Introduction

The Issues

Government-owned and government-subsidized firms in the United States compete with private firms in a wide variety of activities. Amtrak carried freight on the back of its passenger trains. Government-owned electric utilities, such as the Tennessee Valley Authority, compete directly with private firms in the provision of electricity. TVA has also considered expanding into cable television and telecommunications. City governments built waterworks to compete directly with private providers. Fannie Mae and Freddie Mac compete with private firms in automated underwriting systems. The National Weather Service competes with private firms in the provision of customized weather forecasts. The U.S. Postal Service provides both package and express mail delivery in direct competition with private rivals. The Coast Guard competed with private firms in nonemergency marine assistance, and so on. Competition between govern-

ment and private firms is even more important overseas, where many countries historically have had greater government involvement in economic activity.

Competition between government and private firms is disconcerting. Government firms are often endowed with government-granted privileges and immunities not enjoyed by private rivals. Those benefits may include monopoly power, credit guarantees, freedom from paying investors an expected rate of return, exemption from bankruptcy, tax exemptions, direct subsidies, and immunity from antitrust prosecution, disclosure requirements, and other regulations. All such privileges and immunities are valuable.

Those privileges give government firms an artificial competitive advantage over private rivals. By artificial, I mean that a government firm's competitive advantage is not based on economic factors such as superior management skills, more efficient technology, enhanced innovation, better labor relations, better corporate governance, or harder work. The firm's competitive advantage is an artifact of its government-granted benefits.

Government firms may use their special benefits in anticompetitive ways. For example, they might use their monopoly power and other advantages to sustain prices below true economic cost in markets where they face competition. Or they might use those privileges to raise rivals' costs or preclude rivals from entering other markets. They might also leverage their monopoly power in one market into other, formerly competitive markets or engage in a variety of other anticompetitive actions.

Anticompetitive behavior by government firms is harmful. First, there is a straightforward misallocation of resources because prices are not in alignment with true economic cost. Because they are not as concerned with profits as their private counterparts, government-owned firms are more willing to set price below cost and keep it there without regard to long-term losses. Second, more efficient but unsubsidized private firms will contract, not invest, or may not start

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up if they observe or anticipate competition from a government rival. Third, if there is uncertainty over a government firm's intention or ability to expand into an activity, that uncertainty will contribute to private disinvestment. Fourth, taxpayers or other captive groups will have to fund more (or all) of the overhead costs in the competitive activity, even though customers using the good or service are willing to pay for it. Finally, ventures outside of a government firm's core activity may divert resources from that core, socially beneficial activity.

Although competition between government and private firms is an important economic phenomenon, academic research addressing the topic is limited. Scholars have instead tended to focus on the behavior of privately owned firms. Nor is there a developed body of law in the United States on this subject. Antitrust law has focused almost exclusively on competion among privately owned firms. The essays in this book attempt to address that gap.

In Chapter 1, David Sappington and Gregory Sidak discuss the objectives of state-owned enterprises (SOEs). They find that SOEs are concerned about profits as well as the scale and scope of their operations. They explore the implications of such a firm acting to maximize both its size and profits and find that an SOE is more likely to engage in anticompetitive behavior than is a pure profit maximizer. They show that an SOE is more willing to price competitive products below cost than is a privately owned firm, even if the SOE lacks predatory intent. They go on to show that an SOE has an extra incentive to engage in a variety of activities that expand its revenue, including relaxation of regulatory constraints, raising rivals' costs, and erecting entry barriers for rivals. They conclude by showing that, in addition to the incentive, an SOE has enhanced ability to undertake those activities.

In Chapter 2, I review a variety of instances in which SOEs and private firms compete, suggesting that such competition is more common in the United States than generally thought. I discuss why

anticompetitive behavior by SOEs is likely to be socially harmful and review the wide array of government-granted privileges and immunities typically enjoyed by SOEs and ways in which they might be used anticompetitively. I then present seven case studies of industries in which government and private firms either currently or historically have competed in the United States. These include freight carriage, water utilities, financial services, electric utilities, information provision, weather forecasting, and marine-towing services.

Chapters 1 and 2 together demonstrate that SOEs have the incentive, the opportunity, and the capacity to inefficiently compete with private firms. The remaining chapters illustrate that they will, in fact, engage in anticompetitive behavior.

In Chapter 3, Peter Wallison examines anticompetitive behavior by government-sponsored enterprises (GSEs), specifically Fannie Mae and Freddie Mac. He catalogs the advantages those firms have as a result of their government sponsorship. He then applies to the GSEs and their attempted monopolization of the automated underwriting market and other mortgage finance–related markets the analysis of the 2001 decision by the Court of Appeals for the D.C. Circuit in the Microsoft case. Using the analysis in the decision as a road map, he finds that a strong case can be made that the GSEs violated Section 2 of the Sherman Act by monopolizing the automated underwriting market.

In Chapter 4, I consider anticompetitive behavior in postal services in the United States and abroad. Postal services are of particular interest because of both their size and the level of government involvement in almost all countries and because they usually compete directly with private firms in several markets. I first examine the case of the U.S. Postal Service (USPS) and briefly review the special government-granted privileges, subsidies, and immunities enjoyed by the USPS. Using the changes instituted by the 1970 Postal Reorganization Act as a test, I present data consistent with anticompetitive behavior by the U.S. Postal Service. I then review examples of

anticompetitive behavior that have arisen in postal services in other countries.

This topic raises fundamental questions about the proper relationship between business and government in a market economy. Should government operate where private business is actively providing a good or service? If, over time, private enterprise expands the scope of activities it provides, does government have a duty to reduce the activities it provides? If government and private firms do compete, should government firms be able to use their array of privileges and immunities to outbid private rivals in the marketplace?

Collectively, the essays in this book suggest a need for significant policy change regarding competition between government and private firms in the United States. At a minimum, enhanced scrutiny of SOEs and GSEs under antitrust law is appropriate. Additionally, it may be wise to construe narrowly any statutory monopoly that is conferred on an SOE and to limit strictly its ability to expand beyond the market covered by that monopoly.

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