Regulation and Deregulation

Objectives  You may wish to call students’ attention to the objectives in the Section Preview. The objectives are reflected in the main headings of the section.

Bellringer  Ask students to speculate about how the government regulates aspects of their personal lives. List their responses. Lead a discussion of the reasons for each government regulation. Explain to students that in this section they will learn about ways in which the government intervenes in the market to protect competition.

Vocabulary Builder  Have students create a matching quiz for the key terms in the Section Preview. Ask students to exchange quizzes, complete them, and check each other’s answers.

Lesson Plan

Teaching the Main Concepts

1. Focus  The government intervenes in the market when firms try to control the prices and supply of important goods. Ask volunteers to suggest ways in which firms might do this, giving real-life examples if possible.

2. Instruct  Point out that unfair business practices in the past have led to government regulation of some aspects of business. Discuss with students the kinds of practices the government regulates or forbids. As students study the information in the section, discuss the reasons for government regulation of various practices and the benefits and drawbacks of such regulation.

3. Close/Reteach  Remind students that regulation and deregulation are ways in which the government protects and promotes competition in the market. Have students read the business section of a newspaper and bring in articles about regulation.

Graphing the Main Idea

Government  To build understanding of the concept of government, have students use a web graphic organizer like the one below to explain how the government breaks up and prevents the growth of monopolies. Remind students that a web shows a main idea with its supporting details.

Section Reading Support Transparencies  A template and the answers for this graphic organizer can be found in Chapter 7, Section 4 of the Section Reading Support Transparency System.

Market Power

As you have read, monopoly and oligopoly can sometimes be bad for the consumer and the economy as a whole. Markets dominated by a few large firms tend to have higher prices and lower output than markets with many sellers. Before we look at antitrust policies, let’s think about how a firm might try to increase its market power.

Key Terms

predatory pricing
antitrust laws
trust
merger
deregulation

Objectives  After studying this section you will be able to:
1. Understand how firms use market power.
2. List three market practices that the government regulates or bans to protect competition.
3. Define deregulation, and list its effects on several industries.

Section Focus  The federal government sometimes steps into markets to promote competition and the lower prices it brings. In recent years, the government has also deregulated several markets to promote competition.

Graphing the Main Idea

After World War II, National City Lines used its mass transit monopoly to shut down streetcar lines.

It’s 1946. The soldiers have come home from World War II, the cities are booming, and you’re a city planner who needs to get people to work each morning. You can build wide roads and parking lots and encourage people to buy cars, you can invest in a fleet of buses, or you can expand the streetcar lines and train tracks that already criss-cross the town center. Ideally, you will choose the most efficient system.

However, you never get to decide. A company called National City Lines (NCL) buys your city’s streetcar network and decides to raise fares and shut down several lines. Service gets so bad that commuters stay away, and NCL soon shuts down the system. It’s now 1966, and your streetcars are gone. Since the roads are too crowded for more cars, you must buy buses.

In the newspaper, you read that National City Lines was secretly funded by companies that make tires, automobiles, and gasoline—the same companies that now offer to sell you 200 new buses.

This really happened in cities like Los Angeles and Baltimore, where National City Lines turned a mass transit oligopoly into a monopoly by buying up its rivals. National City Lines then used its monopoly to close down the streetcar lines. Although some experts argue that the streetcars might have died out anyway, many critics blame National City Lines for the end result. No one can know what might have happened in a competitive market.

If you think what National City Lines did was unfair, the federal government agrees. In this section, you will read about anticompetitive practices and the tools the government uses to stop them.
To control prices and output like a monopoly, the leading firms in the market can form a cartel, merge with one another, or set the market price below their costs for the short term to drive competitors out of business. The last practice is known as predatory pricing. Economists are skeptical about most claims of predatory pricing because the predator loses money each time it drives an endless series of rivals out of business.

**Government and Competition**

The federal government has a number of policies that keep firms from controlling the price and supply of important goods. If a firm controls a large share of a market, the Federal Trade Commission and the Department of Justice’s Antitrust Division will watch that firm closely to ensure that it does not unfairly force out its competitors. These government policies are known as antitrust laws because a trust is a business combination similar to a cartel.

In 1890, Congress passed the Sherman Antitrust Act, which outlawed mergers and monopolies that limit trade between states. This and other laws gave the government the power to regulate industry, to stop firms from forming cartels or monopolies, and to break up existing monopolies. Over the years, Congress passed new laws to outlaw other anticompetitive practices.

Despite the antitrust laws, companies have used many strategies to gain control over their markets. Some firms require a customer who buys one product to buy other products from the same company, whether or not the customer wants them. For example, a tennis shoe manufacturer can demand that a chain buy and resell its brand-name shirts, windbreakers, and watches if it wants to sell its shoes. Another tactic, the one employed by National City Lines, is to buy out competitors.

