

# The monopolies and restrictive trade practices act economics essay



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A monopoly exists when a specific person or enterprise is the only supplier of a particular commodity . The verb “ monopolize” refers to the process by which a company gains the ability to raise prices or exclude competitors. Although monopolies may be big businesses, size is not a characteristic of a monopoly. A small business may still have the power to raise prices in a small industry. Monopolies are thus characterized by a lack of economic competition to produce the good or service and a lack of viable substitute goods. . In economics, a monopoly is a single seller. In law, a monopoly is a business entity that has significant market power, that is, the power, to charge high prices.

Likewise, a monopoly should be distinguished from a cartel, in which several providers act together to coordinate services, prices or sale of goods. This is to be contrasted with the model of perfect competition in which companies are “ price takers” and do not have market power. Monopolies, monopsonies and oligopolies are all situations such that one or a few of the entities have market power and therefore interact with their customers, suppliers and the other companies in a game theoretic manner – meaning that expectations about their behaviour affects other players’ choice of strategy and vice versa. A monopoly is distinguished from a monopony, in which there is only one buyer of a product or service; a monopoly may also have monopony control of a sector of a market.

When not coerced legally to do otherwise, monopolies typically maximize their profit by producing fewer goods and selling them at higher prices than would be the case for perfect competition. Governments may force such companies to divide into smaller independent corporations as was the case <https://assignbuster.com/the-monopolies-and-restrictive-trade-practices-act-economics-essay/>

of United States v. AT&T, or alter its behavior as was the case of United States v. Microsoft, to protect consumers.

## **Characteristics**

**Price Maker:** Decides the price of the good or product to be sold.

**Single seller:** In a monopoly there is one seller of the good that produces all the output. Therefore, the whole market is being served by a single company, and for practical purposes, the company is the same as the industry.

**Price Discrimination:** A monopolist can change the price and quality of the product. He sells more quantities charging less price for the product in a very elastic market and sells less quantities charging high price in a less elastic market.

**Profit Maximiser:** Maximizes profits.

**High Barriers to Entry:** Other sellers are unable to enter the market of the monopoly.

**Sources of monopoly power :** There are three major type of barriers to entry; economic, legal and deliberate. Monopolies derive their market power from barriers to entry circumstances that prevent or greatly impede a potential competitor's ability to compete in a market.

**Economies of scale:** Monopolies are characterised by decreasing costs for a relatively large range of production. If for example the industry is large enough to support one company of minimum efficient scale then other

companies entering the industry will operate at a size that is less than MES, meaning that these companies cannot produce at an average cost that is competitive with the dominant company. Finally, if long-term average cost is constantly decreasing, the least cost method to provide a good or service is by a single company. . Furthermore, the size of the industry relative to the minimum efficient scale may limit the number of companies that can effectively compete within the industry. Monopolies are often in a position to reduce prices below a new entrant's operating costs and thereby prevent them from continuing to compete. Decreasing costs coupled with large initial costs give monopolies an advantage over would-be competitors.

**Economic barriers:** Economic barriers include economies of scale, capital requirements, cost advantages and technological superiority.

**Capital requirements:** Large fixed costs also make it difficult for a small company to enter an industry and expand. Production processes that require large investments of capital, or large research and development costs or substantial sunk costs limit the number of companies in an industry.

**Technological superiority:** One large company can sometimes produce goods cheaper than several small companies. A monopoly may be better able to acquire, integrate and use the best possible technology in producing its goods while entrants do not have the size or finances to use the best available technology.

**No substitute goods:** The absence of substitutes makes the demand for the good relatively inelastic enabling monopolies to extract positive profits. A monopoly sells a good for which there is no close substitute.

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Control of natural resources: A prime source of monopoly power is the control of resources that are critical to the production of a final good

Network externalities: The use of a product by a person can affect the value of that product to other people. This is the network effect. This effect accounts for fads and fashion trends. It also can play a crucial role in the development or acquisition of market power. The most famous current example is the market dominance of the Microsoft operating system in personal computers. In other words the more people who are using a product the greater the probability of any individual starting to use the product. There is a direct relationship between the proportion of people using a product and the demand for that product.

