C3 TEACHERS

9-12 Microeconomics- Competition and Incentives

Does Competition Trump Incentives?

"Intro to Micro," Street Fins, last modified April 10, 2020 https://streetfins.com/intro-to-microeconomics/

Supporting Questions

1. Are there "low competition" markets, and are they more or less successful than "high competition" markets?
2. Are incentives worth it?
3. Does competition matter to a market?

9-12 Microeconomics- Competition and Incentives

Does Competition Trump Incentives?	
Content Angle and Standards	**D2.Eco.4.9-12.** Evaluate the extent to which competition among sellers and among buyers exists in specific markets. **D2.Eco.3.9-12.** Analyze the ways in which incentives influence what is produced and distributed in a market system. **D2.Eco.5.9-12.** Describe the consequences of competition in specific markets.
Staging the Compelling Question	Teacher will guide students through a class discussion asking "Would you rather start a new fast food restaurant, invent the new McDonalds, or start a business for a new invention never heard of or thought of before?"

Supporting Question 1	Supporting Question 2	Supporting Question 3
Are there "low competition" markets, and are they more or less successful than "high competition" markets?	Are incentives worth it?	Does competition matter to a market?
Formative Performance Task	**Formative Performance Task**	**Formative Performance Task**
Create a venn diagram of markets that could be considered low competition and high competition, and below write an explanation for those markets in the middle.	Class activity of "this side or that side" or various incentives the government and franchises offer, and whether students think this is worth it or not.	Create a T chart of reasons why competition does and does not influence a market.
Featured Sources	**Featured Sources**	**Featured Sources**
Source A: What Factors Influence Competition in Microeconomics? **Source B: What is Competitive Intensity?**	**Source C: Small Business Incentives: Tax Credits, Grants, and More** **Source D: How Do Franchise Incentive Programs Work?**	**Source A** **Source E: The Importance of Competition for the American Economy**

Summative Performance Task	**ARGUMENT:** Does competition trump incentives? Students will complete a class debate on whether they believe incentives or competition influence both business owners and the economy. Each side will have 15 minutes to prepare their opening statements and gather their points. Everyone on each side will have to share at least one point to ensure equal participation. While this is happening, students will write rebuttals (not sharing yet). Then, debate will begin with students responding to points the other team has said and sharing their rebuttals.
	EXTENSION. See "Business Plan" Assignment (the summative assessment for this lesson).
Taking Informed Action	**UNDERSTAND** Competition and incentives are both influences on markets and the economy overall. Competition within certain markets varies and allows for more or less growth of businesses within those markets. Students can examine the differences in competition, as well as the incentives offered to new businesses, be it franchises or small businesses, as well as how competition affects the market overall. **ASSESS** Students should consider what influences new and existing businesses to stay open or close.

	ACT Students could take informed action in one of the following ways: 1. Write a letter in to the local newspaper encouraging new businesses to open up within certain markets 2. Write an article detailing incentives offered to small businesses to give to small business owners 3. Make a poster advertising a market with little competition, encouraging new businesses to open 4. Create a video presentation discussing a specific market and competition within it

Overview

Inquiry Description

This inquiry leads students through an investigation of competition and incentives in markets in all its complexity.

This this inquiry highlights the following additional thematic standards from NCSS:

- POWER, AUTHORITY, AND GOVERNANCE: Social studies programs should include experiences that provide for the study of how people create, interact with, and change structures of power, authority, and governance.

This this inquiry also highlights the following additional thematic standards from the Common Core:

- Key Ideas and Details 7. Integrate and evaluate multiple sources of information presented in diverse formats and media (e.g., quantitative data, video, multimedia) in order to address a question or solve a problem.
- Key Ideas and Details 9. Synthesize information from a range of sources (e.g., texts, experiments, simulations) into a coherent understanding of a process, phenomenon, or concept, resolving conflicting information when possible.

It is important to note that this inquiry requires prerequisite knowledge of some key terms, which are defined and provided to students in the inquiries where relevant.

In addressing the compelling question, “Does competition trump incentives?” students will need to weigh conflicting evidence from a variety of sources and should be sensitive to how the ideas in these documents impact their peers who may represent people of varying economic standing. It might be a wise idea to set some ground rules and common language that demonstrates respect while still maintaining the freedom of academic inquiry. Encourage students to use phrases like “it seems Source A is suggesting…” and “I’m not sure, but I’m beginning to wonder if…” and “is it possible that…” or “In my experience, X has been true.”

Note: This inquiry is expected to take 4 class periods. The inquiry time frame could expand if teachers think their students need additional instructional experiences. Teachers are encouraged to adapt the inquiry to meet the needs and interests of their students.

