

Positives and negatives of monopoly power in a market



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Why do some observers criticise companies that have monopoly power in a market whilst others argue that such power can be beneficial to consumer interests? Then with reference to a country of your choice, briefly discuss the ways in which the government of that country has introduced specific policies to counteract the abuses of monopoly power?

Introduction

A monopoly is commonly explained as a market represented by only one producer in which output or prices are controlled (Peterson, Wallace C., 2009). The extent to which this portrayal is true depends on whether a monopoly wholly places society at a disadvantage. There are, however, critics that suggest a single producer may reduce prices, maintain the certainty, innovate products and raise output for consumers. Either way, the downfalls of a monopoly have prompted governments to implement policies to deter the issues harming society.

Arguments for a monopolist

Reduced prices

A monopolist may indirectly lower the price for consumers. This occurs when a large-scale monopolist is able to reduce average costs of production by purchasing in bulk. This was revealed by Freemove which struck a deal with Motorola and Siemens to provide handsets for its phone network alliances, where the purchase of 6 million phones has produced an average cost saving of 10%, as well as offering its customers a 'highly competitive product' (BBC News, 2010). Theory, as shown in figure 1, demonstrates how Freemove, for

example, causes a shift in its marginal cost curve to right, thereby, creating a lower price than a competitive market with output increasing to Q2. In other words the cost of producing an additional unit of output falls below the price level of 'Pmon'.

Economies of Scale

Figure 1 – (Intertic, 2010)

Maintaining stability

Consumers are also guaranteed a greater degree of certainty from the continuous presence of a monopolist. This comes as a result of numerous costly barriers to entry such as sunk costs discouraging entrants from creating a misallocation of resources for society (Ison, S, Wall, S., 2007, p136) . This fact is supported by BT which stated investors and customers favour the way a task is handled and the most ' obvious pitfall would be to promote the semblance of competition with Mercury', although sunk costs were a challenge for Mercury (The Times, 1991). The difficulty of selling assets when leaving a market can demotivate entrants. This helps to aid the monopolist whilst attempting to maintain the current standards required by consumers.

The potential for innovation

Monopolists may also be able to offer consumers improved quality goods. This, theoretically, is achieved by using the supernormal profits to invest in research and development which normally enables innovative production.

Theory would definitely categorize Microsoft's 90% market share as a <https://assignbuster.com/positives-and-negatives-of-monopoly-power-in-a-market/>

monopolist (Microsoft 1998). However, alternative internet browsers such as Netscape were permitted on windows and instead benefitted consumers with a copious supply of ever-improving technology (Anon, 1991, p324-325). This suggests that monopolists do continue to improve the quality of products in an attempt to meet the preferences of consumers.

Increased output

A monopolist may also be able to use its economies of scale to increase output. This applies to a natural monopoly which is able to reduce its long run average costs of production as result of large-scale production. The electricity power industry was able to spread its capital costs over a higher output as a result of engineering economies of scale which allowed a steady growth in demand (Isser. N. S., 2003, p219). As shown in the diagram below, vast improvements in factors of production for the electricity provider enable it to increase the rate at which more electricity is provided in line with falling average costs. ' Q1' shows the optimum level of output for a wider range of consumers at a lower price.

Natural monopoly

(Ison, S., Wall, S., 2007, p193)

Arguments against a monopolist

Inefficiencies

An argument against a monopolist is that it can be inefficient. This is a result of profit maximising at the point where $MR = MC$, which means the price

exceeds the marginal and average cost of production. With reference to this situation, the Mexican Monopoly telephone company Telefonos de Mexico is hampered by its high costs and inefficient operations due to massive profits (Fraser, D., 1994, p34). This shows that a monopolist can be productively inefficient because it doesn't aim to minimize its average costs at the lowest possible point (See below point C). And it's allocatively inefficient because the high price charged exceeds the marginal cost ideal to satisfy consumer preferences (See below point A).

(Ison, S, Wall, S., 2007, p134).

