

Lecture 14: Regulation, Safety, and Equity

I. Other roles of government in the economy

1. enforce property rights
2. anti-trust
3. income redistribution
4. regulating business and consumer choices

II. Enforce property rights

1. means to protect ownership of property and honoring of contracts
2. handled by police and the courts
3. contributes to trade and investing

III. Anti-trust

1. enforcing the laws against collusive oligopolies and "unfair" trade practices that perpetuates monopoly
2. one action that is clearly illegal: *price-fixing*, where two or more companies agree to set prices or coordinate pricing policy
3. but less agreement on what constitutes anti-competitive behavior and what is just tough business tactics - good example: Microsoft
4. in anti-trust enforcement, federal government will look at proposed mergers and may deny them based on the new company having too much *market power* (control over sales in the market)
 - a. horizontal merger: proposed merger of two companies that produce the same product or service
 - b. vertical merger: proposed merger of two companies at different stages of production for the product or service
 - c. conglomerate merger: proposed merger of two unrelated companies

III. Income Redistribution

1. most controversial of potential roles of government
2. essentially means taxing money away from one individual and providing that money or resources to another individual
3. most done to address poverty: over \$500 billion spent annually in this way
4. but also other programs to assist businesses (incentives, export promotion)
5. in helping low income households, assistance can be of two forms:
 - * cash: traditional "welfare" payments
 - * non-cash, or "in-kind": particular services are provided or paid for: food stamps, Medicaid, child care ("strings-attached")

Issue: provide low income households cash for them to purchase what they want, or purchase for them what others think the households should have

6. *equity vs. efficiency* debate

equity: desire to assist households who have fewer resources so they can attain a higher standard of living

efficiency: but want to preserve personal incentive for a person to better him or herself by working and studying hard and investing

challenge for public policy: designing programs that accomplish both

crucial factor is how to phase out assistance: if suddenly end assistance once income is at a certain level, this adversely affects the efficiency goal

but if gradually end assistance, the number of recipients and program costs dramatically increase

another issue: do government funded income redistribution programs "crowd out" (reduce) private charitable efforts???

IV. Regulation

1. Puts limits on the choices of private businesses and consumers

examples: limitations on financial decisions and on the health and safety of products and the workplace

2. Based on two ideas

a) in some situations, consumers aren't able to evaluate long run consequences of choices

Example: restrictions on selling tobacco and alcoholic products to underage consumers, who presumably don't have the knowledge to evaluate the costs and benefits of their choice over many years; required safety features on products

b) in other situations, consumers and businesses have wide differences in their available information: businesses have much more information than consumers, so consumers are at a disadvantage in evaluating

products and services

Examples: "truth in lending" laws that protect consumers in financial deals with businesses (e.g. - laws on disclosing the "true" interest rate charged - the "APR"); and control of pharmaceuticals allowed to be marketed by the U.S. Federal Drug Administration

3. But there are costs to this regulation

- a) restricts free choice - consumers who say "I can best judge what's good for me"
- b) adds to cost of product (airbags, seat belts, etc. add to cost of vehicles)
- c) may motivate consumers to do *less* information collection on their own, by assuming the government is adequately protecting them
- d) may inhibit or delay some products - long time critics of the Federal Drug Administration who say their regulations have added to the time and expense of developing new drugs (question: should a person dying of cancer be allowed to use an experimental drug or treatment that hasn't been fully certified by the Federal Drug Administration?)
- e) can private warranties, guarantees, and certifications be used instead?

4. Deregulation

- a) in the past, several large industries were heavily regulated by the federal government, enough so that they were effectively government sanctioned collusive oligopolies

Examples:

Airline industry: federal government dictated routes and regulated fares

Trucking industry: federal government dictated routes and regulated prices

Telephone industry: federal and state governments regulated territories and prices

In each of these industries, government also regulated entry of new businesses

Financial services industry: government regulated the financial products banks, stock brokerage firms, and insurance companies could offer

- b) regulation was done in the name of protecting the consumer, but viewpoint gradually changed to realizing the regulations were protecting the existing businesses and restricting choice and raising prices for consumers
- c) since the late 1970s, these industries have been "deregulated", meaning the restrictions have been taken off, and the industries now operate in a competitive industry environment

Best examples seen by consumers: airlines and telephone - companies come and go, "invade" each others' territory, and heavily compete on price

Tradeoff for consumer: Prices are lower and options are greater, but choices are more complicated