In addition to barriers to entry and competition, barriers to exit may be a source of market power. Barriers to exit are market conditions that make it difficult or expensive for a company to end its involvement with a market. Great liquidation costs are a primary barrier for exiting. Market exit and shutdown are separate events. The decision whether to shut down or operate is not affected by exit barriers. A company will shut down if price falls below minimum average variable costs.

## **Monopoly and efficiency**

<http://upload.wikimedia.org/wikipedia/commons/thumb/e/ef/Monopoly-surpluses.svg/250px-Monopoly-surpluses.svg.png>

Surpluses and deadweight loss created by monopoly price setting

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The price of monopoly is upon every occasion the highest which can be got. The natural price, or the price of free competition, on the contrary, is the lowest which can be taken, not upon every occasion indeed, but for any considerable time together. The one is upon every occasion the highest which can be squeezed out of the buyers, or which it is supposed they will consent to give; the other is the lowest which the sellers can commonly afford to take, and at the same time continue their business

According to the standard model, in which a monopolist sets a single price for all consumers, the monopolist will sell a lesser quantity of goods at a higher price than would companies by perfect competition. Because the monopolist ultimately forgoes transactions with consumers who value the product or service more than its cost, monopoly pricing creates a deadweight loss referring to potential gains that went neither to the monopolist nor to consumers. Given the presence of this deadweight loss, the combined surplus for the monopolist and consumers is necessarily less than the total surplus obtained by consumers by perfect competition. Where efficiency is defined by the total gains from trade, the monopoly setting is less efficient than perfect competition.

It is often argued that monopolies tend to become less efficient and less innovative over time, becoming “ complacent”, because they do not have to be efficient or innovative to compete in the marketplace. Sometimes this very loss of psychological efficiency can increase a potential competitor’s value enough to overcome market entry barriers, or provide incentive for research and investment into new alternatives. The theory of contestable markets argues that in some circumstances monopolies are forced to behave

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as if there were competition because of the risk of losing their monopoly to new entrants. This is likely to happen when a market's barriers to entry are low. It might also be because of the availability in the longer term of substitutes in other markets. For example, a canal monopoly, while worth a great deal during the late 18th century United Kingdom, was worth much less during the late 19th century because of the introduction of railways as a substitute.

## **Natural monopoly**

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A natural monopoly is a company that experiences increasing returns to scale over the relevant range of output and relatively high fixed costs. A natural monopoly occurs where the average cost of production “ declines throughout the relevant range of product demand”. The relevant range of product demand is where the average cost curve is below the demand curve. When this situation occurs, it is always cheaper for one large company to supply the market than multiple smaller companies; in fact, absent government intervention in such markets, will naturally evolve into a monopoly. An early market entrant that takes advantage of the cost structure and can expand rapidly can exclude smaller companies from entering and can drive or buy out other companies. A natural monopoly suffers from the same inefficiencies as any other monopoly. Left to its own devices, a profit-seeking natural monopoly will produce where marginal revenue equals marginal costs. Regulation of natural monopolies is problematic. Fragmenting such monopolies is by definition inefficient. The most frequently used methods dealing with natural monopolies are <https://assignbuster.com/the-monopolies-and-restrictive-trade-practices-act-economics-essay/>

government regulations and public ownership. Government regulation generally consists of regulatory commissions charged with the principal duty of setting prices. To reduce prices and increase output, regulators often use average cost pricing. By average cost pricing, the price and quantity are determined by the intersection of the average cost curve and the demand curve. This pricing scheme eliminates any positive economic profits since price equals average cost. Average-cost pricing is not perfect.

### **Government-granted monopoly**

A government-granted monopoly (also called a “de jure monopoly”) is a form of coercive monopoly by which a government grants exclusive privilege to a private individual or company to be the sole provider of a commodity; potential competitors are excluded from the market by law, regulation, or other mechanisms of government enforcement.

