

# The public interest theory of regulation economics essay



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Industrial regulation is the industrial regulation of prices charged to the consumer, which is also known as public regulation. The idea is to determine a price, or rate, that covers the production cost and a fair profit for the company. The Public interest theory of regulation that states that it “ is necessary to keep a natural monopoly from charging monopoly prices and thus harming consumers and society” embodies the idea industrial regulation (McConnell & Brue, 2008, P. 589).

Industrial regulation affects the market by influencing the strategies a company uses to increase profits. In a non-regulated market a company will increase profits by reducing cost by producing more product, but in an industrial regulated market, eventually the company will be required to lower the price of the product in order to balance out the profit to a normal level. The negative effect of this regulation is that since the company is held to a fair profit there is no reason to exercise strategies to minimize production costs.

Also, this type of regulation does not adapt to changing industries and over time ends up enabling monopolies rather than discouraging them. For example, cassette tapes used to be the media on which music albums were distributed on, then compact discs evolved and gave cassette tapes competition, to take the evolution further compact discs are now in competition with ipods and other mp3 players. Regulations could actually block entry of these competing products, and enabling a monopolistic environment, but if the industry were left unregulated the original product would eventually be phased out due to natural competition.

With these regulations in place, the regulations sometimes block entry of competitors into an industry; the legal cartel theory arises from this way of thinking. A legal cartel is a safe haven for some companies and in fact some firms seek a legal cartel because of the guaranteed profit. This is caused by the regulations blocking entry of other companies and regulating the rates of the product. In terms of an oligopoly, a few firms controlling an entire market, the regulating agencies divide the market to create a fair competition environment.

## **Social Regulation**

Social regulation came about after industrial regulation which regulated monopolies and the price of products. Social regulation focuses on environmental conditions in which business is conducted and the effects of the business on society as a whole. Social regulation doesn't apply to certain types of business models like monopolies, oligopolies, or competition styles; social regulation is applicable to all businesses and affect day-to day operations.

The idea of social regulation is to protect the consumer from harmful products and workers from hazardous work environments. Take baby cribs for example, the dimensions of cribs is regulated in order to ensure the cribs are a safe product for babies to sleep in. The space between the slats is regulated as well as the type of bedding used in the crib. There are also regulations in the workplace to protect employees and employers, such as minimum wage requirements, and how many breaks an employee is required to take while working.

## **Natural Monopolies**

A natural monopoly occurs when one company supplies the market demand at a fair price. It would be uneconomical for companies to compete in providing these types of services to the consumer (McConnell & Brue, 2008, p. 589) which creates a natural monopoly. Generally, natural monopolies have large fixed costs, which create a barrier to entry into the market. There are not too many examples of natural monopolies in today's economy but one that many are familiar with are local utilities.

## **Antitrust Laws**

The Antitrust laws, is also referred to as the antimonopoly policy is comprised of four pieces of legislation. The first piece of legislation came about in 1890; this is called the Sherman Act. There are two parts to the Sherman Act, the first section regulates trade and states that “ every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations is declared to be illegal (McConnell & Brue, 2008, p. 583)”. This means that trade cannot be restrained in any form to control prices in a market. The second part of the Sherman Act prevents monopolies from forming, if there is evidence of monopoly actions by a company the persons responsible could be charged with a misdemeanor.

The Clayton Act of 1914 came about because the Sherman Act was too broad and needed to be defined. The Clayton Act strengthened the Sherman Act in prohibiting practices that companies may participate in to create a monopoly, there are four sections in particular that accomplish just that;

section 2 prohibits price discrimination, section 3 prohibits tying contracts,  
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which are contracts that promote the purchase of one product in conjunction with the purchase of another product, section 7 companies cannot acquire enough stock in their competition that would create less competition, and section 8 addresses conflicts of interest that could occur if an individual has a vested interest in two competing firms.

The Federal Trade Commission Act of 1914 created what is known today as the FTC, or the Federal Trade Commission. The role of the FTC is to investigate and monitor trade practices between companies, and regulated unfair or deceptive sales. The FTC investigates companies on its own accord or by request.

Finally, the Celler-Kefauver Act of 1950 is an amendment to the Clayton Act. One part of the Clayton Act prohibits a company or person to acquire enough stocks in a competing company that it creates less competition. The Celler-Kefauver Act takes this concept a step further and prohibits a company from acquiring the physical property of a competing firm that would result in less competition.

## **Regulatory Commissions of Industrial Regulation**

There are three main commissions that comprise industrial regulation; there is the Federal Energy Regulatory Commission (FERC), the Federal Communications Commission (FCC), and the State public Utility Commissions. Generally these commissions regulate the prices charged to consumers. The Federal Energy Regulatory Commission regulates utilities like water, gas, power, and the means of how these resources are provided

and the cost. And there is a State level of regulation by the State Public Utility Commission.

The Federal Communications Commission regulates media like satellite and cable television, satellite radio and radio and telephone services. The FCC is the entity that handles situations like the Janet Jackson and Justin Timberlake situation. Radio is regulated by the FCC as well, along with television there is certain acceptable language and if the broadcast companies do not comply they will be fined and investigated. The FCC also regulates what taxes can be charged on your cell phone or television bill.

## **Primary Federal Regulatory Commissions that Govern Social Regulation**

There are five Federal Regulatory Commissions that provide social regulation, there is the Food and Drug Administration (FDA) that regulates the quality of the food consumed by consumers as well as verifies the validity of claims made by drug companies. The FDA also regulates cosmetics.

The Equal Employment Opportunity Commission (EEOC) regulates the hiring, firing, promotion, and discharge of employees. This commission ensures the fair treatment of anyone that applies for a job and works in America. It prevents discrimination of age, race, gender, disability and religion; an employer cannot deny employment based on these things.

The Occupational Safety and Health Administration (OSHA) regulates a safe and healthy environment in the workplace. One of the many things OSHA

ensures is that in hazardous work environments, the proper equipment is worn by employees to ensure safety.

The Environmental Protection Agency (EPA) regulates air, water and noise pollution. The EPA is the agency that is handling the BP oil spill in the Gulf of Mexico. The EPA also regulates allowable noise levels during production.

Finally, the Consumer Product Safety Commission (CPSC) regulates the production of products and initiates recalls on unsafe merchandise. CPSC has recalled such items as toys or household products that are found to be harmful.