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Business, Industries

10196000Abrief look at market failures via monopoly power: their welfare effects and howgovernments can intervene I’ll be discussing monopoly power and howit’s a form of market failure by identifying several negative effects includingthe welfare losses that occur because of it. I will also be discussing a fewmethods of how government intervention can reduce or eliminate monopoly power. Market failure occurs when goods and servicesare not used up efficiently within the market, meaning that quantity supply andquantity demand are not equal, this doesn’t allow the market to be Paretoefficient meaning that all parties within the market are maximising theirutility, one of the main causes of market failure is monopoly power, and as aresult of monopoly power one party (which is the producer or the firm) isexploiting other parties (consumers) by several methods which we will discusslater.

To better define monopoly power, it is theby-product of extreme free market capitalism where there aren’t many rules andregulations, this allows firms to expand to the point of creating a monopolyand having the greater share of the market. It allows firms to have controlover the market with little to no competition. Firms can also control differentaspects of the market, like the price (price fixing) or the supply level withinit.

There are several reasons why monopoly poweris a form of market failure. The first is price fixing as a result ofmonopolies firms can fix prices as they have control over the market, thisprocess is illegal and may result in the creation of cartels in order toincrease return and to increase their joint profit much as possible, (OPEC) isconsidered a cartel as only a few countries are

controlling the price of oilwithin the market. Cartels are widely known in industries where an oligopoly ispresent (where there are several firms that are controlling the market).

Alsoin 2010 it was uncovered that British Airways and Virgin Atlantic whereoperating an illegal cartel and as a result passengers who book from theirairlines were charged higher prices. Another reason that monopolies is a form ofmarket failure is that product innovation is greatly reduced as a result ofreduced competition, firms with the largest share are able to stop or increasethe difficulty for any new firms who are trying to enter the market thisreduces the level of research and development in a market as there are lessfirms innovating, firms can sometimes use methods like backwards innovationwhere the produce and sell products that are out dated in terms technologicaladvancement as it is much cheaper and can be sold in large quantitiesgenerating large revenue levels, this can be dangerous in markets likepharmaceuticals as research and development is reduced, a similar processhappens with the business Pfizer where the buy new market entries in order toreduce competition. Another method that firms use that results in loss ofinnovation are patents, although it is totally legal however many firms don't only patent their products, they patent new technologies. It is very visible inpharmaceuticals where firms patent their products and drug research in order tohave market power and sell the drugs with higher prices, pharmaceuticals exploitthis idea by patenting drugs for diseases such as HIV and hepatitis C and thus greatlyincreasing their prices meaning that not everyone will be able to afford it, however in India firms don't follow those

patent laws and create the same drugsbut sell them with way cheaper prices.

The welfare effects of monopoly power This is an example of a perfectly competitivemarket where demand is equal of supply meaning that what producers make is soldand that consumers wants are fully met this is called equilibrium and is knownas market clearing. And because it’s a competitive market there is a wide rangeof products with a wide range of prices, so most customers are satisfied. Fig: 1   In a pure monopoly market prices arecontrolled by the controlling firms and as a result prices are increased thisresults in a decrease in output as not all consumers are able to afford the productor service or output can be controlled and reduced (creating artificialscarcity) in order to increase prices, this reduces the consumer surplus andincreases the producer surplus, and the sum of both the net loss of consumersurplus and the net loss of the producer surplus is the dead weight loss. Asdiscussed before this is not Pareto efficient, not all parties are maximisingtheir utility. As we can see form the graph quantity has shifted from Q1 to Q2whereas prices shifted from B to A. Deadweightloss causes a decrease in total surplus, although it is beneficial for firms astheir surplus is increased however for consumers it’s quite the opposite.

Although this results in a decrease in sales however because it is a result ofincreased prices total revenue is actually increased. Government intervention to reduce monopolypowerIn order to reduce market failures viamonopoly power governments can use several methods one of which the prohibitingof mergers. Many firms gain monopoly power by merging or

buying of other firmsone example was the potential purchasing of T-Mobile by AT&T for $39 billion; however the department of justice stopped this purchase from any further advancement.

Mergers and purchases like these pose greatthreats to the industry they are in as a much larger firm is suddenly createdand can negatively affect the welfare of consumers and other firms within themarket. Nationalization is another method wheregovernments can eliminate monopoly power in different industries, it’s wherethe government buys the firm with monopoly power in order to free the industryfrom monopoly and reduce welfare effects. There have been several successful publicationsof nature monopolies, in 2008 and 2009 after the financial crisis some major UKbanks have been partly nationalised including The Royal Bank of Scotland andLloyds Banking Group.

There is another method where governments canuse although won’t reduce monopoly power, however will reduce its negative. Governments might put up regulations and rules that firms have to obey, theycan set up regulations regarding the quality of the product or service, and iffirms follow those regulations properly then consumers won’t be exploited bymonopolies. Governments can break up large monopoliesinto smaller firms so the market consists of a small group of firms. Each firmwill operate separately and as a result there will be competition andinnovation, prices will fall to a competitive level and consumer surplus willincrease.

In conclusion with all the negative effectsthat monopoly power creates and the welfare losses behind it, governments canstill control those monopolies to a degree. However even though governments canintervene it doesn’t seem to be that successful as many monopolies still thriveand control the industries they are in, this could be due to the fact thatgovernments might actually benefit from the fact that those monopolies are running.