginal cost equals the properly discounted return,” (p.231).

Tax Preparation?



The screenshot shows the ProPublica website interface. At the top, there are navigation links for 'ProPublica', 'Illinois', 'Local Reporting', 'Electionland', and 'Data Store'. A 'Donate' button is visible on the right. The main header features the ProPublica logo and navigation links for 'Graphics & Data', 'Newsletters', and 'About'. Below this is a secondary navigation bar with icons for 'Politics', 'Debt', 'Health Care', 'More...', 'Series', 'Video', 'Impact', and a search icon. The main content area displays the article title 'THE TURBOTAX TRAP' in bold, followed by the main headline 'Filing Taxes Could Be Free and Simple. But H&R Block and Intuit Are Still Lobbying Against It.' in a larger, bold font. A short paragraph below the headline reads: 'The makers of TurboTax and other online systems spent millions lobbying last year, much of it directed toward a bill that would permanently bar the government from offering taxpayers prefilled filings.'

Source: [ProPublica \(Mar 20, 2017\)](#)



nytimes.com

SEARCH EAT

The New York Times

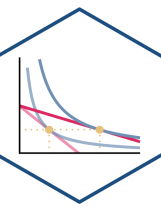
SUBSCRIBE NOW LOG IN

Got Almond Milk? Dairy Farms Protest Milk Label on Nondairy Drinks

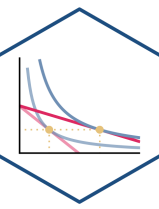
Subscribe for \$1 a week. Ends tomorrow. SUBSCRIBE

Source: [New York Times \(Feb 13, 2017\)](#)

If You Look at the World Long Enough...



Regulation has a Dark Side



George Stigler

1911-1991

Economics Nobel 1982

“[A]s a rule, regulation is acquired by the industry and is designed and operated primarily for its benefits,”
(p.3).

“[E]very industry or occupation that has enough political power to utilize the state will seek to control entry. In addition, the regulatory policy will often be so fashioned as to retard the rate of growth of new firms,”
(p.5).

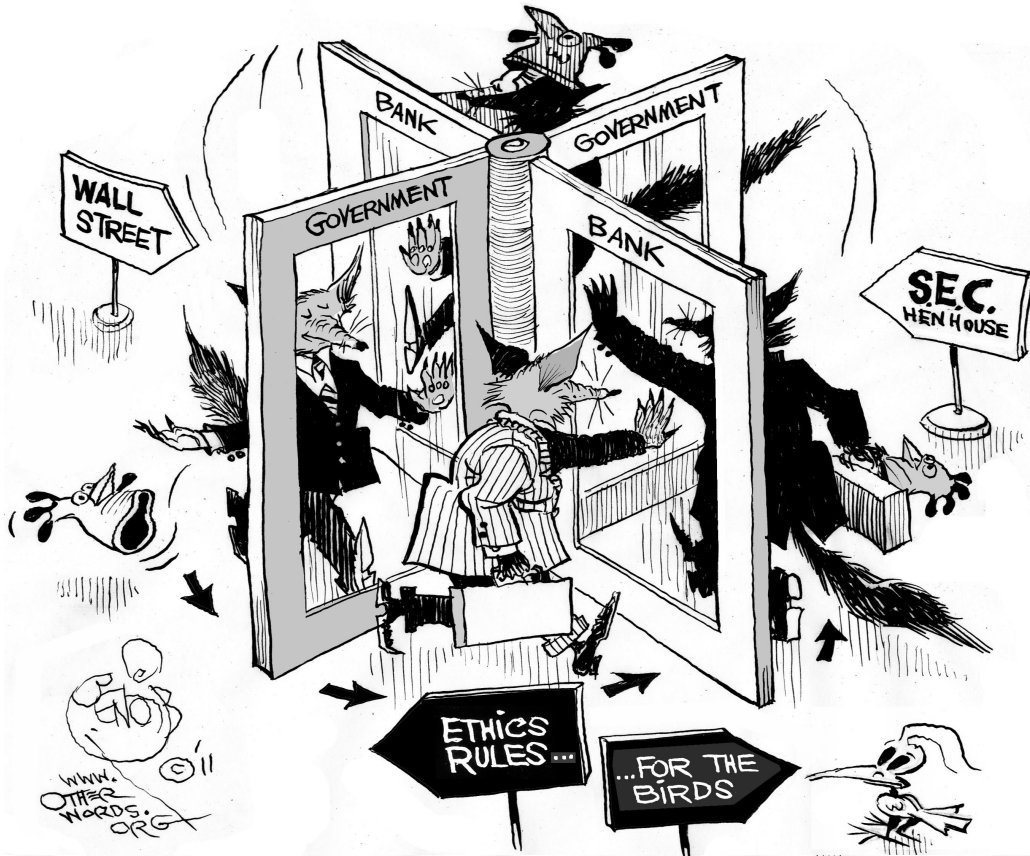
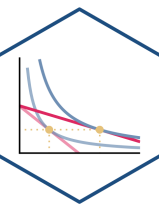
Stigler, George J, (1971), “The Theory of Economic Regulation,” *Bell Journal of Economics and Management Science* 3:3-21

Regulation has a Dark Side



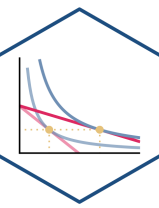
- **Regulatory capture:** a regulatory body is “**captured**” by the very industry it is tasked with regulating
- Industry members use agency to further their own interests
 - Incentives for firms to design regulations to harm competitors
 - Legislation & regulations written by lobbyists & industry-insiders

Regulation has a Dark Side



- One major source of capture is the **“revolving door”** between the public and private sector
- Legislators & regulators retire from politics to become highly paid consultants and lobbyists for the industry they had previously “regulated”

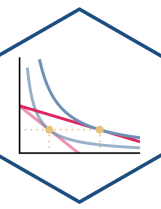
Why Do Firms Rent-Seek?



