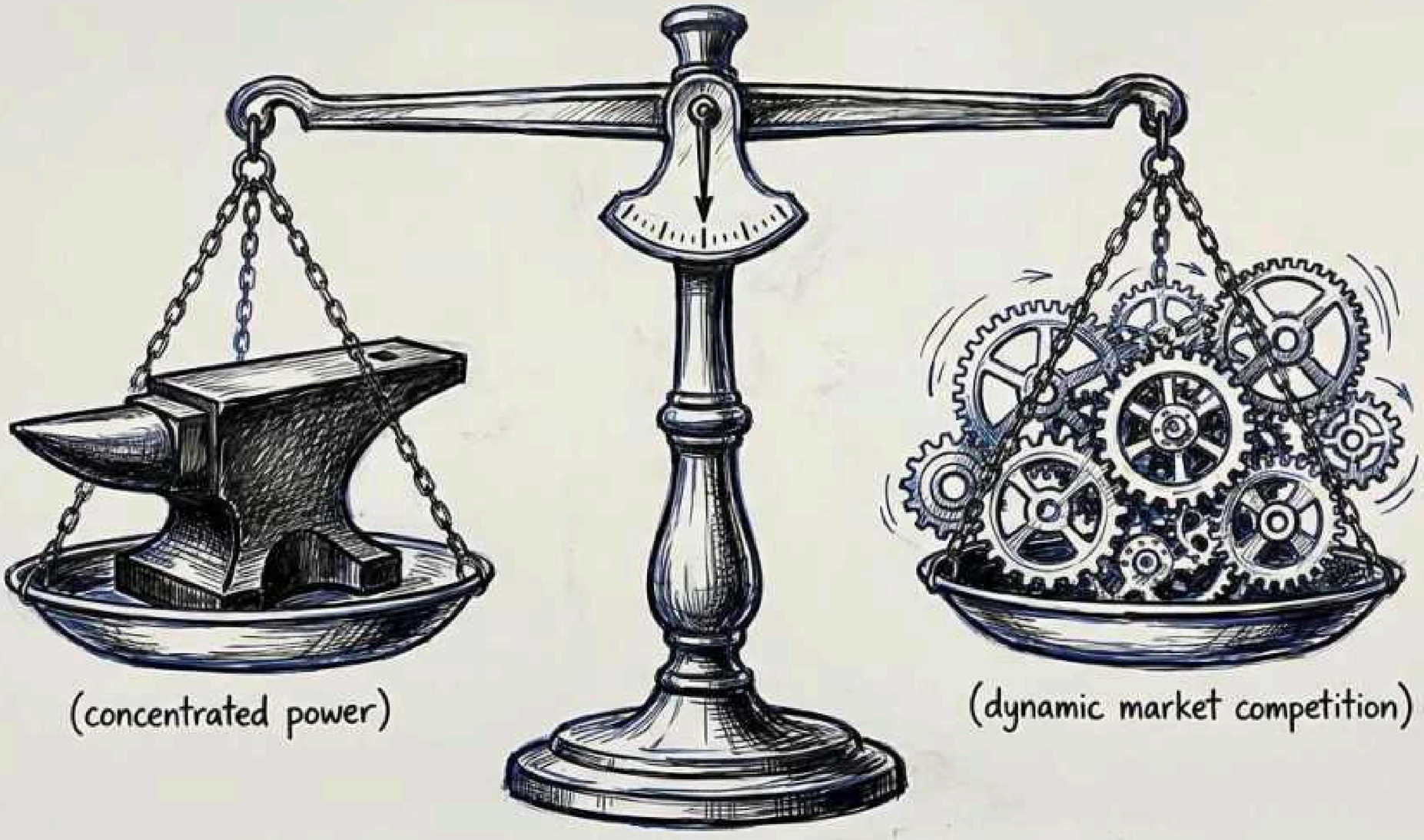
ECON 110 B: Competition, Trade, and Concentrated Power

¶ 4.1

Lecture 4: Markets, Monopolies, and the Global Board.



¶ 4.2

The Mechanics and Failures of Markets



Competition & Prices

Measuring Concentration

Cartels & Antitrust

Natural Monopolies

Global Trade

¶ 4.3

Adam Smith's Engine of Public Benefit



— Self-Interest + Rivalry = Public Benefit

- Rivalry forces lower prices, better quality, and innovation.
- Overcharging or carelessness results in lost customers.
- Good-heartedness is not required for the system to work.