Structure of the Inquiry

In addressing the compelling question students will do three performance tasks building to a Summative Performance Task that draws on student learning throughout the full inquiry. In completing a Venn Diagram students will be able to compare and contrast competition. In “This or That” students will weigh what incentives they value, or view as more or less important to business owners. In completing a T chart, students will be able to prepare for the class debate and summarize what they have learned thus far. In creating a business plan as their summative assessment, students will see how incentives influence them in making decisions in that plan.

Staging the Compelling Question

In staging the compelling question, the class will complete a teacher led class discussion. The question posed is “Would you rather start a new fast food restaurant (Invent the new McDonald’s), or start a new business for an invention never heard or thought of before?”. This question is worded in a way that encourages students to consider the amount of competition within markets, and whether the benefits outweigh the existing competition. Students will answer this question via a hand raise, and then be asked to explain their answer. Then, by the end of this activity, students will be asked the question again, to see whether their answer has changed by the end of the discussion.

Supporting Question 1: Are there "low competition" markets, and are they more or less successful than "high competition" markets?

The first supporting question "Are there "low competition" markets, and are they more or less successful than "high competition" markets?" gives students some insights into the variation within markets, and how some products or services' markets are different. Students will examine the difference in competition of these markets. The formative task requires students to create a venn diagram of markets that could be considered low competition and high competition, and below write an explanation for those markets in the middle. Students should work on their own to read, annotate, and then work with a partner to complete a detailed Venn Diagram for these two sources. What is different about them? What is similar about them? After organizing their ideas, students will respond to the supporting question below their Venn diagram.

Featured Source A:

What Factors Influence Competition in Microeconomics?

By THE INVESTOPEDIA TEAM
Updated August 23, 2021
Reviewed by MICHAEL J BOYLE

From a microeconomics perspective, competition can be influenced by five basic factors: product features, the number of sellers, barriers to entry, information availability, and location. Each factor hinges on the availability or attractiveness of substitutes and, when no alternatives exist and the company is a single seller of a unique product, a monopoly exists and there is zero competition.

Influential Factors

Product features essentially describe the level of differentiation. For example, if a company's product is homogeneous (similar to others already on the market), the good or service is completely indistinguishable from products sold by competitors. This situation would imply heavy competition.

The number of sellers also impacts competition. If there are many sellers of an undifferentiated product, competition is considered to be high. If there are few sellers, competition is low. If there is a single seller, the market is considered a monopoly.

Barriers to entry can influence the number of sellers. Market characteristics such as high capital investment requirements or heavy regulation may prevent new companies from entering the market, which in turn provides a level of protection to existing firms. With lower competition through barriers to entry, firms might be able to charge higher prices.

Information availability is also important, and it revolves chiefly around price discovery. When customers can efficiently and accurately find out prices across competitors, companies are less able to set prices and competition is more heated.

An effective location strategy can corner a group of potential customers or otherwise reach them more effectively than the competition. For example, gas stations are often strategically located on busy corners.

Characteristics of Competition
It's easiest to understand these characteristics of competition through the lens of the two most extreme versions: perfect competition and monopoly. In perfect competition, each firm's marginal profit is equal to the marginal cost; there is no economic profit. In a monopoly, the marginal profit is equal to the marginal revenue, which is the incremental revenue generated from selling one more unit of the product.

Companies in perfect competition are considered to be price takers, meaning that they have no scope to set prices—this is the reason why marginal profit is equal to marginal cost. Perfectly competitive markets are defined by a homogeneous product, many sellers with low market share, and absolutely no barriers to entry or exit. These firms are unable to differentiate their products, and their customers have highly accurate information.

A monopoly involves a single company dominating the entire market. In this situation, the firm sets the price, and the competition is nonexistent.

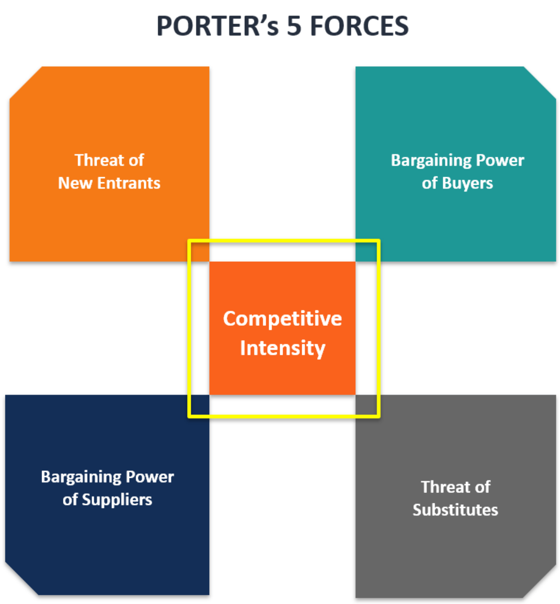
Most markets are somewhere in between perfect competition and monopoly. For example, the market for soft drinks, dominated by Coca-Cola and Pepsi, could be considered an oligopoly, where a few large firms dominate most of the market. The market for tomatoes could be considered a step or two above perfect competition; after all, some people are willing to pay more for organic or heirloom tomatoes, while others look only at the price.

