Economics 123, Spring 2004
Professor Joseph Farrell, farrell@econ.
Class: Tuesdays and Thursdays, 8-9:30
Office hours (at least initially): Tuesdays 10:15-11:45, in 519 Evans.

*****Please do not ask me to sign forms to get you into the class—the department has a procedure for that, which doesn't involve my signing forms.*****

This class is about government regulation of industry, primarily in the US, and with a heavy focus on competition policy (including antitrust), though we will also discuss more "traditional" forms of regulation. There are two required texts: Viscusi, Vernon and Harrington (VVH), and Kwoka and White (KW); other readings will also be assigned.

I expect students to be completely comfortable with the essentials of microeconomic theory and the mathematics required for that. I don't expect us to draw much if at all on "consumer theory" or isoquants (in fact when I teach intermediate micro I try to minimize those tedious topics), but you must be clear on the basics of how idealized competition works and when/why it is and is not efficient. In addition you should have taken, or be able to quickly catch up with, some basic "industrial organization" concepts such as concentration, Cournot models, and simple game theory. Most importantly, though, you need to be interested in microeconomic policy. (And you need to be reliably capable of being wide awake and in Evans Hall by 8 a.m.—it wasn't my first choice either but it's the way it is. If that's not you, I don't blame you, but I do have to ask you not to take this class.)

Class requirements will depend on the number of students, but you should be prepared for (a) a term paper, (b) some tests/exams and problem sets, and (c) an in-class presentation. In all these, I try to build and test sophisticated understanding rather than rote learning or mathematical manipulations, though you will need some math ability to get the most out of the class. On the other hand there will probably be more reading than in a more "technical" economics class. You will need to work hard to ask yourself the kind of questions that you'll learn I tend to ask in class. I strongly recommend forming small (2-4 people) study groups for this purpose; in addition, if there are too many students for everyone to do individual class presentations I may assign presentations to groups.

I also want you to elect a "class representative" after a week or two. You're all individually encouraged to tell me what you're finding fascinating, difficult, tedious, etc.; the job of the class rep is to ask you and report consensus views to me even if nobody feels like it. Remind me to finish class a bit early sometime in the second or third week so that you can elect someone.

My background relevant to this class is that I started out as a math major (and even grad student), then got into economics and became a professor starting at MIT in 1979. I left MIT and spent a couple of years working in the telecommunications industry (for GTE), then came to Berkeley, where I've taught since about 1987. While at Berkeley I've twice taken leaves of absence to work in competition/regulation policy: in 1996-1997, I was the Chief Economist at the FCC during much of the implementation of the Telecommunications Act, and in 2000-2001 I was the chief economist at the Justice Department's Antitrust Division.

For two reasons, this document doesn't contain a class-by-class plan for the semester. The first reason is that our speed will depend on class size and on your general level of preparation. The second reason is that I am plan-in-advance challenged. I do my best with this disability but it is there. If you absolutely need things planned and announced well in advance, consider another class.

My other relevant disability is that I am really bad with names and faces. Please identify yourself by name when you talk in class, and I will do my best to learn.

The overall structure of the class is as follows.

I. **Competition Policy** (biggest part of the class)
   a. Benefits of competition to consumers and to society
   b. The competitors' dilemma and its generic solutions
   c. Policies to sabotage those solutions
      i. Collusion and softening of competition
      ii. Mergers among competitors
      iii. Predation and exclusion

We will study these issues in part through discussing the cases treated in K&W; you will probably be asked (perhaps as part of a group) to do a brief presentation on such a case.

II. **Price and entry regulation** (traditional "natural monopoly" etc.)
   a. Cost-of-service regulation and its dysfunctions
   b. Price caps, benchmarking, other incentive regulation

III. Health and safety and externality regulation
   a. Coasean and other arguments against such regulation
   b. The gaps in such arguments, and what that suggests about regulation

First batch of assignments:

Before 22 Jan. (Thursday): Skim the following readings: VVH pp.1-10, 97-101, 121-135; KW pp. 8-15 and 172-180. (You can use your judgment here: where a reading assignment ends on a page on which a new section begins, normally I mean you to read to the end of the previous section and not start the new section.) Be prepared to discuss in class the basic economics of collusion and the basics of its legal treatment. Don't get bogged down in too many details (you have less than 48 hours for this assignment if you didn't download this document in advance!).

Before 27 Jan. (Tuesday). Re-read the readings above, with somewhat more care. Also read the Addyston Pipe case summary, VVH pages 138-142, and KW Case 10 (lysine). Be prepared to discuss in class *at least two of the following questions*, as well as the main themes of the readings:

1. In calculating an "overcharge," the law does not (typically) take into account whether an overcharged buyer (who is often, as in the lysine case, not a final consumer) might pass through some or all of the overcharge, to its downstream customers. Does this make sense, (a) if the buyer is a monopoly in a downstream market, (b) if it faces competition in its downstream market from other buyers of the cartelized product?
2. How would you set about estimating the probability that a cartel will be detected and prosecuted? Assume that you have access to the sort of data that statisticians and the Justice Department can realistically get, but no magic X-ray vision.
3. Find out about the Justice Department's "corporate leniency policy" and explain why the Department thinks it is a good policy. Give a coherent argument against the policy (either that there shouldn't be such a policy, or that it should be changed in a particular way).
4. Comment on Connor's Cournot logic on p. 268 about predictions of negative prices. Is he right? If not, how did he make this mistake?
5. Identify a key inconsistency in the reported arguments of the Addyston Group.