### **What is MRTP ACT**

The Monopolies and Restrictive Trade Practices Act, 1969, aims to prevent concentration of economic power to the common detriment, provide for control of monopolies and probation of monopolistic, restrictive and unfair trade practice, and protect consumer interest.

Monopolistic trade practice is that which represents abuse of market power in the production and marketing of goods and services by eliminating potential competitors from market and taking advantage of the control over the market by charging unreasonably high prices, preventing or reducing competition, limiting technical development, deteriorating product quality or by adopting unfair or deceptive trade practices.



## Causes of Monopoly

Monopolies can arise in some circumstances as the result of normal business practices that are characteristic of firms in a highly competitive industry. Or they can arise as a consequence of what economists term anti-competitive practices, that is, behavior that is intended to destroy competition through means other than competing on the basis on price and quality (including the quality of services associated with the product). More specifically, monopolies can arise in any of the following, non-mutually exclusive, ways:

- (1) By developing or acquiring control over a unique product that is difficult or costly for other companies to copy. This can occur as a result of a purchase, merger or research and development. An example is pharmaceuticals, which can be extremely expensive and risky to develop (and which are also protected by patents), thereby locking out all but a few large, well funded companies with ample talent. Closely related to this is control over a unique input for a product, such as a unique natural resource.
- (2) By having a lower production cost than competitors. This can result from having a more efficient (i. e., more output per unit of input) production technique or from having access to a unique source of low cost inputs (e. g., a mine containing exceptionally high grade ore). In some cases, a greater efficiency is the result of economies of scale, which means that the production cost per unit of product declines as the volume of output increases due to the ability to use some resource more intensively (e. g., a steel mill or railroad with lots of excess capacity).

This category includes natural monopolies. A natural monopoly exists for a product for which there are sufficient economies of scale such that the product can be produced or supplied by a single company at lower cost than by multiple, competing companies. Examples include utilities such as railroads, pipelines, electric power transmission systems and wired telephone systems. It is often wasteful (for consumers and the economy) to have more than one such supplier in a region because of the high costs of duplicating the infrastructure (e. g., parallel railroad networks in a region or two sets of telephone wires to every house).

(3) By using various legal and/or illegal tactics, often referred to as predatory tactics, aimed specifically at eliminating existing or potential competition, such as (a) buying out or merging with competitors, (b) temporarily charging prices below cost to drive competitors out of business (often referred to as predatory pricing or dumping), (c) using a monopoly in one product to create a monopoly with regard to another product (sometimes referred to as the bundling or tying of products), (d) taking control of suppliers of inputs required by competitors or conspiring with them to raise their prices (or lower their quality of service, etc.) to competitors (e) taking control of, or conspiring with, suppliers of other products used by competitors' customers, (f) threatening costly litigation (e. g., regarding allegations of patent or copyright infringements regardless of the legal merits of such claims), which large companies can easily afford but small companies often cannot and (g) using blackmail or threats of violence.

Horizontal integration is the gaining of control by one company over other producers or sellers of the same product. The acquired companies can  
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appear to be quite diverse. Often the acquisition of control is not publicized, and sometimes different branding is used to create the illusion of competition. For example, a broadcasting company might acquire various radio and/or television channels each with a different focus in order to gain control of most of the entire listener or viewer market in a region and thereby prevent the emergence of competitors.

Such seeming diversity can also offer other benefits to a monopolist. In particular, it can be valuable in separating markets, thereby allowing the monopolist to charge separate, profit maximizing prices in each. It can also make the existence of a monopoly less conspicuous and less of a target for public criticism, government intervention and the emergence of new competitors.

(4) By controlling a platform and using vendor lock-in. A platform is a standardized specification for a product that allows its providers and users and their products to interoperate without special arrangement. This reduces the overall costs of conducting transactions by removing some of the costs of matching up products with buyers. Lock-in is the practice of designing a product that cannot interoperate with products made by other companies in order to make it difficult and/or costly for users to switch to competing systems. Lock-in is also used so that replacement parts or add-on enhancements must be purchased from the same manufacturer. Examples would include a computer operating system or a portable music storage/replay device that is controlled by a single company.

