

Why is it important for the government to regulate natural monopolies

[Government](#)



A natural monopoly arises where the largest supplier in an industry, often the first supplier in a market, has an overwhelming cost advantage over other actual and potential competitors. This tends to be the case in industries where capital costs predominate, creating economies of scale that are large in relation to the size of the market, and hence high barriers to entry; examples include public utilities such as water services and electricity.

It is very expensive to build transmission networks (water/gas pipelines, electricity and telephone lines); therefore, it is unlikely that a potential competitor would be willing to make the capital investment needed to even enter the monopolist's market. Gosport Ferry is an example of a natural monopoly. In these cases, economists have argued that regulation may be appropriate. Government regulation can take many forms, but all involve putting limits on what a business (or consumer) can do. Certain activities, prices, or products become illegal and others become mandatory.

The ideal form of regulation for a monopoly would be to force it to set its price equal to its marginal cost. Forced to price as if it were a price taker, the monopoly should find it profitable to increase output to the economically efficient level. However overheads may increase and if the price is fixed by the government then the businesses profit margins will decrease and then the standard of the service/good may fall. In some cases, monopolies are essential in order to lower cost and save space.

For instance, water and electrical companies have natural monopolies because it would be too expensive for businesses to build several pipelines or power lines. Also, some monopolies prevent the destruction of

the environment, since multiple competing electrical companies would have to destroy more land in order to have multiple power lines owned by separate companies. Therefore it can be beneficial for the government to regulate them to make sure that emerging companies do not enter that market, as it means a better environment and more open space that can be used for alternative projects.

A new business might be able to create a better product than an older one, but this new business might still be in the process of establishing itself. A monopoly company can take control of the majority of essential resources needed to produce a particular product, preventing other companies from producing these products. Monopolies can also run competitors out of business by lowering the costs of their products below the cost of production. These lower prices will draw consumers away from the newer company toward the older company.

Since the established company might have more money saved up, they can remain in business longer while losing profit and can wait until the other company runs out of business before raising the prices high again. For this reason it is important for the government to regulate this as otherwise it restricts the consumer choice and means that they will have to pay more for a product that could be provided cheaper and it can potentially stop new technologies from entering the market that could lead to rapid change.

Monopolies are also beneficial when the costs of having one provider are lower than the cost of multiple competitors. Since the point of antitrust laws is to keep prices as low as possible, antitrust laws would not serve the

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consumer if the costs of competing were great enough to raise the price of the products and services sold to the consumers. As a result if regulated it cheapens prices low for the consumers which will keep disposable income high and then money can be spent elsewhere, increasing the aggregate demand for the country.

Overall it is clear that regulation is important otherwise the dominant firm can dictate prices and keep prices very high and potentially stop the progression of not just that market but others also. Furthermore if left with no regulation then standards could slip and as explained the environment could suffer, so it is very important for the government to oversee natural monopolies.