KEY TAKEAWAYS
- From a microeconomics perspective, five factors (product features, number of sellers, barriers to entry, information availability, and information) can affect competition.
- When a company has a unique product that no other company is selling, a monopoly exists, as there is no competition.
- Most markets are somewhere in between competition and a monopoly.
- The amount of competition will also vary depending on location, the barriers to entry, and the availability of pricing information.
- Alternatively, a product might be completely differentiated, meaning that it is unique. If so, there might be few alternatives and thus low levels of competition. The level of differentiation is largely a subjective matter and subject to consumer opinion.

Featured Source B:

What is Competitive Intensity?

In strategy, competitive intensity is defined as the extent to which companies within a specific industry exert pressure on one another. Some level of competition is healthy because it acts as an impetus for innovation within organizations. Competition, whether in an industry or another setting, drives teams and individuals to give their best. In fact, such rivalry is what keeps a majority of firms on their toes, propelling them to do better than their competitors.
Competitive intensity is one of the concepts covered in detail in Michael Porter's Five Forces framework.



Since its inception in 1979, Porter's Five Forces has been used as the de facto framework for analyzing industries. Other than competitive intensity, the other four forces that shape competition in a market are the threat of new firms entering the market, suppliers gaining bargaining power, the bargaining power of buyers, and the threat of substitute products. But our focus today is on competitive intensity.

Breaking Down Competitive Intensity

According to Porter's framework, competition between firms has two facets, namely, the intensity and dimension. Competitive intensity determines a company's profitability potential. So, with intense competition, a company will be able to transfer more value to its clientele.

A good illustration is the competition that exists between T-Mobile, AT&T, and Verizon. All three are mobile phone companies that compete for the same group of consumers. They achieve this by lowering their prices and offering incentives to customers who decide to switch to their company.

The dimension of competition is a completely different aspect. This deals with the specific features or factors that firms are competing for. Organizations can compete in different areas – pricing, quality, customer support service, product features, and more.

The problem that companies face when they compete in the same dimensions is that they encounter a zero-sum game. Put simply, this is a cyclic situation where one firm's gain becomes another firm's loss. To overcome this hurdle, companies will often venture into two or more market segments. For instance, auto manufacturers make luxury automobiles, targeting high-income earners, and economy cars, which are meant for middle- and low-income earners. CFI's Corporate Strategy Course covers these concepts in more detail.

What Determines the Level of Competitive Intensity?

According to Porter, there are several factors that influence competitive intensity between firms, which include the following:

1. Costs

Porter pointed out that there are specific costs that affect how intense the competition in an industry gets. Costs that could increase rivalry include high fixed costs, high storage expenses, and low switching costs. High fixed costs will encourage firms to lower their prices. However, once the prices decrease, the competition will intensify.

2. Concentration in the Industry

If a particular industry has a very high number of firms offering identical goods or services, this will lead to more competitive intensity. However, in a monopoly or oligopoly market structure that is dominated by just one or a few firms, there will be less rivalry. As such, the extent of concentration in an industry plays a huge role in competition intensity.

3. Rate of Market Growth

The rate at which the overall industry is growing is another aspect that influences competitive intensity. For instance, if the market is growing rapidly, the rivalry between firms will be less intense. A slow growth rate, however, increases competitive intensity. With slow growth, the industry is very close to saturation – there aren't many new customers to attract. But if the market is strong, there's room for new entrants and new clients. There could even be untapped opportunities that firms can take advantage of.

4. Differentiation

The degree of differentiation also determines how intense the competition will be. With competing goods, such as food products and clothing, there's very little room for differentiating the items offered by a particular company. This means that companies will be competing for the same consumers, and this increases rivalry. However, if a firm is offering highly differentiated products that other organizations cannot easily imitate or copy, then it will face relatively less competition.

5. Switching Costs

Apart from fixed costs, switching costs also influence the extent of rivalry between companies. If an organization decides to go for a different supplier from the one it has been using, it will incur switching costs. High switching costs lead to a decrease in competition. The switching costs arise from the fact that customers have invested a lot of their resources in learning how to use a particular product. However, if there aren't any switching costs involved, then industry competition will be pretty intense. Markets that deal with common consumer goods are often the ones that have low switching costs.