The Gravitational Pull of Competition

§ 4.4



Step 1 (Monopoly):

Cost ($2.00) → Price ($3.00) = $1.00 Profit

Step 2 (Rival Enters):

Rival Price ($2.50) → Pavel must cut price to survive.

Step 3 (Market Equilibrium):

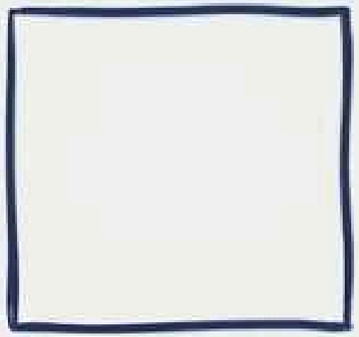
More rivals enter → Price pulled down to Cost ($2.00)

Gain passes from the seller to the buyer.

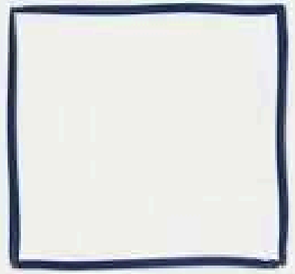
Quantifying Concentration: The HHI

¶ 4.5

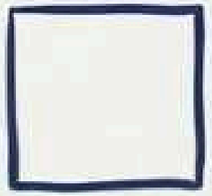
$$HHI = \sum_{i=1}^{n} s_i^2$$



Firm A (40%):
$40^2 = 1600$



Firm B (30%):
$30^2 = 900$



Firm C (20%):
$20^2 = 400$

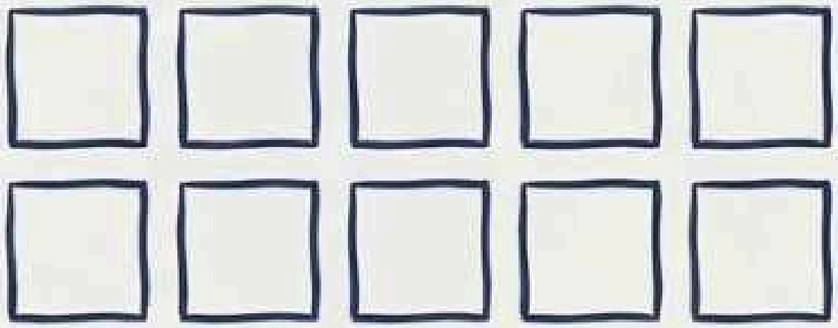
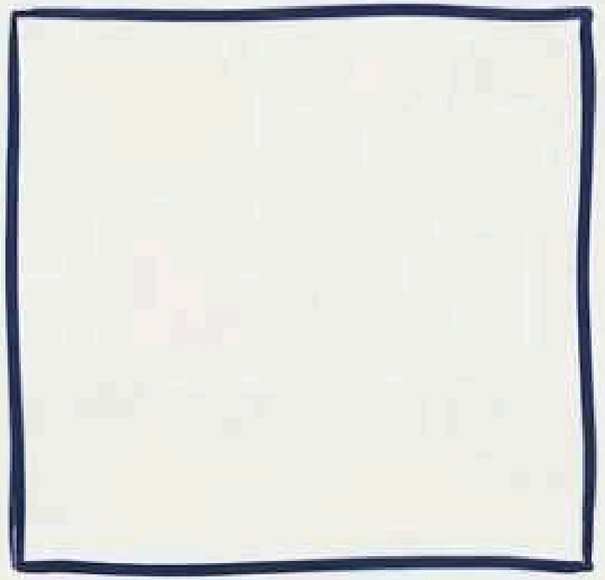


Firm D (10%):
$10^2 = 100$

Total HHI = 3,000

Reading the Index

¶ 4.6

Low Concentration	Maximum Concentration
	
10 equal firms (10% each)	1 single firm (100%)
$10 \times 100 = 1{,}000$ ✓	$100^2 = 10{,}000$ ⚠

The HHI is only a starting point. It ignores two vital forces:

1. Threat of new entrants,
2. Ease of customer switching.

The Conspiracy Against the Public

¶ 4.7



"People of the same trade seldom meet together... but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." – Adam Smith

Smith trusted competition, not capitalists.

