

PRINCETON UNIVERSITY:

**Woodrow Wilson School of Public and
International Affairs**

Spring 2006

**WWS 523
Legal and Regulatory Policy Towards Markets**

Professor Amy Craft

Mondays and Wednesdays, 9:00 – 10:30am

This course develops and applies microeconomic concepts and methodologies that are relevant to the formulation and analysis of public policy towards markets. It studies circumstances where markets work well for the public interest, and scenarios where there are market failures that warrant appropriate legal and regulatory policy. In this domain, answers to policy questions are inevitably challenging and incompletely clear. The course aims to illuminate the various conflicting forces and concerns that should be balanced and resolved in successful economic policy analysis.

This course builds off of the concepts presented in WWS511. It will go into far greater detail and depth into a number of areas of microeconomics, avoiding topics that are covered squarely by the WWS courses on public economics, trade, environmental economics, labor, development and financial markets. Principal areas of focus will be competition policy (i.e. antitrust or antimonopoly laws and policies); consumer information and advertising; policy towards R&D and intellectual property; administrative regulation of public utilities (including energy, telecommunications, and transportation); and privatization of public enterprises.

A large emphasis of the course is on linking the theoretical concepts presented in lecture to case studies and current policy issues. Where possible, the course will examine the application of this conceptual material to emerging market economies and the special issues that arise for these nascent market economies. A key topic for discussion will be the extent to which the U.S. and E.U. models in designing antitrust, regulation and privatization policy are relevant to and appropriate for developing market economies.

One aim of the course is to arm students with the ability to use the professional economics literature in their subsequent work, both in the School and on the job. Consequently, in addition to explaining the principal ideas as clearly as possible, the lectures will present economic models in mathematical form that is related to the style employed in that literature. The lectures will, in the context of applications, cover some of the essentials of the theories of games, incentives and asymmetric information that pervade current economic theory. Some of the reading will be drawn from the economics literature.

Another aim of the course is to develop students' abilities to apply relevant general economic principles to particular policy problems. There will be four assignments of short papers (2 pages) exercising this skill in the context of real cases, and matching class discussion sessions. Students will write a longer paper (target of 15 pages) for class presentation on a policy application of their choice.

The course grade will be based on the series of short papers (25 %), a midterm (25 %), and the policy paper for class presentation (50%).

While most topics in the course will be presented with a mathematical model at the level of WWS 511c, they will all also be discussed with examples and words that are accessible at the level of WWS 511b. The course is open to students who have taken WWS 511b, with the understanding that some lecture material will require prerequisites that they have not had, and that they will be responsible for the principal ideas entailed, but not for the math.

The topics covered in this course will be:

I. Competition Policy

Analysis of appropriate governmental policy towards mergers and joint ventures, explicit and implicit collusion, and business practices that affect rivals. Needed normative tools are presented. Game theory perspectives on oligopoly strategic behavior and entry are developed. Applications to some leading cases will be discussed, including those in the computer, airlines, retail and pharmaceutical sectors. (5 Weeks)

II. Policy Towards Research and Development

Analyses of possible market failures in the private supply of R&D, and the effectiveness of various policy approaches to correct them. Issues involving compatibility standards, licensing, network externalities, and intellectual property are analyzed. (1 Week)

III. Policy Towards Information and Risk

What are socially beneficial roles for government intervention to mitigate information problems? How markets work and fail to perform well under asymmetric information, in view of such mechanisms as consumer search, advertising, investments in reputation, warranties and insurance, liability and regulatory standards, and disclosure requirements. (1 Week)

IV. Public Utility Regulation

Presentation of features of socially optimal pricing, investment, and access policies for natural monopolies, with needed normative tools developed. Analyses of impacts of various forms and architectures of public utility regulation, including a discussion of the failure of California's electricity market. Discussion of examples drawn from international experiences with telecommunications, transportation, and energy regulation. (3.5 Weeks)

V. Privatization

Development of answers to the question of whether activities best belong in the public sector or in the regulated private sector, from the perspective of incentive problems and organizational adaptations to them. (1 Week)

VI. Student Presentations

Students will present their policy papers to the class.

READINGS: Competition Policy

M. Katz and H. Rosen, Microeconomics, Third or Second Editions, chapters on monopoly and oligopoly (for your review, it gives an excellent, clear, and easy-to-read overview of modern thinking about monopoly and oligopoly, without math).

D. Carlton and J. Perloff, Modern Industrial Organization, Third Edition, 2000. (earlier editions good too – useful, comprehensive, pleasant and usually professionally accurate textbook that is closer to 511b than 511c in its level)

R. Willig, "Merger Analysis, Industrial Organization Theory, and Merger Guidelines," Brookings Papers on Economic Activity--Microeconomics, 1991, pp. 281-332.

Department of Justice and Federal Trade Commission Horizontal Merger Guidelines

J. Ordoover and R. Willig, "Economics and the 1992 Merger Guidelines: A Brief Survey," Collaborations Among Competitors: Antitrust Policy and Economics, E. Fox and J. Halverson (eds.), 1991, pp. 639-654.

Jonathan Baker and Daniel Rubinfeld, "Empirical Methods in Antitrust Litigation: Review and Critique," American Law and Economics Review, 1999, pp. 386-435.

C. Shapiro, "Theories of Oligopoly Behavior," Chapter 6 in Handbook of Industrial Organization, R. Schmalensee and R. Willig (eds.), 1989, (deep survey of current literature on abstract theories -- pretty clear, but demanding). (This two-volume set is a standard reference collection of survey chapters that cover field of IO.)

R. Gilbert, "The Role of Potential Competition in Industrial Organization," Journal of Economic Perspectives, 1989, V. 3, N. 3, pp.107-128.

Case-specific readings to be suggested

R. Willig, "Antimonopoly Policies and Institutions," in The Emergence of Market Economies in Eastern Europe, C. Clague and G. Rausser (eds.), 1992, pp. 187-196.

J. Ordoover and R. Willig, "Non-Price Anticompetitive Behavior by Dominant Firms Toward the Producers of Complementary Products," Antitrust and Regulation, F. Fisher (ed.), 1986.

Robert Litan and Carl Shapiro, "Antitrust Policy in the Clinton Administration," in American Economic Policy in the 1990's, 2002.

J. Stiglitz, "Imperfect Information in the Product Market," Ch. 13 in R. Schmalensee and R. Willig, eds., Handbook of Industrial Organization, Volume I, 1989, pp. 771 - 844. [For reference – needs to be skimmed].

J. Tirole, The Theory of Industrial Organization, 1988, pp. 100 - 126, 289 - 295. (This is still the leading theory textbook in the field of IO)