Benefits of Competitive Firms

An industry where companies remain highly competitive offers several benefits, such as low prices on commodities, incentives to reduce production costs, and the introduction of different technologies and incentives. These benefits can be classified into three main categories:

1. Innovation

In a bid to outdo their competitors, firms will always try to be innovative. Innovation can help a company differentiate itself and attract new customers. More customers translate into higher revenues and profits. Companies that try to be innovative also benefit customers. If several companies try to differentiate their products, then consumers will have a variety of unique products to choose from.

What's more, consumers are always willing to pay higher prices if they feel that they are getting value for their money. So, in a world where so many products seem identical, a little bit of creativity can help a firm to go a long way.

2. Decrease in Prices

If a consumer knows that they won't incur any expense when switching to a different product, they will be more willing to try out a range of products. To prevent this, many firms cut down on their prices so they don't end up losing clients. Along with lower pricing, firm owners try to gain a better understanding of unmet consumer needs. This way, they can work toward developing products and services that meet these needs.

3. Economic Growth

Competition also fosters economic growth. With rivalry comes innovative technologies, which boost economic growth. A good example would be advancements in the smartphone industry, which has facilitated the growth of world economies.

Key Takeaways

Porter's competitive intensity determines the level of rivalry existing in a particular industry. This competition can be influenced by several factors, including the concentration of the industry, cost of switching, fixed costs, and the rate of industrial growth. Luckily, there are several actions that firms can undertake to ensure they stay ahead of their competitors. These include differentiating their products, reinventing themselves constantly, and identifying untapped opportunities.

Supporting Question 2: Are Incentives Worth It?

The second supporting question "Are Incentives Worth It?" gives students some insights into incentives offered to those starting small businesses, or opening a franchise location. Students will examine the differences between franchise incentives and government incentives. The formative task requires students to complete a class activity of "this side or that side" or various incentives the government and franchises offer, and whether students think this is worth it or not. Students should work with a partner to read and annotate the sources. After organizing their ideas, students will respond to the supporting question by participating in the "This or That" activity.

Featured Source C:

Small Business Incentives: Tax Credits, Grants, and More

Small business owners often find themselves in a dilemma: they want to grow their business to meet demand, but tight financial circumstances can make it difficult to expand. Or if they do have adequate resources, uncertain situations, such as the one created by the COVID-19 pandemic, can make expansion a risky proposition for a small business. Even if it may not seem like the time to expand, the opportunity exists. There are several tax credits, grants, and incentives that can encourage growth. These small business incentives can help you create jobs, train staff, and even open a new location.

Tax incentives for small business owners

Tax incentives can come in the form of exemptions, credits, deductions, or exclusions that reduce a company's tax liability to the state or federal government in exchange for making certain choices (e.g. reduce its environmental footprint, increase health benefits for employees, support minorities, etc.). Business owners can then use that money to invest in other aspects of business growth and improvement. Exemptions, deductions, and exclusions can reduce taxable income, but the most desirable is a tax credit, which is a set amount of money that a business can subtract from the total amount of taxes owed. There are a number of federal government tax incentives for small business. Two examples include the Small Business Health Care Tax Credit and Work Opportunity Tax Credit (WOTC).

The Small Business Health Care Tax Credit

In general, this small business incentive benefits companies that have fewer than 25 full-time equivalent employees, pay average annual wages per FTE of less than $55,200 for tax year 2020, and pay at least half of employee health insurance premiums. To qualify for the credit, businesses must pay premiums for employees enrolled in a qualified health plan offered through a Small Business Health Options Program Marketplace (or qualify for an exemption).

Work Opportunity Tax Credit (WOTC)

The federal Work Opportunity Tax Credit (WOTC) applies when you hire people from certain groups, such as veterans, ex-felons, or food stamp recipients. There is no limit on the number of qualified employees you can claim and companies can receive a credit of up to $9,600 per employee. The WOTC is authorized through Dec. 31, 2020. However, it has been renewed since its inception and it's worth keeping your eye on it.

Financial grants for small businesses

A grant is a designated amount of money given by an organization for a designated purpose. Small business grants can come from municipal, state, or federal governments and even corporations. Grants are not a loan. Financial grants to small businesses do not have to be repaid. Through a grant, a small business can secure funding to advance a specific program or initiative that can help it grow. The following list of different types of grants highlights what each may offer.

