Monopolies and Anti-Competitive Markets: Crash Course Economics #25

Crash Course: Economics
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=====Introduction(00:00)=====

Jacob: Welcome to Crash Course Economic my name is Jacob Clifford.

Adriene: And I'm Adriene Hill. Today we're going to talk about monopolies! Which are terrible, illegal, and only serve to exploit helpless consumers, except when they're delivering essential services that competitive free markets kind of fail to deliver.

J: So, are monopolies good? Or bad? Or...

A: Both.

(Crash Course Economics Intro)

J: When some people hear the word "capitalist" they picture the robber barons of the 19th century. Cutthroat monopolists, like Andrew Carnegie, JP Morgan, and John D. Rockefeller. They dominated industries like oil, railroads, banking, and steel and would do anything to crush their competitors. After all, in Rockefeller's words "The growth of a large business is merely a survival of the fittest."

Now, it's true that market economists love competition, but monopolies are the antithesis of competition. In most cases, economists want to prevent monopolies, not celebrate them. Let's go to the Thought Bubble.

=====Thought Bubble(00:55)=====

A: A pure monopoly is a market controlled by one seller with a good or service that that has no close substitutes. But the true power of a monopoly comes from its ability to keep competitors out of the market. Monopolies are able to erect obstacles that economists call barriers to entry. If a company starts offering a brand new product in a market with low barriers, they won't maintain the market power for very long.

Take gourmet food trucks. In the last decade, gourmet cooks started moving to the street food business, competing in a market historically associated with lower-quality options like hot dog vendors. These food truck were a hit. Demand was high and the barriers to entry were relatively low, so more and more competitors jumped in. Now food truck are kind of everywhere. And that's exactly how capitalism is supposed to work. People wanted more street food options and profit-seeking entrepreneurs gave them what they wanted. Incentives and competition made society better off.

But imagine a city where there are a limited number of licenses for food trucks, and I own all of them for my fleet of artisanal macaroni and cheese trucks. I also know the mayor, since he's a big fan of artisanal macaroni and cheese. If I can convince the mayor to ban traditional push cart food vendors, with their shwarma and their bacon-wrapped hot dogs, I'll have a monopoly on street food.

I'm not increasing profit by producing more stuff. I've influenced government regulations in such a way that anyone who's hungry, but doesn't want to enter a building, has to buy food from me. This is sometimes called crony capitalism, and it's a big reason many economists call for government transparency and accountability.

=====Oligopolies(02:40)=====

J: Thanks Thought Bubble. Companies don't have to have a literal monopoly to exercise monopoly power. When a single company has a huge market share in its industry, like Google does in search, they wield a lot of the same power that a pure monopoly would. Now, when few firms have a large majority of market share, it's called an oligopoly. The market for mobile device operating systems is a good example with Google's Android and Apple's iOS. The point is that one company doesn't need to have 100% market shares to operate like a monopoly.

In the example of the anti-food-truck ordinance, the barriers to entry was government regulation, but what some other ways companies maintain large market shares? Well, there's also control of resources, like DeBeers once had 90% of market share in diamonds because they controlled the world's diamond mines. Another barrier is high start up costs. You might want to build a nuclear power plant to compete with your local power company but you need a whole lot of money to get in the game.

=====Integration(03:28)=====

A: Monopolies can restrict output and charge higher prices without worrying about competitors. This is why most economists support anti-trust laws that promote competition and outlaw anti-competitive tactics. They're called anti-trust laws because monopolies use to be called "trusts."

In 1890, the U.S. passed the Sherman Act, named for Senator John Sherman. Sherman argued, "If we will not endure a king as a political power we should not endure a king over the production, transportation, and sale of any of the necessaries of life." The Sherman Act outlaws any monopolization or attempted monopolization. Court rulings and later laws gave the Department of Justice and the Federal Trade Commission greater authority to prevent monopolies.

If the Coca Cola company wanted to purchase PepsiCo, it's be a tough regulatory sell. In the U.S. mergers and acquisitions need to be approved by the government agencies. Economists call the act of buying companies that produce similar products horizontal integration. Like, AT&T tried to buy T-Mobile, but failed because regulators believed the new company would control too big a share of the wireless communications market.