Why Cartels Collapse: The Prisoner's Dilemma

¶ 4.8

		Baker B: Keep Price High	Baker B: Cut Price
Baker A	Keep Price High	$100 / $100	$20 / $150
Baker A	Cut Price	$150 / $20	$50 / $50

The Dominant Strategy: Cutting always pays better individually, destroying the cartel.

The Architecture of Durable Monopolies

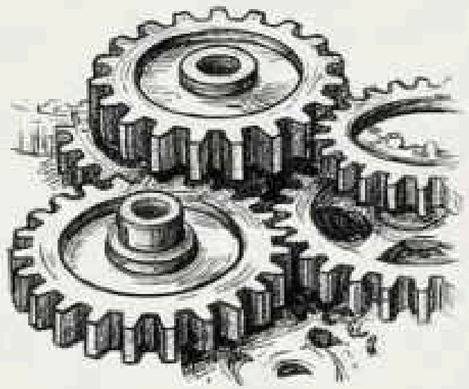
¶ 4.9

Government Protection



- Licenses
- Tariffs
- Exclusive Franchises

Market Dynamics



- Economies of Scale
- Network Effects

Private power that lasts usually has a public prop.

The Logic of Natural Monopolies

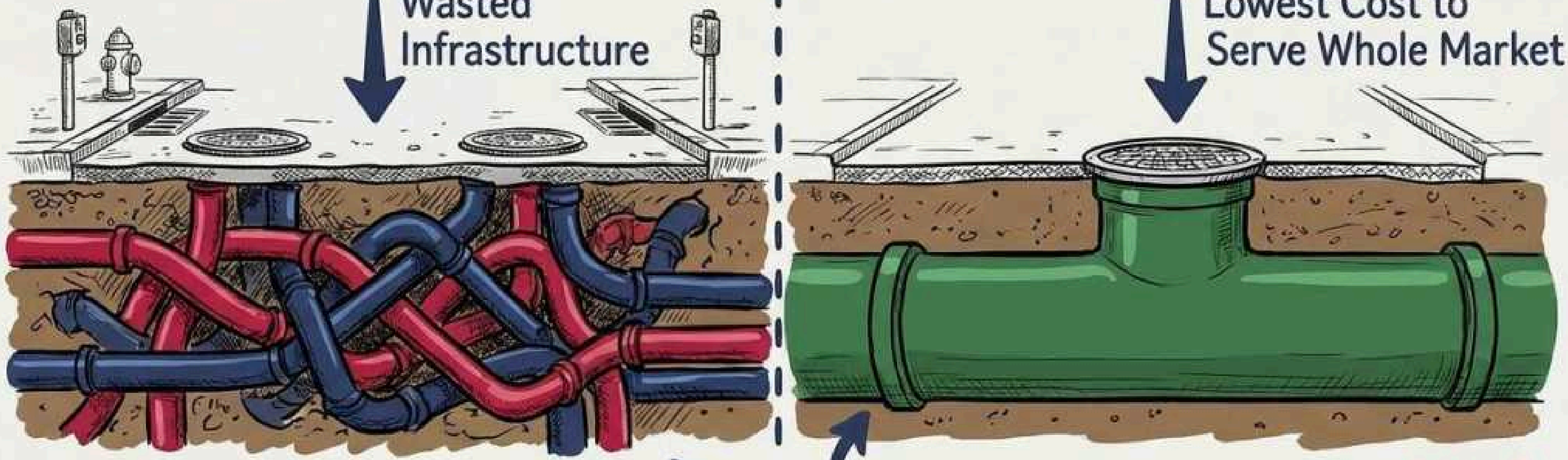
¶ 4.10

The Absurdity

Wasted Infrastructure

The Efficiency

Lowest Cost to Serve Whole Market



Requires Regulation or Public Ownership

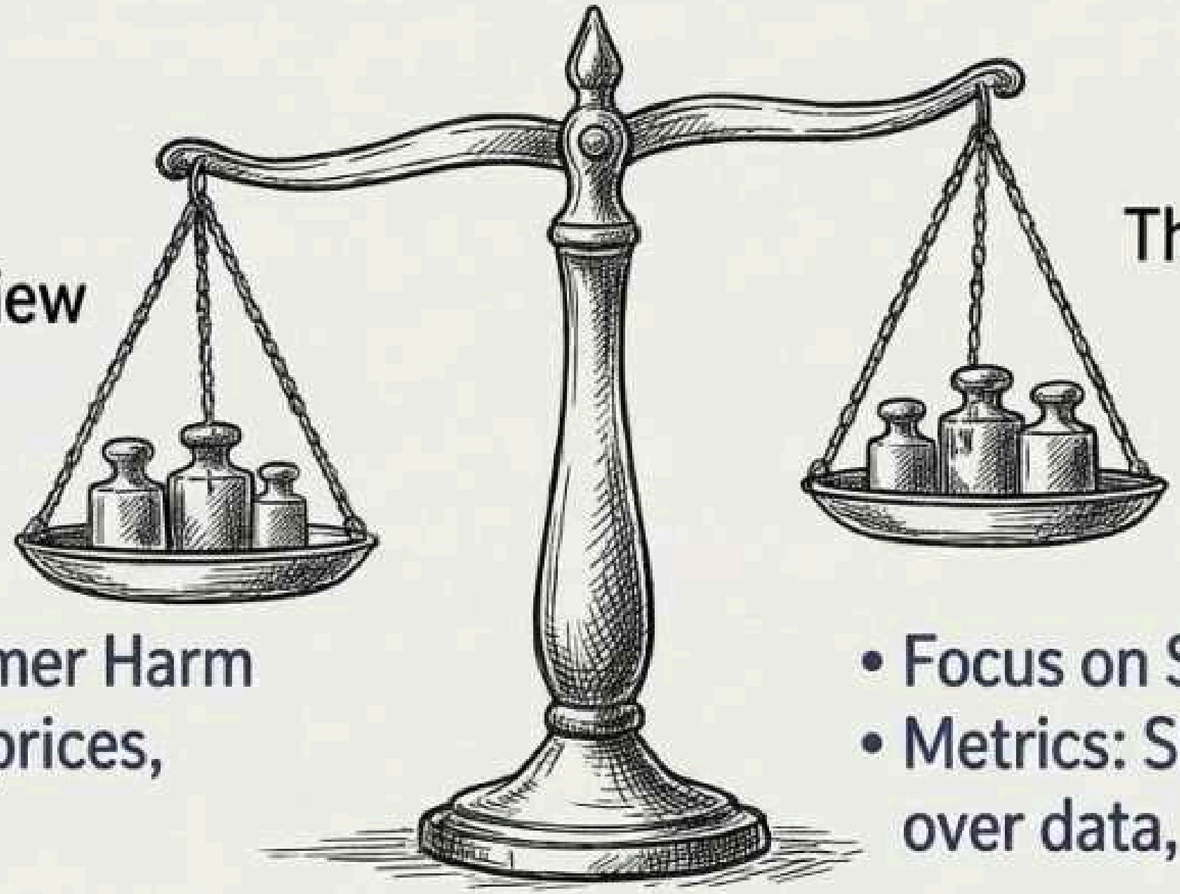
Risk of Regulatory Capture.

The Antitrust Debate (Sherman Act, 1890)

¶ 4.11

The Traditional View

- Focus on Consumer Harm
- Metrics: Higher prices, worse quality.