Federal and state small business grants

The Small Business Administration (SBA) points out that the federal government tends to focus its grants on nonprofits, educational institutions, and state and local governments. However, opportunities for federal small business grants may exist if your business is involved in research and development or wants to expand training for employees. These grants can help cover employee training expenses, often for both new and existing employees. Each training program is different — some will reimburse companies for a percentage of their trainer fees while others will also cover space rental expenses. A few programs will even cover the wages of the employees being trained. Reach out to the U.S. Department of Labor and state economic-development agencies to find out which opportunities might be available for your business.

Local small business grants

Local municipalities may offer grants to help business grow programs that can benefit their region. For instance, some cities are helping restaurants in the wake of the COVID-19 pandemic by covering the cost of outdoor patio heaters. By doing so, restaurants get help meeting consumer demand while abiding by health guidelines for eating outdoors during the pandemic, even during cold weather. Other grants may be targeted to help a region increase its appeal by encouraging certain types of businesses. There can be grants for startups, grants to improve environmental practices, or grants for small businesses trying to expand into a particular field such as optics, renewable energy, or manufacturing. Check with your city or county for opportunities.

Corporate small business grants

Motivated by a desire to give back to the community or help a small business grow in a way that highlights its own mission or marketing message, large corporations can be a source of small business grants. For example, a women's clothing company committed to sustainability could offer a grant to small businesses that are pursuing activities that bolster women and girls in environmental justice issues. There are grants for forward-thinking ideas, providing kids' camps, or for businesses that are owned by at least 50% veterans, among many others. Corporate grants can be competitive, but they are worth researching.

Other incentive programs for startups and small businesses

Outside of tax credits and grants, other small business incentives do exist. Small business incentive programs can ease your tax burden or provide financial assistance in exchange for helping a city, county, or state achieve its goals of stimulating its economy and improving the lives of residents. Pay attention to the specifics of each program so you can align your growth plan accordingly.

State hiring incentives

If your company is ready to grow, state hiring incentives can help offset your expenses, but make sure you understand a program's specifics before bringing on new hires.

Are employees part-time or full-time?
Will you be providing benefits?
What is the expected wage?

Are you hiring minorities or members of underserved communities?
Expansion incentives
Whether you're a startup, expanding your current business, or relocating your operations, a government agency will want to know details on various ways your business will improve the region:

Will your business improve the appearance of the surrounding area?
Is your business part of a region's targeted industry?
Are you relocating to an area that is distressed or needs redevelopment?
Do you have other sources of funding for your startup or expansion?
Job creation
Because local, state, and federal governments want to strengthen the economy, you'll also likely need to discuss how many new job positions your business will be providing:

How many jobs will your business create versus how much incentive money you will receive?
What is your anticipated timeline for filling these positions?
What happens if the economy falters outside of your control and you aren't able to create the agreed-upon number of jobs?

Tracking down small business incentives can be tricky, so be prepared to make a lot of calls and fill out a stack of paperwork. But the rewards are often significant, and can help your business grow even more than you may have dreamed.

Even during times of great uncertainty, small business owners and entrepreneurs with startup dreams have the advantage of being able to design their own version of a new status quo. It starts with finding the array of small business incentives available to help give you a financial boost. Consider using Paychex Tax Credit Services to help you identify and claim these lucrative incentives.

Featured Source D:

How Do Franchise Incentive Programs Work?

Franchise incentive programs benefit both the franchisor and the franchisee. These programs attract potential franchise owners who may need a boost to start a new business. Incentives also make it easier for franchisees to expand their ownership territory or for business owners to turn their existing businesses into a franchise.

Franchise incentive programs are offers or benefits meant to entice prospective franchise owners. Franchisors offer different types of incentives, but these mostly come in the form of a discounted franchise fee, a marketing expenditure contribution, a fee deferment program, or a conversion incentive program. Franchisors can offer incentives to anyone, but many choose to offer incentives based on financial qualifications. Veterans, minorities, or existing franchise owners may also qualify for specific franchise incentive programs.

Discounted Franchise Fee

A franchise fee is the initial cost to join the franchisor. Some franchisors offer a discounted franchise fee for veterans, owners who want to open multiple locations, or potential owners who meet financial requirements.

The franchise fee is not the same as the total upfront cost to open a franchise, rather it is a portion of the initial investment. According to the U.S. Small Business Administration (SBA), today's franchise fees typically range from $20,000 to $50,000. The initial franchise fee to open a Tide Cleaners location, for example, is $10,000. The initial investment range to open a plant store (the store format that you must use for your first Tide Cleaners outlet) is $681,100 to $1,573,300.

Marketing Expenditure Contribution

A marketing fee is part of the royalties franchise owners pay the franchisor. For Tide Cleaners, the marketing fee is 4 percent of net sales. Of that fee, 2 percent goes to the national ad fund, and the other 2 percent goes to local marketing.