**Regulating Business Practices**

The government has the power to regulate all of these practices if they give too much power to a company that already has few competitors. Microsoft sells operating systems, software that tells a computer how to run. In 1997, the Department of Justice accused Microsoft of using a monopoly in operating systems to control the market for a program known as a browser. A browser allows people to access Web sites.

Microsoft insisted that computer manufacturers that sold its operating system also include its browser. The government accused Microsoft of predatory pricing because the company gave away its browser for free, which would ruin the other browser company, Netscape. Microsoft’s power in one market gave it a big—and possibly unfair—advantage in related markets.

Microsoft argued that the browser was part of its operating system and could not be sold separately. Microsoft’s defenders said that companies do compete with Microsoft, and people buy Microsoft software because they like it. In November 1999, a federal judge ruled against Microsoft. Microsoft appealed, and in 2001, President Bush settled the case. According to the settlement, Microsoft could link its browser to its operating system but could not force computer manufacturers to provide only Microsoft software on new computers.

**Predatory Pricing**

Predatory pricing is selling a product below cost to drive competitors out of the market. Antitrust laws outlaw this practice.

**Antitrust Laws**

These laws encourage competition in the marketplace. A trust is like a cartel, an illegal grouping of companies that discourages competition.

**Microsoft’s Case Against Google**

Google, another large tech company, faced a similar case in 2010. The Department of Justice accused Google of predatory pricing for several years, but the case was dropped in 2015.
Differentiated Instruction

Ask students to list the key terms and then use them in one or several paragraphs in which they summarize the reasons why the government steps in to protect competition in the market.

LPR

Differentiated Instruction

Explain to students that breaking up monopolies and blocking mergers are two different ways of preventing large firms from dominating the market. Ask students to think about how these two tactics approach the problem from different sides. When students have considered this question, hold a class discussion so that they can share their conclusions.

Economic Detective Activity

Unit 2 folder, p. 45, “The Business of Buck Bidness,” provides an integrated application of chapter concepts.

Background Note

Airline Policy

The September 11 attacks precipitated a new twist on government policies toward the airlines. After the attack, the demand for air travel decreased, and airlines announced that they were losing money fast enough that they were threatened with bankruptcy. The national government responded by providing $5 billion in cash and $10 billion in loan guarantees. One motivation for the aid package was to cover the airlines’ losses resulting from closing the airports for four days after the attacks—an action ordered by the national government. The costs of the four-day closure was about $1.2 billion, a small fraction of the bailout package. The question is, Why did the airline industry receive a bailout package when other industries did not?

Figure 7.11 Key Events in Federal Antitrust Policy

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900</td>
<td>Theodore Roosevelt becomes President and begins enforcing the 1890 Sherman Antitrust Act, which outlaws mergers and monopolies that restrain trade between states.</td>
</tr>
<tr>
<td>1911</td>
<td>Supreme Court breaks up John D. Rockefeller’s Standard Oil Trust.</td>
</tr>
<tr>
<td>1914</td>
<td>Clayton Antitrust Act outlaws practices that limit competition or lead to monopoly.</td>
</tr>
<tr>
<td>1936</td>
<td>Robinson-Patman Act defines and outlaws several forms of price discrimination.</td>
</tr>
</tbody>
</table>

Over the past century, the federal government has acted often to promote competition in American industry.

Breaking Up Monopolies

The government used antitrust legislation to break up existing monopolies such as the American Tobacco Company and John D. Rockefeller’s Standard Oil Trust in 1911. In 1982, the government broke American Telephone and Telegraph (AT&T) into seven regional phone companies, including BellSouth, USWest, and PacificBell. Because the government treated local telephone service as a natural monopoly, AT&T legally controlled all the cables and networks that linked telephones in homes and businesses. The government stepped in only when AT&T used its legal monopoly in local phone service to take control of other markets for long-distance phone calls and communications equipment. Today, there are many firms in the market for long-distance service and the market is more competitive. Although thousands of workers lost their jobs, consumers benefit from lower prices and better technology.

Blocking Mergers

In addition to breaking up monopolistic companies, the government has the power to prevent the rise of monopolies. The government does this by blocking company mergers that might reduce competition and lead to higher prices. A merger occurs when a company joins with another company or companies to form a single firm. Government regulators also follow the effects of past mergers to check that they did not lead to unfair market control. You read in Section 1 that prices often fall when the number of firms in a market increases. The reverse is also true. Prices often rise when the number of firms in an industry falls.

