(De)Regulation Of Business Part II

Deregulation was just the removal of rules without considering why the rules were there in the first place.
John Courage

Areas of Government Regulation

In addition to regulating business behavior in the market place, the US government regulates all business in five general areas.

- advertising
- employment and labor
- environment
- privacy
- safety and health

Government Regulation: Advertising

- Laws pertaining to marketing and advertising set in motion by the Federal Trade Commission exist to protect consumers and keep companies honest about their products.
- Every business in the country is required to comply with the truth-in-advertising laws and could face lawsuits for violation.

Government Regulation: Employment and Labor

- Employment laws pertain to minimum wages, benefits, safety and health compliance, work for non-US citizens, working conditions, equal opportunity employment and privacy regulations -- and cover the largest area of subjects of all the business regulations.
- They include the Fair Labor Standards Act, the Employee Retirement Income Security Act and the Immigration and Nationality Act.

Government Regulation: Environment

- The carbon footprint of businesses on the environment is regulated by the Environmental Protection Agency alongside state agencies.
- The EPA enforces federal environmental laws through educational resources, frequent inspections and local agency accountability.
- The Environmental Compliance Assistance Guide exists to help businesses achieve environmental compliance.

Government Regulation: Privacy

- Sensitive information is usually collected from employees and customers during hiring and business transactions, and privacy laws prevent businesses from disclosing this information freely.
- Not only do various laws exist to keep businesses from spreading this information, but people can sue companies for disclosing sensitive information.

Government Regulation: Safety and Health

- The Safety and Health Act of 1970 ensures that employers provide safe and sanitary work environments through frequent inspections and a grading scale. A company must meet specific standards in order to stay in business.
- In accordance with the 1970 act, employers must provide hazard-free workplaces, avoiding employee physical harm and death, through a number of procedures.

Deregulation

Whenever there's regulation, a push for deregulation follows.

Deregulation can be accomplished legislatively, with Congress passing new laws or amending old ones. Or it can be handled administratively, with agencies writing new rules or choosing not to enforce some rules.

Usually, deregulation isn't complete: Some regulations are removed or eased, but others remain.

Deregulation in Practice

- The push to deregulate is prompted by two concerns:
  - The inefficiencies that regulation imposes.
  - Advancing technology destroyed the basis for a previously natural monopoly.

Railroads

The Interstate Commerce Commission (ICC) was created in 1887 to limit monopolistic exploitation of the railroad situation while assuring a “fair” profit to railroad owners.

Railroads

With the advent of buses, trucks, subways, airplanes and pipelines as alternative modes of transportation, railroad regulation became increasingly obsolete.

Railroads

The Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980, granted railroads much greater freedom to adapt their prices and service to market demands.

Railroads

- Railroad companies used that flexibility to increase their share of total freight traffic.
- The railroads prospered by reconfiguring routes and services, cutting operating costs and offering lower rates.

Railroads

Between 1986 and 1993, the average cost of moving freight by rail dropped by 69%.

Railroads

- After a series of mergers and acquisitions the top four railroads moved nearly 90% of all rail freight in 1998-99.
- Some firms held monopoly positions on specific routes and charged 20%-30% more than on non-monopoly routes.

Chart: Railroad Traffic: Before and After Deregulation

Telephone Service

- With high fixed costs and very low marginal costs, the telephone had long been an example of a natural monopoly.
- Technology outpaced regulation and greatly reduced the cost for new firms to provide long-distance service.

Long Distance Telephone Service

- In 1982, the courts put an end to AT&T's monopoly.
- Since then, over 800 firms have entered the industry, and long-distance telephone rates have dropped sharply.
- Rates have fallen and service has improved.

Local Telephone Service

- As competition in long distance services increased, the monopoly nature of *local* rates became painfully apparent.
- Local rates kept increasing after 1983 while long-distance rates were tumbling.

Local Telephone Service

New technologies permitted wireless companies to offer local service if they could gain access to the monopoly networks.

Local Telephone Service

Congress passed the Telecommunications Act of 1996 requiring the Baby Bells to grant rivals access to their transmission networks.

Local Telephone Service

The Baby Bells have been accused of charging excessive access fees, imposing overly complex access codes, requiring unnecessary capital equipment and raising other entry barriers.

Local Telephone Service

The FCC and state regulatory agencies lowered entry barriers in 2001-02 which allowed rivals to increase market share to 12%.

Airlines

- The Civil Aeronautics Board (CAB) was created in 1938 to regulate airline routes and fares.
- Its primary objective was to ensure a viable system of air transportation for both large and small communities.

Airlines

- The focus of the CAB was on profit regulation.
- A secondary objective was to ensure air service to smaller, less-traveled communities.

Airlines

- Short hauls entail higher average costs and, therefore, higher fares.
- By fixing airfares, the CAB eliminated price competition between established carriers.

Airlines

- Regulators used cross-subsidization to keep local rates low.
- Cross-subsidization: use of high prices and profits on one product to subsidize low prices on another product

Airlines: No Entry

- The CAB was extremely effective in restricting entry into the industry.
- From 1938 until 1977 the CAB never awarded a major route to a new entrant.

Airlines: No Price Competition

- The CAB eliminated price competition between established carriers.
- The CAB fixed airfares on all routes.

Airlines: Bloated Costs

- Despite the high regulated fares, established carriers were unable to reap much profit.
- Costs rose as carriers used frequent flights and product differentiation to attract passengers.

Airlines: Bloated Costs

- *Profit regulation came to be regarded as a failure*.
  - Airlines weren't making substantial profits.
  - Consumers weren't being offered very many price-service combinations.

Airlines: New Entrants

- The Airline Deregulation Act of 1978 eliminated the regulatory barrier to entry.
  - Barriers to entry: obstacles that make it difficult or impossible for would-be producers to enter a particular market

Airlines: New Entrants

- Between 1978 and 1985, the number of airline companies increased substantially.
- Price competition reduced average fares as much as 40% below regulated levels.

Airlines: Increasing Concentration

- Unable to match lower fares and increased service, scores of airline companies exited the industry in the period 1985-95.
- The combined market share of the three largest carriers nearly doubled between 1985 and 1993.

Airlines: Increasing Concentration

- Some companies have gained near monopoly power in specific hub airports.
- Ticket prices are 45% to 85% higher on monopolized routes than on routes where at least two airlines compete.

Airlines: Entry Barriers

Major carriers exploit their hub dominance and keep rivals out through their ownership of landing slots.

Airlines: Entry Barriers

- Defenders of deregulation argue that most airline markets are competitive.
- They argue the airline industry is a contestable market.
  - Contestable market: an imperfectly competitive industry subject to potential entry if prices or profits increase

Continued in (De)Regulation of Business Part III