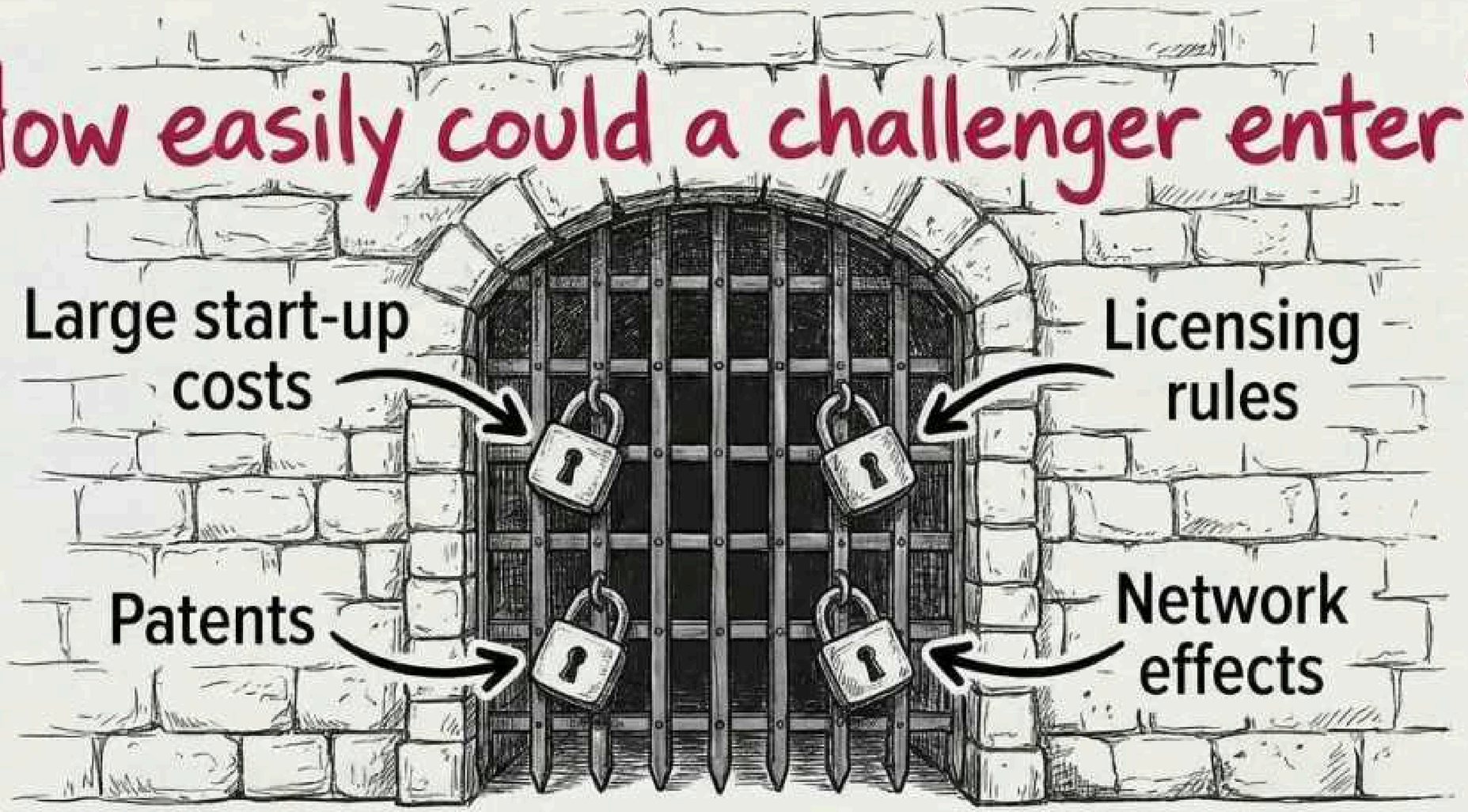
The Broad View

- Focus on Structural Power
- Metrics: Sheer size, control over data, threat to democracy.

Should we intervene when prices are low but power is vast?

