I. Quick Summary of Antitrust/Regulation Material

An oligopoly is an industry composed of a few large firms. Examples: soft drinks, automobiles. Such firms are viewed as having the ability to set price, known as market power.

One way to obtain the ability to set price is by product differentiation, that is, creating products that are different than one's competitors' products, thereby making it possible to charge more without all consumers switching (example: cereals). Product differentiation makes demand for a firm's products more inelastic.

U.S. law prevents some actions taken to increase market power, including price-fixing (conspiring with competitors), predatory pricing (charging low prices to drive competitors out of business), and some mergers. Laws Prohibiting Cartels, Collusion, and Monopolization of markets: Sherman Antitrust Act (1890), and Clayton Act (1914). Agencies involved: Department of Justice and Federal Trade Commission. Types of Mergers: Horizontal (firms selling competing products), Vertical (firm and its input supplier), and Conglomerate (other).

An industry is said to be concentrated if a small number of firms control most of the production. Industry concentration is assessed using either CR4 (four firm concentration ratio) or HHI (Hirschmann-Herfindahl Index). CR4 is the sum of the market shares of the four largest firms. HHI is the sum of the squared market shares of all the firms. Example: If there are five firms in an industry, with market shares of 50, 20, 15, 10, and 5, the CR4 is 95 [50+20+15+10], and the HHI is 3250 [$50^2+20^2+15^2+10^2+5^2$ = 2500+400+225+100+25]. An industry with a CR4 exceeding 50, or an HHI exceeding 1800, is said to be very concentrated.

Some firms are permitted to be monopolies, but regulated [examples: Bell Operating Companies, electric utilities, cable TV providers]. Two types of regulation are typically used. *Price regulation* sets a maximum price for the product or products that the firm sells [example: gasoline had a maximum price for many years]. *Rate of Return regulation* sets a maximum profit rate.

Advantage of price regulation: Strong incentives to minimize cost. Disadvantage: Requires a lot of information about costs to set correctly. Rate of return regulation is easier to implement, since regulator can observe expenses, but may induce regulated firm to inflate costs as a way of earning the rate of return on a larger base.

Price discrimination involves charging different prices to different consumers for the same good. E.g. student discount. Price discrimination is effective when a firm has market power and can prevent arbitrage. Generally want to charge customer with the more elastic demand a lower price.