Some franchisors offer a marketing expenditure contribution, which allows owners to avoid paying the marketing fee until they reach a specific amount. Right now, Tide Cleaners is offering a limited-time incentive for new franchisees. They will receive a marketing expenditure contribution for their first plant store in the amount of $25,000. Existing owners who plan to open a Micro Drop Store or a Locker Only Drop Store will receive up to $7,500 of marketing expenses.

Fee Deferment Program

In some instances, franchisors can defer the payment of monthly royalty fees or the initial franchise fee. In the case of an initial franchise fee deferment, the franchisor may defer collecting the initial fee until the franchise is open for business.

Tide Cleaners offers a limited-time fee deferment incentive for existing owners who plan to open a Micro Drop Store or a Locker Only Drop Store. Right now, project management fees and start-up assistance fees will be deferred until one year after opening.

Conversion Incentive Program

Business owners can often benefit by turning their existing business into a franchise location. Not only will they receive the perks of joining the franchise system, they can also bypass some of the initial fees required of new owners.

Tide Cleaners offers a conversion incentive program for dry cleaner or laundry services business owners. Owners who convert existing, non-franchised dry cleaner businesses to Tide Cleaners locations may avoid having to pay royalties for six months.

Supporting Question 3: Does competition matter to a market?

The third supporting question "Does competition matter to a market?" gives students some insights into the effects of competition in markets, and how it positively and negatively affects markets. Students will examine the first source again, reviewing what they have already learned, and then a second examining the pros and cons of competition in different markets. They will break this last reading up working in groups to summarize its points. The formative task requires students to create a T-chart of reasons why competition does and does not influence a market. Students will answer the supporting question underneath the T chart they complete, and then discuss in the small groups they read in.

Featured Source A

[see above]

Featured Source E:

The Importance of Competition for the American Economy

JULY 09, 2021
By Heather Boushey and Helen Knudsen

Healthy market competition is fundamental to a well-functioning U.S. economy. Basic economic theory demonstrates that when firms have to compete for customers, it leads to lower prices, higher quality goods and services, greater variety, and more innovation.[1] Competition is critical not only in product markets, but also in labor markets.[2] When firms compete to attract workers, they must increase compensation and improve working conditions.

There is evidence that in the United States, markets have become more concentrated and perhaps less competitive across a wide array of industries: four beef packers now control over 80 percent of their market, domestic air travel is now dominated by four airlines, and many Americans have only one choice of reliable broadband provider. There are a number of reasons for these trends towards greater concentration, including technological change, the increasing importance of "winner take all" markets, and more lenient government oversight over the last 40 years.[3]

When there is insufficient competition, dominant firms can use their market power to charge higher prices, offer decreased quality, and block potential competitors from entering the market—meaning entrepreneurs and small businesses cannot participate on a level playing field and new ideas cannot become new goods and services. Research has also connected market power to inequality. In an economy without adequate competition, prices and corporate profits rise, while workers' wages decrease. This means large corporations and their shareholders gain wealth, while consumers and workers pay the cost. The pandemic has further underscored the dangers of an economy that depends on a few companies for essentials, exemplified by the supply chain problems we face when a small handful of corporations creates bottlenecks for a critical product.

This is why today, President Biden will sign an Executive Order on Promoting Competition in the American Economy. It launches a whole-of-government effort to combat growing market power in the U.S. economy by seeking to ensure that markets are competitive. Because of the scale and scope of the market power problem, the President's Executive Order makes the promotion of competition central to the government's mission by dedicating the entire government to reversing these trends.

Signals that indicate greater market power

Even though competition is fundamental to a thriving and fair economy, there is growing evidence that, over time, markets across the United States have become less competitive and that market power is expanding. There are two kinds of evidence that indicate that there are widespread concentration problems in the U.S. economy. First, there is evidence that market concentration, as well as profits and markups, are rising across industries. Second, market-specific studies show that consolidation has led to harmful price increases, providing one of the clearest indicators of enhanced market power.

Alongside the rise in prices, which is both an indication of a market power problem and an important consequence for consumers, economists have identified two other important consequences of rising concentration: first, there is growing evidence that it is hampering innovation; and, second, research shows that it is leading to substantial concentration in the U.S. labor market—not just markets for goods and services, which has the effect of suppressing wages.

Evidence of rising economic concentration

There are numerous studies that show increased concentration across a large number of industries in the economy. In fact, concentration has increased in over 75 percent of U.S. industries since the late 1990s. These studies show that the largest companies in the economy have grown at the expense of smaller firms. While it could be that, in some cases, concentration has grown because firms with a high market share are more efficient or more innovative than their competitors, the prevalence across so many industries and the trendlines are cause for concern.