(5) By receiving a government grant of monopoly status, i. e., becoming a government-granted monopoly. Today this is usually accomplished through the acquisition of a license, patent, copyright, trademark or franchise.

Common examples include a franchise for cable television for a certain city or region, a trademark for a popular brand, copyrights on certain cartoon characters or a patent for a unique product or production technique.

As governments usually have the final authority regarding the creation, maintenance and extension of monopolies, public relations, particularly lobbying and advertising, are important tools for monopolists for convincing politicians to ignore, approve or even bless anti-competitive acquisitions, mergers, etc. Among the arguments typically made by monopolists are that such acquisition or merger is in the public interest because it would allow them to (1) spend more money on research and development in order to develop new and improved products, (2) standardize what would otherwise be a chaotic market (i. e., vigorous competition) and (3) reduce costs, and thus prices, through (a) the reduction of redundant production facilities and employees, (b) concentrating production at the most efficient production facilities and (c) obtaining greater economies of scale. Monopolists also frequently support such requests with the claim that they are model corporate citizens and that they are great contributors to charitable and educational causes.

The term barriers to entry is used by economists to refer to obstacles to businesses or to individuals wanting to enter a given field. Some of these barriers occur naturally, whereas others are erected or strengthened by monopolies in order to maintain or enhance their monopoly positions.

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Examples include the extremely high cost of developing new drugs, limited sources for a low cost input, a dominant platform for software or other products, patent protection of a low cost production technique, the difficulty of trying to compete with famous brands and air transport agreements that make it difficult for new airlines to obtain landing slots at popular airports.

### Why Monopolies Can Be Beneficial

Despite their reputation for evil, monopolies can actually generate a net benefit for society under certain circumstances. These are usually situations in which the power and duration of the monopoly are carefully limited.

Natural monopolies can be particularly beneficial. This is because of their ability to attain lower costs of production, often far lower, than would be possible with competitive firms producing the same product in the same region. However, it is almost always necessary for such monopolies to be regulated by a relatively uncorrupted government in order for society to obtain the potential benefits. This is because such monopolies by themselves, as is the case with all monopolies, have little incentive to charge prices close to cost and, rather, tend to charge profit-maximizing prices and restrict output. Likewise, there is often little incentive to pay much attention to quality.

It has long been recognized that government-granted monopolies (i. e., patents, copyrights, trademarks and franchises) can benefit society as a whole by providing financial incentives to inventors, artists, composers, writers, entrepreneurs and others to innovate and produce creative works. In fact, the importance of establishing monopolies of limited duration for this <https://assignbuster.com/the-monopolies-and-restrictive-trade-practices-act-economics-essay/>

purpose is even mentioned in the U. S. Constitution<sup>7</sup>. In addition to being for limited periods of time, such monopolies are also generally restricted in other ways, including that there are often fairly good substitutes for their products<sup>8</sup>.

### Why Monopolies Can Be Harmful

Large monopolies have considerable potential to damage both economies and democratic governments (although they can be very beneficial for other types of governments<sup>9</sup>). Unfortunately, the full extent of the damage is usually not as obvious, at least to the general public, as are the seemingly beneficial effects. And monopolists often go to extreme lengths to disguise or hide such harmful effects. Among the ways in which unregulated monopolies can harm an economy are by causing:

(1) Substantially higher prices and lower levels of output than would exist if the product were produced by competitive companies.

(2) A lower level of quality than would otherwise exist. This includes not only the quality of the goods and services themselves, but also the quality of the services associated with such goods and services.

(3) A slower advance in the development and application of new technology. Advances in technology can improve the quality (e. g., ease of use, durability, environmental friendliness) of products, and they can also reduce their costs of production. Innovation is not as necessary for a monopolist as it is for a highly competitive firm, and, in fact, it can be a bad business strategy. Research and development by monopolists is often largely focused

on ways of suppressing new, potentially competitive technologies (and includes such techniques as stockpiling patents) rather than true innovation 10. This can be a serious disadvantage, because economists have long recognized that innovation is a key factor (and possibly the single most important factor) in the growth of an economy as a whole<sup>11</sup>.