Vertical integration, on the other hand, is when a company directly owns or controls its supply chain. For example, in the 1920s, the Ford Motor Company owned much of the entire. supply chain needed to make cars. It owned iron and coal mines, and made its own steel, glass, tires, and even paper in the massive River Rouge factory complex in Michigan. Vertical integration is complicated, and it's not always illegal.

When a company just expands its business to in-source part of its supply chain, that's usually not subject to anti-trust regulation. Companies can run into some trouble when they try to vertically integrate via mergers. Anti-trust regulations can also prevent companies from making anti-competitive deals with their suppliers. In the late 1990s, Microsoft was accused of pressuring PC manufacturers to pre-install Microsoft's web browser, Internet Explorer, and exclude their main browser competitor, Netscape. Regulators busted them, and almost busted up the company. Even Toys-R-Us! It's gotten into trouble for conspiring with toy supplier, like Hasbro and Mattel, to stop manufacturers from selling certain toys to other stores.

=====Patents and Intellectual Property(05:48)=====

A: So monopolies and monopolistic behaviour are bad, right? Well, it turns out that sometimes they're useful. Look at patents. A patent grants an inventor exclusive right to profit from a specific product or process. In the U.S., it is actually written into the Constitution. Patents and other intellectual property rights encourage innovation. Pharmaceutical companies spend billions of dollars each year developing drugs, and patents allow them to recover those research and development costs and, ideally, earn profit.

A patent essentially guarantees their right to be a monopoly, but not forever. After a certain amount of time, usually about 20 years, a patent expires, which lowers the barriers to entry. competition moves in, prices fall, and companies look for something new to patent. Intellectual property law and patents are really complex. And Stan, he's actually done a whole series about them.

=====Natural Monopolies(06:39)=====

J: Natural monopolies are special situations where it is more cost effective to have one large producer rather than several smaller competing firms. The best examples are public utilities in markets such as electricity, water, natural gas, and sewage. They may be privately owned or publicly owned but either way, they remain a monopoly because the government limits competition.

I mean, if there were three competing electric power companies in one city, that would mean building three different power plant, and running three sets of power lines through the streets. The result would be higher in costs. So, in this case, it would be cheaper to have one electric company because they have economies of scale. The monopoly can still raise prices and abuse its power, so the government often regulates prices and fees. Now, of course there are debated over when the government should interfere and which markets justify natural monopolies.

Nike has about 90% market share in basketball shoes, but it's not a natural monopoly. It's a non-coercive monopoly. There are plenty of other shoe companies and people aren't forced to buy Nike shoes. So there's no reason for the government to get involved. But that's not always the case. Up to the 1970s AT&T was given natural monopoly status, which gave it nearly complete control of the telephone industry.

In 1974 an anti-trust lawsuit was filed by the Department of Justice, and the end result was the largest corporate breakup in American history. AT&T dissolved into seven regional telephone companies, other companies like Sprint and MCI quickly jumped into the market. This process is called deregulation, it's happened in many markets from delivering mail to airlines.

=====Price Discrimination(08:00)=====

A: So let's step back here. Why are we so worried about monopolies? Well, a lot of this has to do with pricing. For one, monopolies can charge more for their products than they could if the market was competitive. They can also engage in a practice called price discrimination. Price discrimination is the practice of charging different consumers different prices for exactly the same product. In fact the earliest regulations on railroads came about because they were engaged in price discrimination. they charged different rates tp haul freight. This gave an advantage to companies that shipped more freight and helped to force smaller producers out of business, creating even more monopoly power in the economy.

But price discrimination isn't just for monopolies, and it's not always illegal. To pull off price discrimination, a business needs to be able to segregate the market based on consumers' willingness to pay. The airline industry does this using time, charging those that book early less than those that book late. A price-sensitive student might be only be able to pay $200 so she books a seat weeks or month in advance. A time-sensitive businesswomen that need to be at a board meeting tomorrow, might be willing to pay $800 for that same type of seat on the same flight. The point is charging a single price wouldn't generate as much profit as charging different prices.

Price discrimination happens more often than you think. Discounts based on age or occupation are good examples. Price discrimination works best when firms have a large share of market power. If there were hundreds of airlines it is unlikely that any one of them could price discriminate without losing customers.

=====Conclusion(09:34)=====

A: Like a lot of things we look at here at Crash Course, monopolies and pricing are complicated. Generally, competition is a good thing, Except when it isn't.

Thanks for watching. We'll see you next week.

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(Outro)