Haileybury MUN

Research report

General Assembly 2

The question of competition laws

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Definition of Key Terms

Economies of Scale

When firms grow through internal or external expansion of their firm, they will experience economies of scale. It is a cost advantage that occurs when output rises, as a result, average cost of producing one unit of output falls. Firms may experience different types of internal economies of scale depending on the industry. The main types of economies of scale are marketing, financial and technical.

Marketing economies of scale or when is when firms are able to buy their resources or materials in bulk and have more negotiating power due to their large firm, allowing the firm to negotiate for lower prices. Therefore, reducing the cost of production as the cost of their raw materials would fall. This usually happens when the firm has monopsony power.

Technical economies of scale arise when firms invest into new expensive specialist technology. As machinery can work all night and day, this would increase the productivity of the firm as it would produce more than human labour and thus reduce the average cost of producing one unit of output.

Larger firms are known to commercial banks as more ‘credit worthy’ and would be able to get loans much easier than smaller firms. As they would be making large sums of profits, this would make it more appealing for banks to provide loans to them. Therefore, they would be able to take out more loans with favourable interest rates.

Diseconomies of Scale

In contrast to economies of scale, diseconomies of scale occur when a firm expands too much to the point where their long run average cost begins to rise.

Monopolies

Firms that are the dominant or single supplier of a good or service in an industry. Key characteristics found in a monopolistic market include the assumption that there is only a single or dominant firm in the market, high barriers to entry and that the firm aims to maximise profits.

Natural monopolies occur in a market where it is naturally not efficient to have more than one supplier of a good or service. This could be the result of high barriers to entry due to high sunk costs to start up a business in the industry. Natural monopolies commonly arise in the utilities industry, for example, water or electricity suppliers in a certain region.

Price Fixing

A form of anti-competitive or predatory practice made between firms. Essentially, it is an illegal agreement between rival firms to set the price of their product at a certain level. This is to ensure that consumer surplus would decrease and so would consumer choice as the substitute products would not vary in prices.

Antitrust

A competition law, in the United States of America, enforced to protect consumers from the anti-competitive practices of monopolies or other firms and to promote fair competition to other businesses.

Introduction

In a free market, competition is vital for producers as well as consumers. It is defined as the "rivalry among sellers where each seller tries to increase sales, profits and market share by varying the marketing mix of price, product, distribution and promotion." In other words: to attract more consumers, sellers aim to set their prices lower and thus become more competitive.

Competition laws are imposed by competition agencies or regulators to ensure that the level of competition in the market is stable and protected. Regulatory authorities can fine companies, prohibit mergers, set price caps, force firms to increase their supply, make firms invest into new technology, make firms sell some of their market share and even imprison top management as part of competition policy.

Without competition laws, monopolies would be able to set their prices extremely high to earn as much profit as they want. Since the demand is unresponsive, consumers do not have much of a choice leading them to have to pay such high prices to purchase their goods. To solve this issue, the government or competition authorities can set a maximum price, typically below the equilibrium price, so that the firm has to reduce their prices. Enabling the product to become more affordable for consumers.

Not only that, these laws allow smaller firms or new firms to compete and target to expand for growth through innovation and investment. If bigger firms set their prices extremely high, this would prevent smaller companies from entering or staying in the market. As smaller firms tend to produce in smaller quantities, their average cost per unit would be higher than other big firms. Therefore, when these big firms reduce their prices, this may force smaller firms out of business when they would not be able to lower their prices.

Colluding in terms of economics, is the illicit agreement between rival firms for their own shared advantage: higher profits. The collusion between major firms can be immensely harmful to consumers as these firms would ensure their prices do not fall below a certain level or they have to be set at a certain price. As a result, there would be a reduction in consumer choice as the prices would essentially be identical for the same product. Competition authorities consider this as predatory practices as not only is this at the expense of consumers, but it is also becoming disadvantageous for smaller businesses.

Key Issues (with competition policies)

Regulatory Capture

Regulatory capture, a form of government failure, is when a regulatory agency advances with the interests of the firm they are regulating instead of acting in the public's interest. For example, in 2011 Her Majesty's Revenue and Customs (HMRC), a branch of the UK government, was accused of providing generous tax agreements to large companies they were investigating. This is just one of the many occurrences of regulatory capture. It usually begins with the regulatory body being too sympathetic to the firms they are investigating in or they become too friendly with them. From this, authorities may provide greater leniency to the firm they are regulating through moderate punishments, leading to ineffective outcomes.

Inefficiency in the Market

Most firms aim to expand and grow to gain more profits and market power. Some people may argue that competition laws prevent businesses from expanding. As part of imposing competition policies, regulatory authorities can prohibit firms from merging with others, avoiding the firm from gaining a very large share of the market,

Nevertheless, some mergers are extremely beneficial, not only for the firm but for consumers as well. Mergers tend to make the firm more efficient as they do not require redundant workers when they merge as some of them are duplicated when joined together. By cutting out duplicated jobs, this would allow more workers to specialise in their jobs and be more productive. Furthermore, the reduction of duplicated jobs leads to unemployment of those workers and also reduces the number of employment opportunities in the market. Thus, resulting in higher unemployment rates, clearly damaging to the nation.

Ineffectiveness of the policy

Fining major companies for anti-competitive prices does not necessarily guarantee more competition. It simply depends on the proportion of their revenue, if the ratio of the fine to their revenue is negligible there would be little to no change in the firm's practices.

Additionally, it is extremely difficult and subjective to establish what is or what is not in the public's interest. Even if they do establish the boundaries, how would they weigh how harmful the offences are and how would it determine the size of the fine or magnitude of their punishment? How would regulators know if firms are setting their prices low to be more efficient or just to get more profit? These drawbacks of the policy may cause some misconducts by the regulatory authorities.

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