The adverse effects of monopolies can be much more noticeable on an individual level than in the aggregate. These effects include the destruction of businesses that would have survived had competition been based solely on quality and price (with a consequent loss of assets of the owners and jobs of the employees) and prices for products so high as to cause hardship or be unaffordable for some people.

It is often said, even by those who have negative opinions about monopolies, that “ monopoly itself is not necessarily bad, but rather it is the abuse of monopoly power that is harmful.” This statement is an excessive simplification, and it can be indicative of a lack of understanding of the full extent of harm that can be caused by monopolies.

The abuse of monopoly power clearly can be harmful to an economy. The term abuse in this context refers to such tactics as predatory pricing, colluding with suppliers and the leveraging of a monopoly in one product to gain a monopoly for another product. But what is often overlooked, even by legislation whose supposed purpose is to restrain or regulate monopolies, is the fact that monopolies can be harmful even if they do not engage in such practices.

If a monopolist engages in behavior that produces results similar to that by firms in an industry that is characterized by intensive competition, then there might not be a problem. Unfortunately, however, this is rare even for a seemingly benevolent monopolist. The reason is that the very strong incentives to maximize profits that exist for virtually any business, whether pure monopolist, perfect competitor or somewhere in between, produce very different results for a monopolist than they would for a firm in a highly competitive industry. And monopolists usually do not rank benevolence as a top corporate priority.

Thus, the management and employees in a monopoly might not at all be aware that they are harming the economy, especially if their behavior is similar to that by a non-monopoly. In fact, they may even genuinely believe that they are benefiting the economy because of their conviction that they are more efficient and productive than a number of firms competing with each other would be.

Another reason that the positive effects of even a benevolent monopolist would not be as great as for a competitive company is that innovations that improve quality and reduce production costs are often the result of desperation. Monopolists generally consider themselves successful, and thus, although they often are innovators to some extent, they usually just do not have that extra motivation to produce truly breakthrough innovations that smaller companies desperate to gain market share have.



## **The Apple Monopoly**

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[UsersanilkumarPicturesapple-monopoly1\[1\].png](#)

The largest company in the world decides to attack a smaller player that is entering on a portion of the market where it is currently dominating. You may have thought of Apple's continuous legal battle with Samsung but I was thinking of what led Microsoft to be declared a monopoly in 1997. So is it time to start thinking about Apple as a monopoly?

### **Big target**

Since it became the largest corporation in the world, Apple has increased its chances at becoming the target of all kinds of lawsuits and disapproval. The recent issues around treatment of workers at the Foxconn plants are only the beginning and one can expect Apple to fall to more and more scrutiny which begs the question as to how long it will take before the company becomes the target of an antitrust lawsuit and there may be a number of reasons for which the company could be targeted.

With near-control in spaces like digital players (the iPod), tablets (the iPad), online music (iTunes), and ultrabooks (the Macbook Air), Apple's position as a monopoly based on technological superiority and economies of scale. But majority ownership of a market does not a monopoly make. If it did, many more companies would be investigated for monopoly power at one point or another. What generally leads companies to being accused of being a monopoly is when they act in a way that is hurting their competitors.

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... and competitors are starting to make the case for abuse of power.

## Gathering Cloud

**<http://static.guim.co.uk/sys-images/Guardian/Pix/audio/video/2012/8/20/1345486370038/Apple-conference-in-San-F-010.jpg>**

There has long been concerns on the part of the music industry about the power Apple has gained over it. The iTunes store represents the majority of online music sales and has, as a result, been able to essentially get the music industry to agree to pricing terms that have made many artists complain. It is generally assumed that the US\$. 99 price that has become the standard for online music tracks was something that Steve Jobs kept insisting on and that the music industry had little say in the matter. There is already a case wending its way through the California court system on this.