- Markets serve **consumers** (“consumer sovereignty”), *not* producers (or workers, etc)!
- Successful market economies **produce wealth** and **destroy jobs** (and sometimes, industries)
- Economic growth \equiv more output with fewer inputs
- A **political problem**: why would producers permit the **destructive** side of creative destruction?



No Easy Solutions, Only Trade Offs!

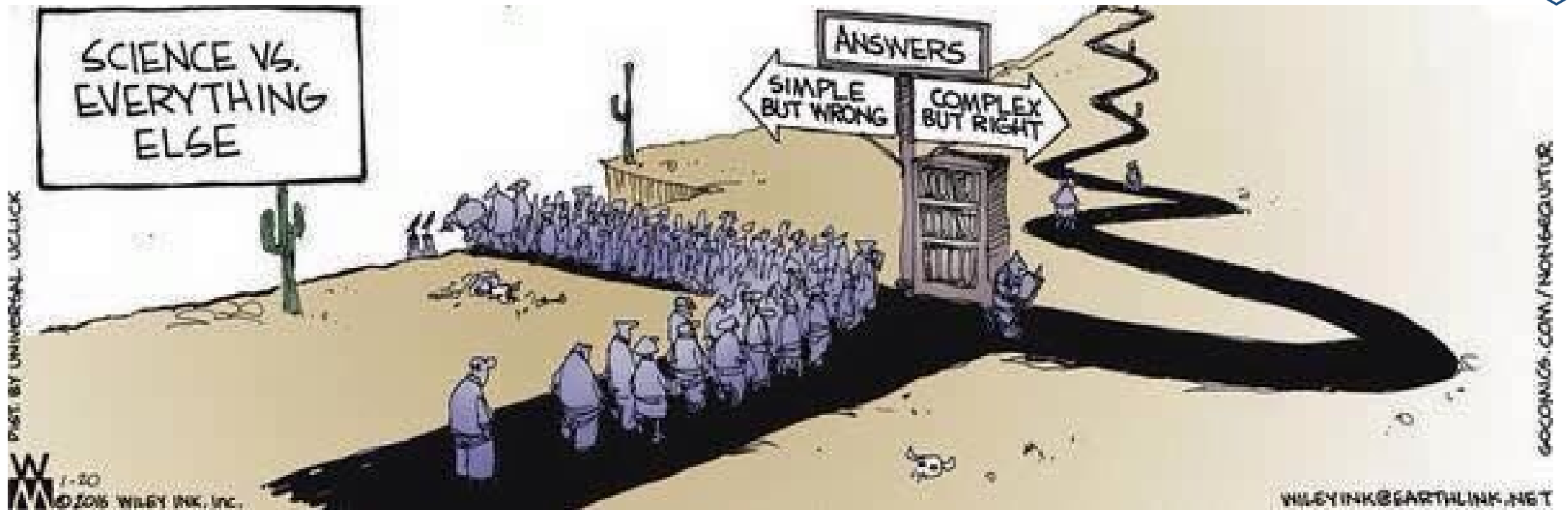
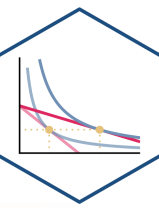


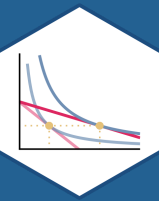
Thomas Sowell

1930—

“[In economics] there are no solutions, there are only tradeoffs.”

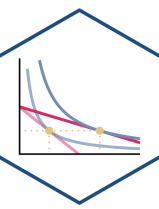
No Easy Solutions, Only Trade Offs!





Antitrust

Antitrust and Competition Law I



- Aren't monopolies illegal in the U.S.?
- **Yes:** engaging in anticompetitive practices in the U.S. is illegal under **antitrust laws**
 - Laws intended to promote economic competition and reduce excessive market power
 - enforced by DOJ (criminal) and FTC (civil)



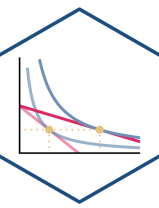
Antitrust and Competition Law II



- Aren't monopolies illegal in the U.S.?
- **No**: most monopolies exist *because* of explicit or implicit government-backing
 - Some markets actually work *better* as a monopoly (“**the good**”, **natural monopoly**, patents, etc.)
 - Some markets and regulators are **captured** via **rent-seeking** firms to block competition (“**the ugly**”)



Antitrust and Competition Law III



Sherman Antitrust Act (1890)

§ 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 [...]"