

## SLIDES FOR CLASS

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# 1. Introduction to Price Fixing: Legal and Economic Foundations

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Antitrust Law

Spring 2017 NYU School of Law/Georgetown University Law Center

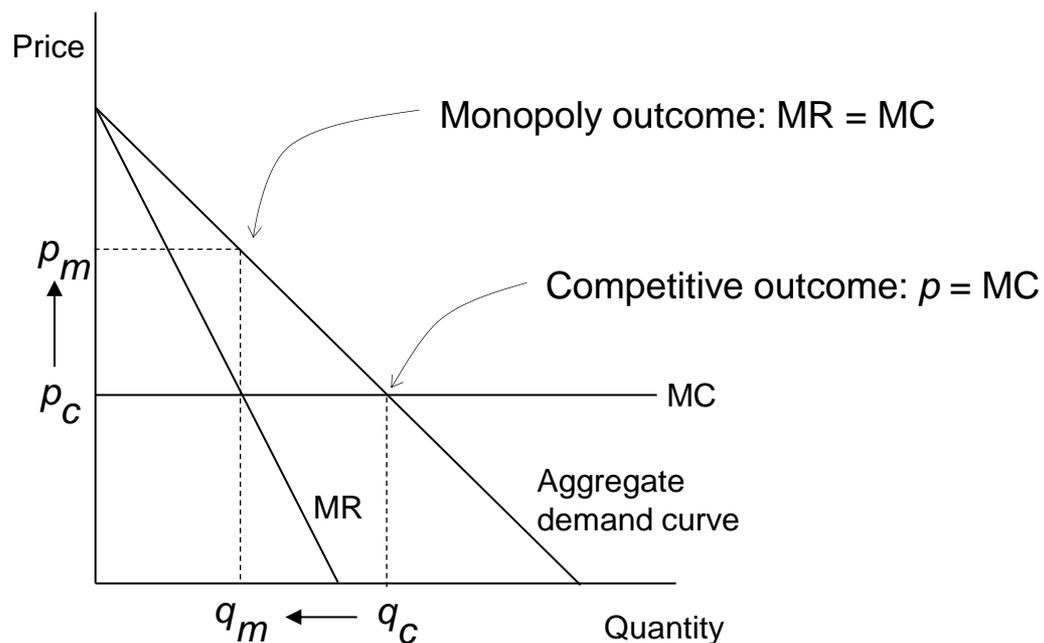
Dale Collins

# Public Policy of Price Fixing

- Modern view on why monopolies are bad:
  - Increase price and decrease output
  - Shift wealth from consumers to producers
  - Create economic inefficiency (“deadweight loss”)
  
  - May (or may not) have other socially adverse effects
    - Decrease product or service quality
    - Decrease the rate of technological innovation or product improvement
    - Decrease product choice

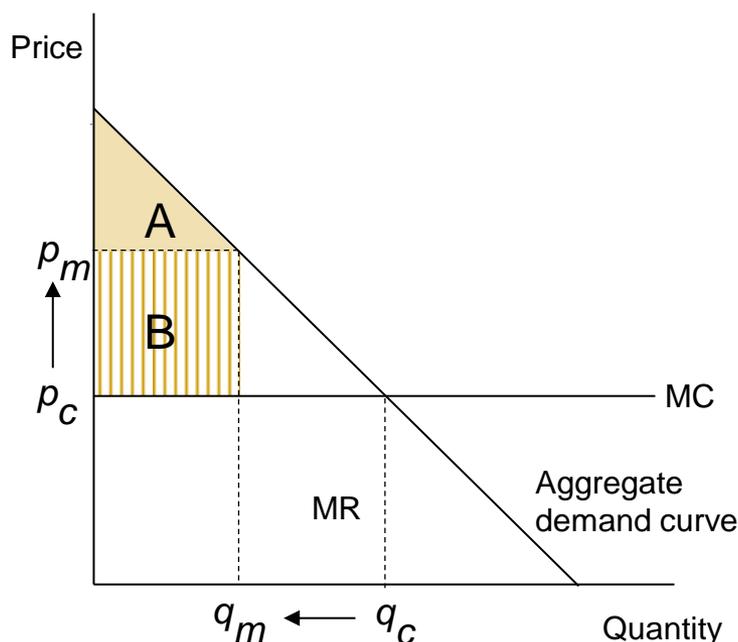
# Public Policy of Price Fixing

- Output decreases:  $q_c \rightarrow q_m$
- Prices increase:  $p_c \rightarrow p_m$