This is underscored by a set of studies that show that the profits and markups of the largest firms—indicators that many economists point to as aggregate measures of market power across the economy—have grown over the last 30 to 40 years. In a free and open market, we would expect new companies to enter the market and compete down these profits. However, these increases in the profits of large, dominant firms coincide with a decrease in business dynamism in the U.S. economy—with fewer startups launching and less labor market fluidity.

Consequences of increased concentration

While informative, national-level, industry-wide studies give little insight into whether increased concentration and markups are a result of decreased competition; that is, they cannot tell us whether or not the concentration is problematic for the U.S. economy. As mentioned above, on the one hand, industry-wide concentration can increase when a firm becomes more efficient or more innovative or when a national firm increases its footprint.[4] Similarly, increased markups can be the result of improved technology driving down marginal costs. On the other hand, increased concentration can also be the result of anti-competitive mergers or increased barriers to entry, which could also increase markups.

In order to figure out whether the patterns of increased concentration and markups are problematic, economists must look more closely at individual markets, since market-specific studies allow a more detailed understanding of the competitive mechanisms that are leading to these patterns. To better understand these markets, economists have done deep dives into an array of industries—ranging from concrete to health care. These studies tend to focus on what happens after two (or more) firms merge. Studying mergers is especially important because a merger changes market structure in a way that is not caused by a firm improving its product or becoming more efficient. Rising consumer prices following a merger indicate that a firm has gained market power, which gives them increased price-setting capabilities and suggests that the merger harmed consumers.

There is evidence from an array of market-specific studies looking before and after mergers that strongly suggests that consolidation has led to less competition and greater market power. These studies show that as market conditions changed, prices rose, indicating that firms had the capacity to charge more since they had—in these cases—merged with their competitors:

One review of this literature shows that of 49 such studies, 36 found merger-induced price increases. Another review finds that the average price effect in mergers studied was 7.2 percent.
A review of hospital merger studies finds that most of the mergers led to price increases of at least 20 percent.
A study of a large health insurer merger shows that it led to a 7 percent average premium increase.
A study of airline mergers in the 1980s finds that prices increased between 7.2 and 29.4 percent in markets where the merging airlines competed directly.
A study of the MillerCoors joint venture finds that it resulted in tacit coordination with Anheuser-Busch, leading to a 6 to 8 percent increase in retail beer prices.
Looking across these kinds of studies, the conclusion is that consolidation does indicate a market power problem with the consequence that consumers are facing higher prices than they would if the market was more competitive.

Other negative consequences of market concentration

There is also growing evidence that market power negatively affects innovation. There have long been questions about whether market concentration fostered or inhibited innovation. Even decades ago, Kenneth Arrow argued that concentration hindered invention: “pre-invention monopoly power acts as a strong disincentive to further innovation.”[5] Emerging evidence points to this being the case today: one study shows that firms with monopoly power are less likely to advance technological changes; another paper focuses on the channel through which less innovation occurs in the presence of market power; and another study finds that while price markups increased after a merger, there was no corresponding increase in productivity.

There are emerging concerns that this effect on innovation may be affecting the economy more generally. In his book, The Great Reversal, Thomas Philippon documents that the increase in concentration across the economy is reducing economy-wide investment. Similarly, scholars are finding that greater market power is a factor in low interest rates and high firm financial wealth, but relatively little investment. If concentration is allowed to continue, this may dampen U.S. productivity and growth, limiting the future competitiveness of the U.S. economy.

Decreased competition in labor markets

As firms become more concentrated, they are able to push wages down, exemplifying another instance where we see the growing consequences of market power. With greater market power, employers have less competition for the best workers since there are fewer other firms. Such power in the labor market can be deployed in several ways; we discuss two below.

First, consolidation in output markets not only affects consumer prices, but also wages and working conditions as the number of employers in an industry decreases. For example, as hospitals have merged, not only have consumers faced decreased choices in where to get their medical care, but nurses, doctors, and other health care employees have had less of a choice of employer. In fact, a study found that large hospital mergers led to lower wage growth for nurses, pharmacy workers, and hospital administrators.

Firms can also exert market power by limiting their employee's ability to change jobs through noncompete agreements. These agreements prevent employees from quitting and—within a certain time period—taking a job with a different employer who may benefit from the employee's industry-specific skills. This translates into lower pay, as the employee has limited ability to deploy their skills elsewhere.

