

The Economic Way Of thinking

Competition & Government Policy

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Summary

Competition as a process

■ it arises when these are present:

- ① large number of sellers and buyers, no one controls no one.
- ② market participants possess full and complete information.
- ③ sellers produce a homogenous product
- ④ There is costless mobility ~~into~~ of resources.
- ⑤ Economic actors are price takers

■ This model is kind of unrealistic, it ignores the role of entrepreneurship, ignores the plan adjustment process that characterizes real world market activity

Preasures of competition

- Sellers seek to maximize revenue with keeping the price above marginal cost.
- prices higher than marginal cost are an invitation to competition, thus one has to strategize very efficiently to be able to win to that competition.
- A strategy used often is price discrimination
- The subjective estimations of demand of one product done by several businesses affects the demand on other businesses, because based on these estimates the prices are set.

Controlling Competition

• why don't competitors don't just get together and agree on some policy for them all to have profit fair and square? Because they like to compete and rarely want to do this, but when they do they create a cartel.

• the incentives to compete are so large that even if they solve it almost always ends up in one of them residing from the deal and competing.

• Cartels have 2 problems: prevent competition from its members and prevent anyone else from entering.

- The excuses for price searcher and price takers are very creative as to why there should exist legal restrictions on competition.
- But to restrict entry and exit of a market sector is to diminish entrepreneurial activity.
- Frederick Bastiat and satire of the candle factory and the sun.
- Legal restrictions on competition seek to make entry difficult.

Restrictions On Competition

- Restrictions on competition seek to reduce uncertainty and to guarantee profit.
- Associations like plumbers union, physicians' association etc, seek to rule out competition using the government.

Competition for the Key Resource: The \$1,000,000 taxi licence.

- NY city bided medallions up to \$1,000,000 for each new taxi cab license.

Competition and Property Rights

- Profit and losses arise from uncertainty and cannot exist in the absence of uncertainty.
- Entry barriers: what do they create? the answer lies in the property rights and rules of the game.

The Ambivalence of government policy.

- Just as the wolf shouldn't take care of the sheep, government shouldn't restrict competition.
- As much as you defend these laws nonetheless: principle: A law that restricts competitors restricts competition.
- An argument used to defend them is that they protect against predatory practices.

Selling below cost

- Laws that prohibit sales below cost should sound convenient to business firms because they reduce competition and so called "dumping", but why does the consumer go along with it as well?
- Why does the public support these laws?

What is the appropriate cost?

- The concern is the total revenues and total costs, courtesy items that are "free" should be selling below cost, non-rivals goods also sell below cost, this is not the concern of the entrepreneur.
- What price should it be set? Does anyone sell below cost?
- Sometimes people sell below cost to allow people to try their product. Hence courtesy items for example.
- Entrepreneurs are concerned with the net profit, ~~the~~ the difference between total revenue and total cost.

"Predators" and competition

- There is a possibility of predatory pricing or dumping
- This is a way of accepting evil (laws regulating below cost prices) instead of an evil of unknown dimensions;
- These laws are convenient to firms and thus we should approach them skeptically.

Regulating Prices

- To regulate prices the government must know as much as the managers and would thus need to have two sets of managers to be able to regulate prices.
- Who will guard the guardians?
- How will regulators determine the cost of running enterprises?
- Competition has done a better job at restraining market prices than government.

"Antitrust" Policy

- Set of laws enacted in 1890 to prevent the creation of monopolies
- Support the premise that competition needs some sort of government interference to be of benefit.
- Reflects the effects of 19th century businessmen to use trusteeships as a device to prevent competition.
- Monopolization is a threat to public welfare.

Interpretation and applications

• Since this is regulated what happens with the following:

- ① Horizontal merger: two of the same industry merge
- ② Conglomerate merger: different industries merge
- ③ Vertical merger: an industry and a derivative of that industry merge.

• Government again restricts competition to protect sellers.

Vertical Restraints: Competitive or Anticompetitive

- Vertical Restrictions cause manufacturers to sell less because they charge more, subsequently retailers are less.

The range of opinion

- People endorse it and think it works and others think antitrust laws are bad and are made by ignorant politicians
- the shorter laws are full of contradictions and often have the opposite effect.

Toward evaluation

- Laws that restrict potential competitors reduce the range and availability of substitute goods and allow sellers more room to increase their own wealth by denying opportunity to others.
- Laws of this sort are impractical because of the concept of perfect competition
- Competition cannot be judged by how equal a price is among a good.

- ignorant politicians use equality of price to determine the competition situation.

Once over lightly

- Competition is a process.
- Competition must be viewed by a way of entrepreneurial breeding ground not by the amount of sellers.
- to use government as a defender of competition is hope not reality, restrictions cause exclusion of competition and often causes the opposite effect.
- Firms like to use governments to restrain or exclude potential and existing competition.
- Firms are very creative as to what excuse to use in order to beg for government intervention.