Chapter 12: (DE)REGULATION OF BUSINESS

When is government regulation necessary?

What form should regulation take?

When is it appropriate to deregulate an industry?

Regulation of Business

- Anti-trust vs. Regulation
- Natural Monopoly
- Regulatory Options
- Costs of Regulation
- Deregulation in Practice

Anti-trust vs. Regulation

- Market Structure
  » Number and concentration of firms
- Market Behavior
  » Performance, pricing, production etc.
- Anti-trust
  » Examines both structure and behavior
- Regulation
  » Focuses only market behavior
Social vs. Economic Regulation

- Social Regulation
  - Concerned with public welfare
  - Workplace safety, environmental protection, product & food safety
  - EPA, OSHA, FAA, Coast Guard

- Economic Regulation
  - Control pricing, production levels
  - FCC, SEC, FDIC, Patent office

Natural Monopoly

- Natural Monopoly
  - Industry in which significant economies of scale exist
  - Existence of more than one firm is inefficient
    - One large firm can produce at lower cost than many small firms

- Economies of Scale
  - Cost per unit decrease as output increases

Community needs 10 units of electricity

<table>
<thead>
<tr>
<th>$/unit</th>
<th>Quantity units of electricity</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>2.5</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>10</td>
</tr>
</tbody>
</table>

Two firms each produce 5 units
TC of firm 1
TC = ATC(Q) = $3(5) = $15
TC of firm 2 = $15
TC of 10 units = $30

One firm produce 10 units
ATC
TC = ATC(Q) = $2.5(10) = $25
Regulatory Options

* Unregulated Behavior
  » Pick Q where MR = MC
  » Price > ATC,
    - So economic profit > 0
  » P > MC
    - Results in inefficient resource allocation
    - Constrain output

Regulatory Options

- Price Regulation (Efficiency)
  » Marginal cost pricing
  » Pick Q where P = MC
  » Price < ATC
    - So economic profit < 0
  » Requires a subsidy to stay in business
**Regulatory Options**

- Profit Regulation
  - Average cost pricing
  - Pick Q where \( P = ATC \)
  - Price = ATC,
    - So economic profit = 0
  - Only make a normal profit
    - However, no incentive to keep costs down

**Costs of Regulation**

- Administrative Costs
  - Costs of administering decisions
- Compliance Costs
  - Firms have to keep up with "red-tape"
- Efficiency Costs
  - Regulation may worsen resource allocation

**Balancing Benefits and Costs**

- Benefits of Regulation
  - Better resource use, safer workplace, cleaner environment, etc.
- Case for more regulations
  - If benefits exceed costs
- Case for less regulations
  - If costs exceed benefits
Deregulation in Practice

* Deregulation
  » Elimination of past regulations of economic activity

* Examples
  » Railroads, Trucking, Telephone Service, Airlines, Cable TV

Desired results

» Lower prices to consumers
» Increased competition

* Reregulation
  » Reimposition of regulation of formerly regulated industry
    - Cable TV