In all, these uncompetitive labor market conditions are quite common—with 60 percent of labor markets being highly concentrated. Importantly, researchers have documented that uncompetitive labor markets are associated with lower wages relative to what a truly competitive market would provide. A meta-analysis of labor market studies finds that firms pay their workers less than they would in a competitive labor market, with the median estimate showing that firms pay workers 58 percent of their value. New work has also found that more than one in ten U.S. workers are in labor markets where pay is reduced by at least 2 percent due to employer concentration.

Signs that policy change is necessary

There is strong evidence that one of the reasons for the current rise in market power is a shift in policy. Antitrust enforcement has become more lenient over the last 40 years, and regulators have not had sufficient resources to enforce the laws on the books.

Antitrust laws are traditionally enforced by the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC). They challenge anticompetitive mergers and other anticompetitive behavior by firms, such as exclusionary practices. The DOJ also prosecutes the criminal antitrust laws that bar collusive behavior, such as price-fixing.

To enforce the law, the DOJ and the FTC publish merger guidelines that lay out when a merger is likely to be challenged. Since the guidelines were first published in 1968, enforcement practice has become increasingly lenient.

In 1968, in a highly concentrated market (four firms having 75 percent of market share), even the merger of two small firms (each with 4 percent market share) would be challenged routinely. Today, such mergers are almost never challenged; indeed, based on guidelines released in 2010, mergers are unlikely to be challenged even if they leave only four substantial competitors in place. The increase in these thresholds reflects, in part, the agencies giving more credit to efficiencies that might arise from mergers. At the same time that these guideline thresholds have increased, the level of purchase price that requires companies to give notice of their mergers to the agencies has risen, leading to a larger number of mergers going unreviewed—even as firms strategically acquire competitors.

In part because of these changes and because of real-term reductions in funding, Federal agencies have been bringing fewer antitrust cases. In fact, the number of criminal antitrust cases brought by the DOJ in the last four years has declined to an average of 22 a year, down from an average of over 60 cases a year across the previous six years. On the civil side, from 2010 to 2019 only about 3 percent of mergers that met the filing threshold have received "second requests," which are a more thorough review by the agencies. When mergers are challenged, they are at the extreme, where four or fewer competitors are remaining.

Government suits enforcing the laws against anticompetitive conduct have also been rare. The DOJ's lawsuit against Google and the FTC's lawsuit against Facebook, both filed in 2020, are the first major Federal monopolization cases since the Microsoft case in 1998.[6] As the economy evolves with technology and "winner take all" markets become more important, it will be crucial to guard against anticompetitive conduct as well. These shifts have come at the same time that judicial precedent has moved in the direction of skepticism towards antitrust enforcement.

The Executive Order on Promoting Competition in the American Economy launches an effort to solve these problems

The President's Executive Order establishes a whole-of-government approach to push back on decades of decline in competition. The Order not only calls on the traditional antitrust agencies—the DOJ and the FTC—to enforce existing laws vigorously and to consider updating their merger guidelines, it also directs all agencies and departments to use their detailed knowledge and expertise to ensure that their work clearly supports competition in the markets they regulate—including paying close attention to labor markets. This whole-of-government approach is necessary because the antitrust agencies are limited both by resources and the current judicial interpretation of the antitrust laws. It also relies on the fact that Congress has delegated authority to police anticompetitive conduct and oversee mergers to many agencies—not just the DOJ and the FTC.

The Order therefore directs or encourages roughly a dozen agencies to engage in more than 70 specific actions that will remove barriers to entry and encourage more competition. For example, the Order encourages the Department of Health and Human Services to work with states developing drug importation programs and to consider finalizing rules allowing hearing aids to be sold over the counter at a fraction of their current price. It requires all agencies to use their procurement and spending powers to avoid entrenching monopolists and to create new business opportunities for small firms. It encourages the FTC to issue rules curtailing noncompete agreements which inhibit labor mobility, preventing workers from switching to jobs that offer better pay and benefits. And, it directs the Department of Agriculture to consider strengthening its enforcement of laws designed to prevent large meat-processing companies from taking advantage of farmers.

The U.S. economy faces a serious market power problem which results in increasing wage inequality and wealth concentration, high prices, and stagnating wages. The President's Executive Order relies on the full range of powers granted by Congress to address it, ensuring that the economy works for all Americans.

Summative Performance Task

At this point in the inquiry, students have examined the relevant sources to the compelling question.

Students should be expected to demonstrate the breadth of their understanding and their abilities to use evidence from multiple sources to support their claims. In this task, students will stretch their learning to creating a business plan, which will require prior knowledge of this inquiry.

Completion of the summative assessment will involve presenting these business plans to a board of local business owners to share what they have created.

For the full rubric and description of this assessment, see the Business Plan Assignment document.