# Public Policy of Price Fixing

- Shift in wealth from inframarginal consumers to producers\*
  - Total wealth created (“surplus”):  $A + B$
  - Sometimes called a “rent redistribution”

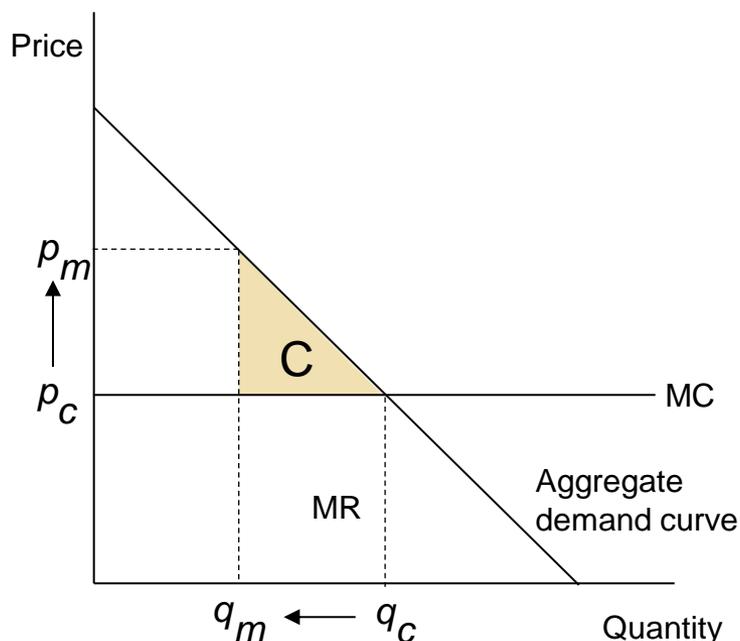


	Competitive	Monopoly
Consumers	$A + B$	$A$
Producers	$0$	$B$

\* Inframarginal customers here means customers that would purchase at both the competitive price and the monopoly price

# Public Policy of Price Fixing

- “Deadweight loss” of surplus of marginal customers\*
  - Surplus C just disappears from the economy
  - Creates “allocative inefficiency” because it does not exhaust all gains from trade



\* Marginal customers here means customers that would purchase at both the competitive price and the monopoly price

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# Unit 1: Lessons

- Life
  - Never spell antitrust with a hyphen
  - Blue Book your citations
  - Understand the difference between Type I and Type II errors and pay attention to them
  - Almost all questions I will ask in class will have a simple answer
    - Corollary: If you give a complex answer, it will likely not be the right answer

# Unit 1: Lessons

- Economics and economic models
  - Firms maximize profits (subject to their available technology)
    - *Corollary:* The answer to the question “Why did the firm do X?” is almost always “To make more profits”
    - The *next* question is “How does X enable the firm to make more profits”
  - Consumers maximize their utility (subject to their budget constraints)
  - Demand curves slope downward
    - *Corollary:* The more it costs, the less you want it
  - In normal markets, firms maximize profits when they set price or output so that  $MR = MC$
  - In normal competitive markets, firms price so that  $p = MC$

# Unit 1: Lessons

## ■ Cartels

- Firms form cartels to increase their profits
  - Cartels work by decreasing the ability or incentive of customers to substitute between member firms
  - This makes the firm's residual demand curve more inelastic and allows the firm to raise price
- Cartels are hard to form and maintain because:
  - Market conditions may destabilize any cartelization effort
  - Members need to collectively agree on a rule to allocate monopoly rents
  - There is a strong short-run incentive on the part of individual members to cheat
- But there are long-run benefits to firms from participating in cartels, so—
  - Cartels can exist (sometimes for long periods of time)
  - But typically operate imperfectly

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# Lessons

- Public policy
  - When cartels are successful
    - Raise price and lower output
    - Shift wealth from consumers to producers
    - Create economic inefficiency (“deadweight loss”)