The government tries to predict the effects of a merger on prices and service when it decides whether or not to approve a merger. Recently, the Department of Justice has looked at data collected by scanners at supermarket check-out lines to see how prices vary when two competitors join forces. In 1997, the Justice Department examined the proposed merger of two companies that sell office supplies. Their studies showed that one company charged less in cities where the other company also had stores. Using this data, the Federal Trade Commission (FTC) convinced the courts that the merger would hurt competition and force customers to pay higher prices. In the end, the Department of Justice did not allow the two companies to merge.

Consider these suggestions to take advantage of extended class time:

- Refer students to the cartoon on p. 173. Ask them to find additional examples of cartoons that express opinions about business practices today or in the past. Then have students draw their own cartoons on this subject. Display the cartoons and discuss them in class.

- Refer students to the time line on pp. 174–175. Review the legislation that has been enacted to promote competition. Then ask students to research the regulatory agencies that the government has created to promote competition and restrict unfair practices. Have students present their findings in a chart.
Preserving Incentives
While some mergers hurt the consumer by reducing competition, others can actually leave the consumer better off. In these cases, corporate mergers will lower overall average costs and lead to lower prices, more reliable products or service, and a more efficient industry. The government must act carefully to make the right decision. In 1997, the Justice Department and the FTC released new guidelines for proposed mergers. Now, companies that want to merge have the chance to prove that the merger would lower costs and consumer prices or lead to a better product.

Deregulation
In the late 1970s and 1980s, Congress passed laws to deregulate several industries. Deregulation means that the government no longer decides what role each company can play in a market and how much it can charge its customers. Over several years, the government deregulated the airline, trucking, banking, railroad, natural gas, and television broadcasting industries. Depending on the degree of deregulation, the government’s action allowed—or forced—firms in these industries to compete more in markets by eliminating many entry barriers and price controls. While deregulation weakens government control, antitrust laws strengthen it. Yet the government uses both of these tools, deregulation and antitrust laws, for the same purpose: to promote competition.

Many critics say that government efforts to regulate industries have created inefficiencies. In some cases, the economic facts that created the need for regulation in the first place have changed. For example, in Section 1 you read how the invention of cellular phones challenged the natural monopoly of local phone service and opened the market to new companies. The trucking industry was also regulated as a natural monopoly from the early 1900s until 1978. By then, many had decided that the government was regulating industries that were not natural monopolies at all.

Judging Deregulation
Deregulation has met with mixed success. In most cases, many new firms entered the deregulation the removal of some government controls over a market

Economics Assessment Rubric

Learning Styles Activity
Learning Styles Lesson Plans folder, p. 20 asks student groups to illustrate events in a firm’s attempts to increase market power as well as to examine possible government action.

Interdisciplinary Connections: History
Theodore Roosevelt In 1901 many Americans were concerned about industrial combinations called trusts. People felt that these trusts were causing continuing price increases. President Theodore Roosevelt responded by reviving the Sherman Antitrust Act, which had been in place since 1890 but had not been enforced.

Making the Connection Have students find out more about Theodore Roosevelt and his antitrust activities against railroad, beef, oil, and other monopolies. Have students research legislation that was passed and court rulings that were handed down during Roosevelt’s administration as well as the results of these laws and rulings on monopolistic practices. Hold a class discussion of how these historic events affect today’s government regulations.
Answers to . . .

Section 4 Assessment

1. Antitrust laws are designed to encourage competition in the marketplace.
2. The government approves mergers only when the combined company will not be able to exert unfair control over markets or prices.
3. Predatory pricing usually leads to one or more firms being forced out of a market, limiting consumer choice and competition and resulting in higher prices.
4. Banking deregulation led to the Savings and Loan Crisis of the 1980s, as banks had more freedom to make riskier investments. Airline deregulation led to some mergers and some firms dropping out of the business but also to lower air fares for consumers.
5. These industries were considered natural monopolies. The government regulated these and other industries to prevent businesses from using market power to control prices and output.
6. Students’ answers should demonstrate understanding of both editorials as well as skills in comparing and contrasting arguments.

Key Terms and Main Ideas
1. What is the purpose of antitrust laws?
2. Under what conditions will the government approve a merger?
3. How does predatory pricing hurt competition?
4. How did deregulation change the banking and air travel industries?

Applying Economic Concepts
5. Decision Making Why did government once regulate the banking, trucking, and airline industries?
6. Try This Use the library to find an editorial from 1911 in support of the breakup of Standard Oil, and compare it to a recent editorial that criticizes Microsoft. Which arguments are the same? Which are different?
7. Critical Thinking Why does the government believe it has the right to intervene in markets to promote competition? Is this consistent with the idea of laissez faire and free markets?

Progress Monitoring Online
For: Self-quiz with vocabulary practice
Web Code: mna-2078

Answer to . . .

Building Key Concepts Government regulation had prevented banks from making some of the risky investments that later led to bank failures.