

1. What are the basic purposes of competition (anti-combines) policy?

Ans: Competition policy has three basic objectives. First, it seeks to prevent monopolization of an industry in which one firm, or a dominant firm, controls an industry. Second, it strives to promote competition in markets so that there is no harmful manipulation of price and output by a firm. Third, it promotes allocative efficiency in the economy.

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2. Describe the economic case against monopoly.

Ans: Monopoly will be economically inefficient in the allocation of resources because monopolistic firms will restrict output and charge prices that would not be the case if the industries were competitive. The monopolist maximizes profit by equating marginal revenue with marginal costs. In this case, product price is greater than marginal cost, so there is an under-allocation of resources to the production of the product. In a competitive industry, price is equal to marginal cost, so society cannot gain by producing one unit more or one unit less of output.

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3. What were the two basic means of control by government as substitutes for, or supplements to, market forces in monopolized industries?

Ans: First, regulatory agencies were formed to control the economic behaviour of natural monopolies. Second, competition (anti-combines) legislation was passed to inhibit or prevent the growth of monopolies in other industries.

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4. Anti-combines legislation was replaced with a new act of parliament. What is this new act, and when did it come in place? What is the purpose for the new act and which government body is charged with adjudicating over questions of market structures and mergers?

Ans: The Combines Investigation Act was replaced by the Competition Act in 1986. The Competition Act is meant to promote competition in the Canadian economy. The main innovation of the new act is that market structures and mergers that may reduce domestic competition are now adjudicated under civil law (an easier process than criminal law). The Competition Tribunal is charged with adjudicating these cases. Price fixing and related activities are still handled under criminal law.

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5. What were the major changes to anti-combines legislation under the Competition Act of 1986?

Ans: Under the Competition Act of 1986, uncompetitive market structures and mergers came under the jurisdiction of civil law. This change made prosecutions easier. Prior to the Act, illegal practices came under criminal law and were more difficult to prosecute because the standard of evidence was higher and penalties more severe. A quasi-judicial Competition Tribunal made up of Federal Court judges and laypersons was set up to adjudicate cases that came under civil law. The Tribunal could issue remedies and sanctions including rejecting mergers and requiring firms to divest assets.

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6. Evaluate. Under Canada's Competition Act, monopolies and mergers are illegal.

Ans: While competition policy is intended to encourage competition and restrict monopoly practices, monopolies and mergers are not illegal. A firm can be a monopoly. However, it is not allowed to abuse its monopoly position. Likewise, the Act has not challenged mergers that do not lessen or prevent competition substantially. Mergers that allow firms to reap economies of scale have been approved on the basis of allocative efficiency.

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7. Describe the three types of mergers and give examples.

Ans: There are horizontal, vertical, and conglomerate mergers. (a) Horizontal mergers are between companies selling similar products in the same market. Two examples are Air Canada's merger with Canadian Airlines, and Great West Life's merger with Canada Life (insurance). (b) Vertical mergers are between firms at different stages of the production process in the same industry. An example would be PepsiCo's merger with three restaurants—Pizza Hut, Taco Bell, and Kentucky Fried Chicken. (c) Conglomerate mergers are between firms in unrelated industries such as that between Bell Canada Enterprises (telecommunications) and CTV (television) or between America Online (Internet service) and Time Warner (publishing and broadcasting).

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8. What has been the general approach to the enforcement of competition legislation based on the type of mergers?

Ans: The application of competition legislation to mergers varies based on the type of merger. Conglomerate mergers are generally permitted. Vertical mergers are not prohibited because they do not substantially lessen competition. However, a vertical merger between two large firms in highly concentrated industries often warrants careful examination. Horizontal mergers are scrutinized but may be permitted depending on the circumstances. For example, the Competition Bureau allowed Safeway to take over competing companies provided that some divestiture was done. If a firm is going bankrupt it can be permitted to merge with another firm as in the case of Canadian Airlines. If an industry is subject to strong foreign competition, domestic firms in the industry may be permitted to merge. The circumstances are examined on a case-by-case basis to determine the degree to which competition might be lessened in an industry when there is a horizontal merger.

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9. How does competition policy conflict with other government policies? Give an example.

Ans: Competition policy is only one type of policy for government and focuses on one primary objective-to maintain competition in the economy. There can be other important goals for the economy that conflict with the strict enforcement of the policy. The nation seeks to increase its exports and improve the balance of trade. To compete in world markets, domestic firms may need to be permitted to merge. By becoming bigger, they can enjoy economies of scale and compete internationally. Another example would be in emerging technologies. In some cases, as in the defence industry, it might be necessary to permit mergers to reduce worker layoffs. Firms may be permitted to merge because they are developing new forms of communications or technology that cut across a narrowly defined market. Strict enforcement of anti-combines legislation may restrict industries from restructuring over time and developing new products.

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10. “In practice the competition legislation deals more with oligopolies than with pure monopolies.” Is this true?