Higher price

Similarly, a higher price is most commonly known to impact consumers negatively. The price making monopolist at times can price discriminate. Centrica, the UK's largest domestic supplier slapped 35% on the price of gas, especially during a time when wholesale oil and gas prices were at a three-year low (The Independent, 2009). This shows that commodities such as gas carry a high inelastic demand and enable monopolists to set higher prices, even when the cost of production remains unchanged. The price rise, therefore, minimizes consumer surplus.

Lower output

Another issue arising from a monopolist is that the production of output can be limited. This is then believed to have adverse effects on the performance of an economy. Transneft, the Russian state monopoly of pipelines has limited the amount of barrels the Russian oil company Yukos can export to

the West (The Times, 2004). Such a move has an effect of raising the costs of production for oil companies which is then passed onto the consumer with little alternatives but to accept the higher price. These higher prices can therefore be reflected by a higher rate of inflation which goes against the government's objectives.

Barriers to entry

The presence of a monopolist strains competition from taking place due to its barriers of entry. Certain barriers to entry such as government licences are granted to particular monopolists. This is the case with the Royal mail which was criticized by the industry regulator as "failing to invest properly, is too inefficient and is not developing sufficient new products" (Buckley, C., 2008, p1). Such issues arise when barriers to entry blocks competition from forcing the monopolist to become increasingly innovative and productive. It also shows that consumers reliant on the Royal Mail's postal services are likely to suffer from "chronically poor services" (Leigh, E., 2006, p1).

UK Government policies

Deregulation

Deregulation is believed to deter the common problems of a monopolist. The intention of this policy is to allow for the outcome of competition to benefit consumers. The White Paper 1984 of parliament proposed that privatizing state buses would increase competition and provide the opportunity for lower fares, new services and more passengers (Glaister, S., 1991, p286-287). As revealed earlier in this discussion, a monopolists' intention to profit maximize means the above benefits of "state privatization" for consumers <https://assignbuster.com/positives-and-negatives-of-monopoly-power-in-a-market/>

are only ever absent. In addition, deregulation can be criticized as achieving the opposite outcomes. Britain's biggest privatized utility provider PowerGen has caused more than 850, 000 people to live in fuel poverty (Nelson, D, Carter, J., 1995, p1). This shows that privatization doesn't necessarily achieve the intended objectives of a lower market price, but instead gives freedom to a firm to place its interests before consumers.

Enterprise Act 2002

Some of the ways in which the threats of a monopolist are controlled is through regulatory bodies. The Office of fair trading has introduced the Enterprise Act 2002 which enables it to acquire the likeliness of competition being abused by a merger through the competition commission (Ison, S, Wall, S., 2008, 194-195). However these government bodies haven't succeeded entirely in preventing consumers from being disadvantaged. Competition watchdogs have decided to leave the company struggling to avoid a break-up, despite BAA's near airport monopoly harming consumers (Done, k, Peel, M., 2008, p4). This shows that in the interests of the competition commission, it may at times be inconsiderate of how monopolists affect consumers.

Price caps

Regulatory bodies have also monitored the higher prices abusing consumers. The telecommunications regulator Ofcom has decided to set price caps on Sky to lower the price of channels to its rivals Virgin Media and BT vision (BBC News Business, 2010). Such price caps are believed to prevent

monopolists from raising the costs on other firms which should prevent the <https://assignbuster.com/positives-and-negatives-of-monopoly-power-in-a-market/>

risks of leaving the market. Setting a maximum price may, however, add more problems. Price caps create a situation of excess demand. The lower price set by regulatory bodies causes an increase in demand which overtakes the amount of goods supplied in the market (Griffiths, A, Wall, S., 2008, p28). This means that out of all the available demand, a limited number of consumers will have access to the good. Inequalities in living standards may arise.

Maximum price

(Griffiths, A, Wall, S., 2008, p28)

Conclusion

Overall, monopolies have proven to be both beneficial and harmful towards society. During this discussion, some of the positive aspects of a monopolist were the lower prices set and the innovative production shown by technological firms. Although, one of the most obvious downfalls demonstrated was the higher price charged against a lower output with limited substitutes, thereby, compressing the welfare of consumers. On the whole, governments have set price limits, deregulated and investigated monopolists, yet the effectiveness of these measures are still open to discussion.