Then last year, in an attempt to muscle in on the e-books market, Apple leveraged its position of strength in the tablet market to get the the publishing industry to change the way it is handling pricing of e-books, prompting the US Department of Justice and the European Union to start investigating the company on potential monopoly grounds.

Then came the revelation, through his official biographer, that Steve Jobs swore to destroy Android. At the time when those comments were made, the iPhone was the dominant phone in the smartphone segment so this unfortunate statement could end up being the equivalent of Microsoft's claim that it should be allowed to bundle a ham sandwich with Windows if it felt like it. This was followed by increasing legal battles with many of the

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companies offering Android-flavored phones, the largest one of which is the on-going country-by-country fight between Apple and Samsung.

## **The dangers of being called a monopoly**

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Roll the tape back 15 years and the largest tech player was Microsoft, which also was the largest company in the world in terms of overall market capitalization. When Windows 1995 came out, the first calls regarding monopoly power came along but most people felt that the company was doing a good job. Then Netscape starting failing and decided to complain to the US Department of Justice about the fact that Microsoft was bundling its internet browser with its operating system.

This idea of bundling served as the basis of complaint and the claim that Netscape was failing because of the fact that Microsoft could crush competitors by just adding similar applications to its platform and bundling them in for free. From a logical standpoint, it may not quite be the case: for example, on the consumer end, Microsoft bundled an online service (MSN) but failed to gain traction against America Online; on the server end, Microsoft bundled the IIS web server with their server offering but Apache and Linux continued to thrive.

Similar arguments will be made around Apple's power and its bundling of the iTunes store and the app market with the iPhone and iPad, as well as its integration of OSX and Apple TV into a complete Apple ecosystem. The

claims of this being the reason for their competitor's failures will hold about <https://assignbuster.com/the-monopolies-and-restrictive-trade-practices-act-economics-essay/>

as much logical weight as the ones against Microsoft did but the problem is that it will not matter.

Once Apple has been convicted in the public court of opinion, no matter what the verdict on an antitrust case it, it will push the company to be more tentative and more hesitant, losing some of the swagger it currently holds. For Microsoft, what it meant is that the company became a lot more worried about appearing like a monopolist and its bureaucracy became heavier, ensuring that the company would not do anything that would get it into legal hot waters. The net is that the company's own hesitation in entering certain markets and its insistence on not playing a very heavy hand when it did enter new markets made it an underdog in most of the areas where it needed to go.

### **Can it avoid it?**

<http://www.technobuffalo.com/wp-content/uploads/2012/08/Apple-VS-Samsung-6.jpg>

The big question is whether Apple can continue growing and avoid being charged with any form of antitrust or monopoly crimes. As it grows bigger, it might become increasingly difficult to navigate. The company is current doing a good job in terms of managing the Foxconn crisis and it looks like the capable people in the management team may be able to navigate through the minefields of monopoly lawsuits.

Pointing to how most of the money in the app market goes to developers will go part of the way in helping them counter critics but they may have to

watch out if the music, TV, movie, or publishing industry decide they need <https://assignbuster.com/the-monopolies-and-restrictive-trade-practices-act-economics-essay/>

more power in the relationship. Managing the right balance of power will probably be but one of the greater challenges Apple will have to face in the future.

Today, Apple sits at the top of the technology landscape but tomorrow, after the antitrust and other monopoly related lawsuits start popping up, the company may grow more hesitant and could eventually lose some of its power as a result. I fear that top is getting closer: with no real competitors but itself left, Apple gets to look at the rest of the industry and savor the moment when it is king but the question remains as to how long it still has in this position before the revolutionaries call for its head.

## **Examples of monopolies**

The salt commission, a legal monopoly in China formed in 758.

The British Honourable East India Company; created as a legal trading monopoly in 1600.

Netherlands East India Company; created as a legal trading monopoly in 1602.

The “ Caf” A food conglomerate of Benedictine College founded in 1858.

Western Union was criticized as a “ price gouging” monopoly in the late 19th century.[]

Standard Oil; broken up in 1911, two of its surviving “ child” companies are ExxonMobil and th