Ans: This does seem to be true generally. Pure monopolies are rare and those that do exist tend to be “natural monopolies” that are subject to regulation. Another point seems to be that competition policy is used today mainly to prevent further concentration of power in already oligopolistic industries. Therefore, the laws are dealing with oligopolies before one of the firms gets a monopoly position. The cases mentioned in the text seem to support this view.

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11. Explain: “Competition policy is basically pro-business, because it is anti-monopoly. To believe that it is anti-business is to believe that monopoly is pro-business.”

Ans: Clearly the response to this quote depends on which side of the fence you are on. Large firms seeking to consolidate more power would not agree that competition policy is pro-business. However, from the standpoint of the consumer and small- to medium-sized businesses, this statement makes sense. Competition legislation promotes competition and restricts monopolistic practices.

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12. “Monopoly has developed in both product and resource markets because of the shortcomings and inefficiencies of competitive markets.” Do you agree? Explain.

Ans: This is true in the case of “natural monopolies” where economies of scale lead to the most efficient size firm being one that monopolizes the market. More and smaller firms would be inefficient in such cases because their low levels of output would result in high average total costs.

Monopolies have also developed as a result of patent law protection, but in this case the shortcomings or inefficiencies of the competitive market cannot be blamed, but rather the monopoly is a result of government policy.

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13. What is a natural monopoly?

Ans: A natural monopoly is an industry in which a single firm faces such extensive economies of scale that society is best served by having a monopoly. In this case, a single firm can produce its output at a lower average total cost than could several firms.

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14. What are two ways to promote economic efficiency where a natural monopoly exists?

Ans: To promote economic efficiency, government can either own the natural monopoly through public ownership or regulate the prices charged by the monopoly through industrial regulation.

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15. Explain: “An effectively regulated natural monopoly will have trouble attracting capital to sustain and modernize its facilities.”

Ans: The answer to this question hinges on what is meant by the wording “effectively regulated.” If this wording means setting price equal to marginal cost, then the statement is indeed true. Marginal costs for a natural monopoly are less than average costs. A price equal to marginal cost therefore will be a price (average revenue) that is below average cost. Suffering losses, the firm will find it difficult to attract capital to sustain and modernize its facilities.

If the wording in the question means setting rates to allow for a fair return, then the statement may or may not be true. “Economic” profits do not occur under this type of “effective regulation.” However, it is the promise of “economic” profits that is most attractive to investors. Therefore, the statement may be true especially during periods of prosperity. On the other hand, despite the fact that a well-regulated monopoly promises only “normal” returns, there is little risk involved in achieving at least that amount of return. This security of investment might offset the lack of incentive that “economic” profits provide.

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16. What are the goals of industrial regulation of natural monopoly?

Ans: The purpose of industrial regulation is to limit the prices that a natural monopoly can charge. At the same time, regulators want to ensure that the firm’s regulated output is sufficiently high for society to reap benefits of the firm's economies of scale.

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17. What are the drawbacks associated with industrial regulation of a natural monopoly?

Ans: Industrial regulation of a natural monopoly involves establishing prices that the firm can charge to ensure that the inefficiencies of an unregulated monopoly are reduced and to provide a normal profit to the firm. However, this fair-rate-of-return regulation also reduces incentives for the firm to be cost efficient. Higher operating costs do not cut into profit when regulators approve of higher prices to ensure that a normal profit is maintained. This X-inefficiency can offset the potential cost savings of large scale production.

A second concern is with industrial regulation is it can maintain a monopoly's position even though conditions no longer justify the existence of a natural monopoly. For example, technological advancement can significantly lower a firm's minimum efficient scale. Without regulation, technological change would open the industry to new competition. However, regulators may mistakenly or deliberately protect the monopoly by blocking new entrants into the market.

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18. Contrast the public interest theory of regulation with the legal cartel theory of regulation.

Ans: The public interest theory of regulation arose because of “natural monopolies” that if left unregulated would charge higher prices and produce less output than was deemed beneficial for society. Regulation will help ensure that natural monopolies produce at a level of output that takes advantage of the lower unit costs resulting from economies of scale. This perspective views regulation as a way to control natural monopolies so that they better serve the public interest in the form of lower prices and more output.

In contrast, the legal cartel theory of regulation views regulation as serving the monopoly interest rather than the public interest. Natural monopolies or oligopolies may want to be regulated because it protects them from becoming owned by the public. Even more important, however, is when ownership remains private. In this case, regulation offers firms a form of a legal cartel that protects them against the rigors of competition. Also, a private cartel may be unstable, but a cartel that has the sanction of government can exist for a long time. The evidence to support this view comes from the strong support for regulation given by businesses in such industries as the airlines, railroads, and trucking.

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19. What have been the major outcomes from deregulation of industry? Give three examples of changes in particular industries.

Ans: The economic effects have generally been positive. Society has benefited from lower prices, lower costs, and increased output. There has also been more technological advance and innovation in deregulated industries. Airline fares, adjusted for inflation, have declined by one-third while airline safety has improved. Rates for trucking and rail transportation have fallen by half. There has been a drop in the cost of telecommunication and brokerage services. Deregulation has sparked technological innovations in telecommunications and related industries.