Contestability and Barriers to Entry

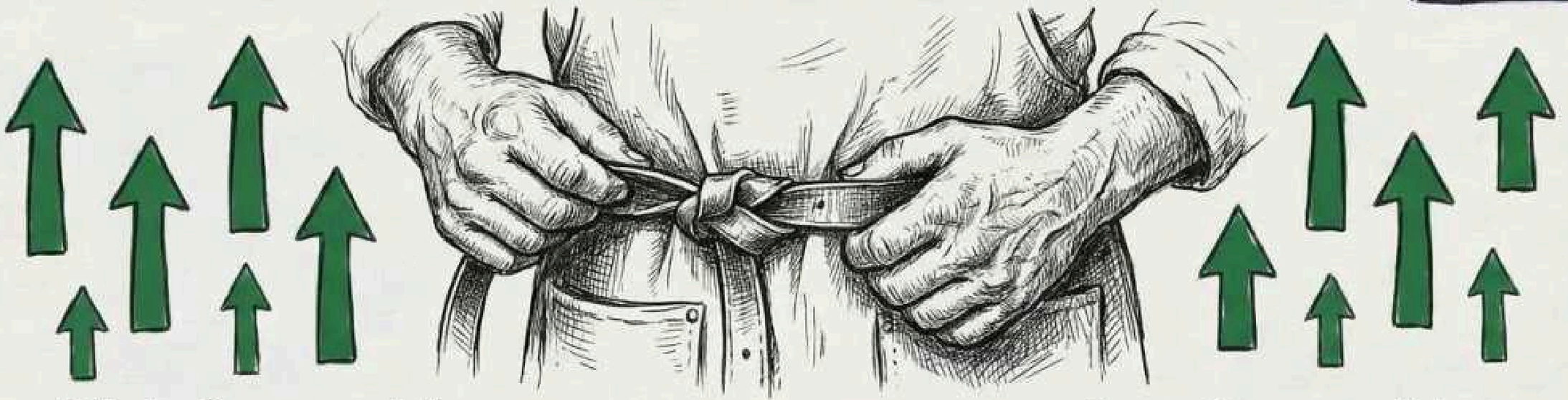
¶ 4.12



William Baumol

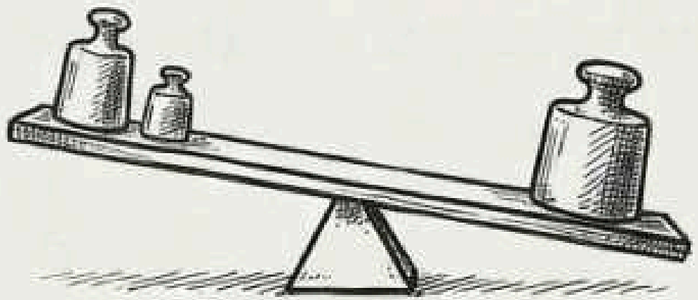
Competition for Labor

¶ 4.13



High Competition

Many employers = Better pay, better conditions, ability to leave bad jobs.



Low Competition

Few employers / high moving costs = Need for external worker protections.

Free-market economists view employer rivalry as the ultimate employee protection.

Comparative Advantage: The Setup

¶ 4.14

			
Millbrook Worker	12 Loaves	OR	6 Shirts
Marlow Worker	4 Loaves	OR	4 Shirts

Millbrook: 1 Shirt costs 2 Loaves.

Marlow: 1 Shirt costs 1 Loaf.

Marlow has comparative advantage in shirts; Millbrook in bread.

The Mathematics of Specialization

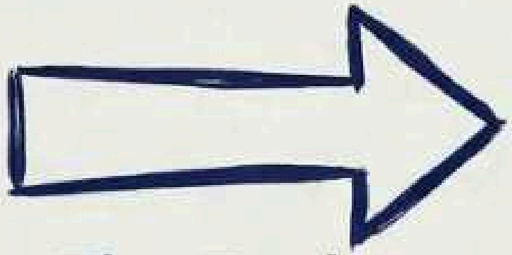
¶ 4.15

Before Trade (Split Days)

~~8 Loaves, 5 Shirts~~

The Trade:

Marlow trades 2 shirts for 3 loaves.



The Trade:

Marlow trades 2 shirts for 3 loaves.

After Trade (Specialized)

SURPLUS

Millbrook:
9 Loaves, 2 Shirts
(+3 Loaves, -1 Shirt)

Marlow:
3 Loaves, 2 Shirts
(+1 Loaf)

The Economics of Tariffs

¶ 4.16



Total Cost to Consumers: $100,000,000

Jobs Saved: 1,000

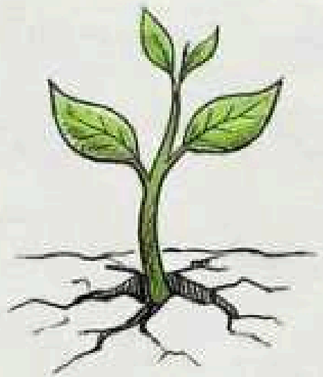
$$\frac{\$100{,}000{,}000}{1{,}000} = \$100{,}000 \text{ per job saved}$$

$100,000

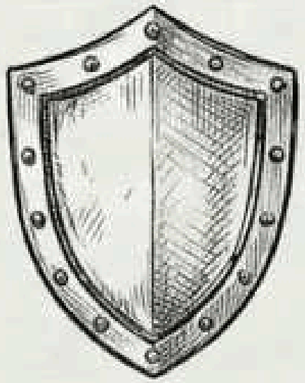
Tariffs raise import prices, protect domestic producers, and raise revenue—but at a steep consumer cost.

