

ECON 5103 Unit 13, Video 1

Chapter 14

Government in the marketplace, part I

Market Power and government protections

New Section 2 Page 1

Market power: the ability of a firm to charge a price for a product that exceeds its marginal cost.

Market power tends to increase as the number of firms in an industry declines. (Reduced competition means that firms won't undercut each other's prices.)

Market power results in high product prices that

--harm consumers

--result in an inefficiently small level of output in an industry

New Section 2 Page 2

**Antitrust Laws** are meant to outlaw practices that would give firms too much market power, harming consumers.

The "Rule of Reason": Business practices that result in increased market power that harm consumers to an unacceptable degree are outlawed. (This leaves the Department of Justice leeway in interpreting when to intervene in markets.)

New Section 2 Page 3

### **Sherman Act (1890, amended in 1974)**

Outlaws agreements which "unreasonably restrains competition" (interpreted by courts to mean that it hurts consumers by increasing prices excessively)

Can be used to break up a large firm that has attained this power through agreements that "unreasonably restrain competition."  
(Standard Oil, AT&T)

New Section 2 Page 4

## **Sherman Act, cont'd**

Does not outlaw large firms if their growth is due to having a superior product, service or pricing (e.g. Wal-Mart) or is due to "historic accident"

## **Clayton Act (1914, amended in 1936 and 1950):**

Outlaws:

Price discrimination if it leads to excessive market power that leads to higher average prices (e.g. Exxon sells gas cheaper to some gas stations than others)

Exclusive agreements and tie-ins that harm consumers (e.g. Intel tells Dell only to use Intel chips to get a discount)

Can be used to prevent mergers and acquisitions (friendly or unfriendly) that would give the new firm "monopoly power" that hurts consumers

## Regulating the prices that monopoly charges rather than outlawing it

Example: public utility (water, sewer, electric)

Most common alleged price regulation: Allow monopoly to charge a price equal to average cost of production. This means zero economic profits for the monopoly--a "**normal rate of return**" that is achieved in the long run by firms in competitive industries.

New Section 2 Page 7

Also be aware of **price-gouging** laws, which can vary by state/city and are often invoked during natural disasters

■

### **Price Gouging is Illegal!!**



The Galveston County Emergency Operations Center wishes for everyone to be aware -- [price gouging is illegal!](#)

The Texas Deceptive Trade Practices-Consumer Protection Act provides that it is a false, misleading, or deceptive act or practice to take advantage of a disaster declared by the Governor by:

- selling or leasing fuel, food, medicine, or another necessity at an exorbitant or excess price, or
- demanding an exorbitant or excessive price in connection with the sale or lease of fuel, food, medicine or another necessity

New Section 2 Page 8

Patents:

A patent is legal form of monopoly not subject to antitrust laws (including pricing laws).