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20. What are the major differences between “industrial” regulation and “social” regulation?

Ans: The focus of industrial regulation is on the economic performance of natural monopoly or with large firms in a concentrated industry. The major concerns of industrial regulation are with product prices and with the effects of business practices on competition and output. This type of regulation has the longest history in Canada.

In contrast, social regulation is concerned with the production of goods, the conditions under which goods are produced and their effects on society, and with the characteristics of the goods. This type of regulation affects all industries, whether concentrated or highly competitive. This regulation also involves more direct government intervention into the production and distribution of goods and services.

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21. What are social regulation and agency examples?

Ans: Social regulation primarily targets social issues such as product safety, working conditions, and the effects of products on society. Examples of social regulatory agencies would be the Employment Standards Branch and Environmental Management Branch of provincial governments.

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22. What arguments are made in support of social regulation?

Ans: Social regulation does address important social and economic issues for society. The process may not be perfect but it is necessary to protect society from unsafe products, poor working conditions, and other similar problems. Although social regulation is expensive, it is the “price” that has to be paid for improving living conditions in the society. There have also been benefits from such regulations. For example, air quality standards have improved. There are fewer deaths of children in car accidents because of child seat belt laws.

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23. What are criticisms of social regulation?

Ans: The criticisms of social regulation are several. First, the goals of the regulation may be uneconomical (the marginal benefits are less than the marginal costs) and often do not take into account solving the problem in the most economically efficient way. Second, the regulatory goals may be set on the basis of inadequate information. Third, there can be unintended side effects from social regulation. For example, stricter environmental laws may reduce jobs in certain industries and hurt regional economies. Fourth, the regulatory personnel have chosen to work for regulatory bodies because they feel strongly about an issue or the need for a business reform. This situation can make regulatory personnel overzealous.

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24. Explain what critics see as the problem with social regulation.

Ans: The goals set by the regulators may be uneconomical and not take into account the costs and benefits of the regulation. Some regulations are based on limited or incomplete information about the value of the product or hazards from it. Regulations have unintended side effects because of perverse incentives. In some cases, the regulations have driven business to bankruptcy. The regulations killed the businesses they were designed to regulate. There are also complaints about overzealous personnel who have a social agenda and use the government agency to promote it.

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25. What are the likely economic effects of social regulation on prices, innovation, and competition?

Ans: The economic consequences of social regulation largely impose increased cost on businesses. The higher costs of production lead to higher prices and less output because it can reduce labour productivity. Regulation may also reduce the rate of innovation in an economy because of the higher costs of meeting regulatory standards in bringing a product to market. There is also the potential for a heavier burden to be placed on smaller firms that have fewer financial resources to devote to regulatory compliance, resulting in less competition.

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27. Why do supporters of social regulation need to remember that “there is no free lunch”?

Ans: The economic effects from regulation are generally negative. They result in higher prices for consumers, tend to reduce innovation because of fear of not meeting a guideline or rule, and they can reduce competition because only well-financed firms may be able to comply with a regulation.

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28. Critically evaluate: “Governments always get in the way, so less government is always better.”

Ans: The market has well-documented flaws (externalities and imperfect competition being two key examples). When these flaws exist, industrial and social regulation can increase economic efficiency and consequently improve society’s well-being. By limiting excessive greed, regulation can bolster political support for a regulated “market system.” Thus, the concept of “less government is always better” is clearly false.

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29. Do the costs of social regulation outweigh the benefits?

Ans: Whether the costs of social regulation outweigh the benefits is difficult to determine because it is easier to measure the costs than the benefits, especially when benefits result only after substantial passage of time. It is not easy, for example, to measure the benefits of less discrimination in the workplace, the value of a cleaner environment, or the production of safer products. The discussion of costs and benefits also needs to be considered on a case-by-case or industry-by-industry basis. The question is not one of whether or not to have social regulation, but how much regulation is needed. That issue often means that ideology about the proper size and scope of government drives the debate more than the costs and benefits of a decision.

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30. What were the charges, findings, and proposed court remedy in the Microsoft antitrust case?

Ans: In 1998, Microsoft was charged with violating section 2 of the Sherman Antitrust Act by using business practices that maintained its Windows software monopoly. Microsoft denied the charges and argued that technological advances made any monopoly highly transitory. The findings from the Federal district court ruling in 2000 showed that Microsoft had a 95 percent market share of operating systems for PCs. They also showed that Microsoft used anticompetitive practices to maintain and enhance its monopoly. These practices included combining its Windows software with the Internet Explorer to counter a threat from the Netscape Navigator browser, giving preferential treatment to software developers who created products featuring Internet Explorer instead of Netscape, and developing Java software for Windows to undercut Java software from Sun Microsystems. A Federal district court concluded that the remedy for these anticompetitive practices was to divide the company into two firms, one responsible for Microsoft software applications and the other responsible for selling the Windows operating system. This remedy was overturned upon appeal by Microsoft and a settlement was reached that limited the company's behaviour.

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Learning Objective: Last Word