The Case for Shelter (Protectionism)

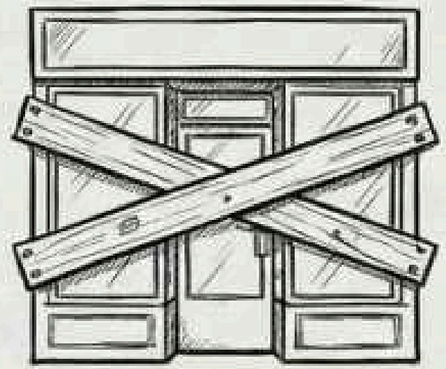
¶ 4.17



Infant Industries



National Security



Community Shock

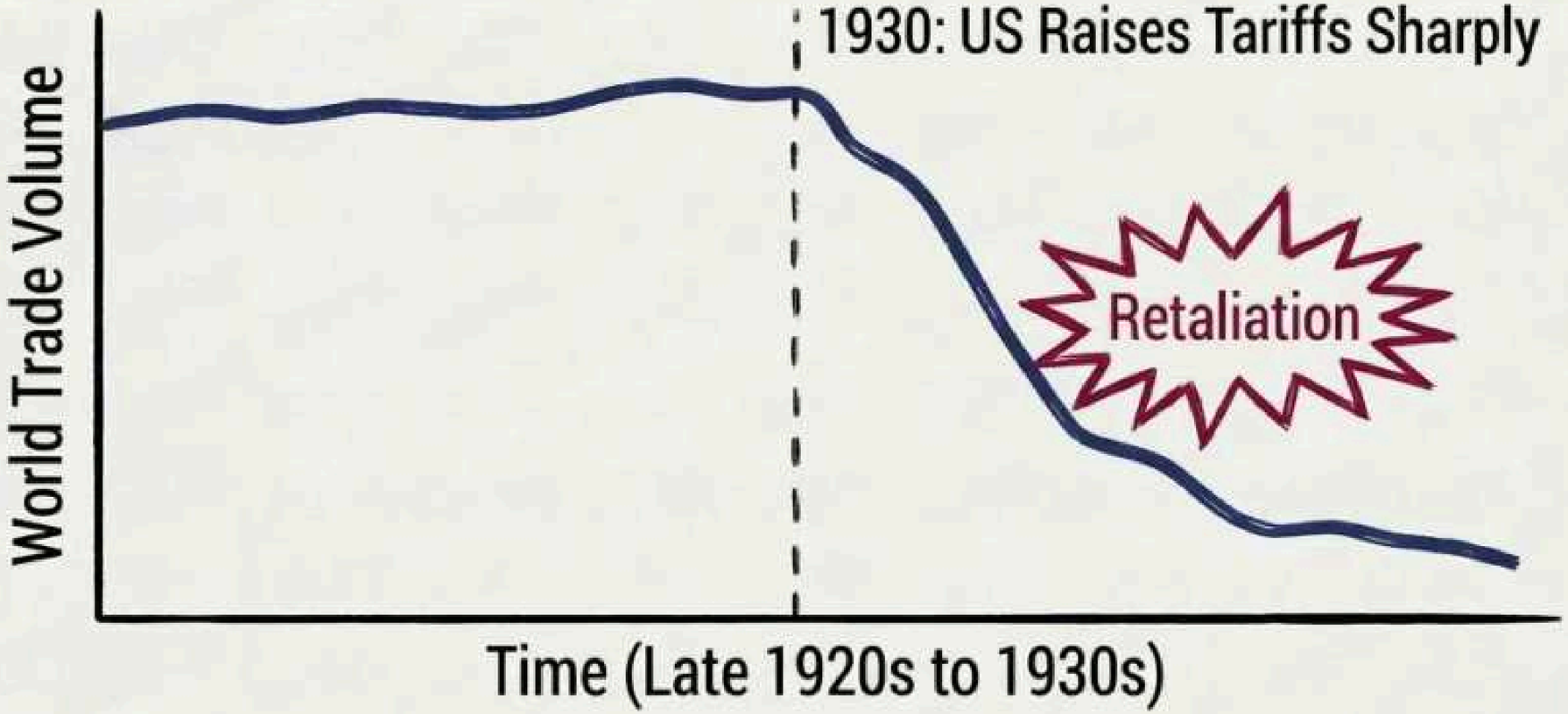


Foreign Subsidies

Counter-Argument: Free-trade economists argue these cases are extremely narrow; direct aid to displaced workers is more efficient than blocking imports.

History's Warning: Smoot-Hawley (1930)

¶ 4.18



Most economists view this as the ultimate caution against trade wars during the Depression.

The Post-War Trade Boom

¶ 4.19

The Architecture:
GATT → WTO

The Growth:
Rapid expansion in South Korea, China, India.

The Nuance:
Government guided the investment, and real workers in certain industries suffered losses.

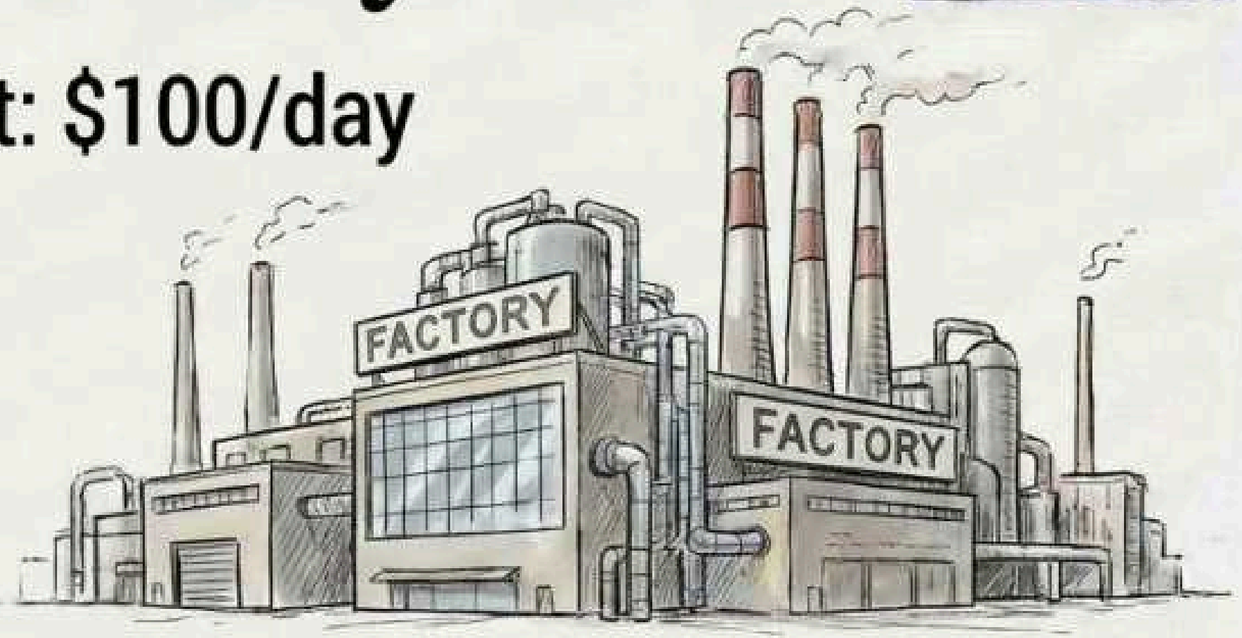
Did free trade or state guidance drive the growth? Economists debate the exact credit.

Bigness is Not Always Bad

¶4.20

Fixed Cost: $100/day





Small Firm (50 loaves):
$100 / 50 = $2.00/loaf

Large Firm (100 loaves):
$100 / 100 = $1.00/loaf

Larger firms produce more cheaply. Savings pass to customers only if competition forces them to.

¶ 4.21

Application: Analyze Your World







1. How many firms compete?
2. How easily could a new firm enter?
3. Is it government or the market itself protecting the biggest players?

Choose an industry you use often. Apply today's frameworks.

¶ 4.22

Looking Ahead to Lecture 5

What Government Should Do



What Government Should Leave Alone

The boundary between state action and free markets.