Essay – Section B

2 a)

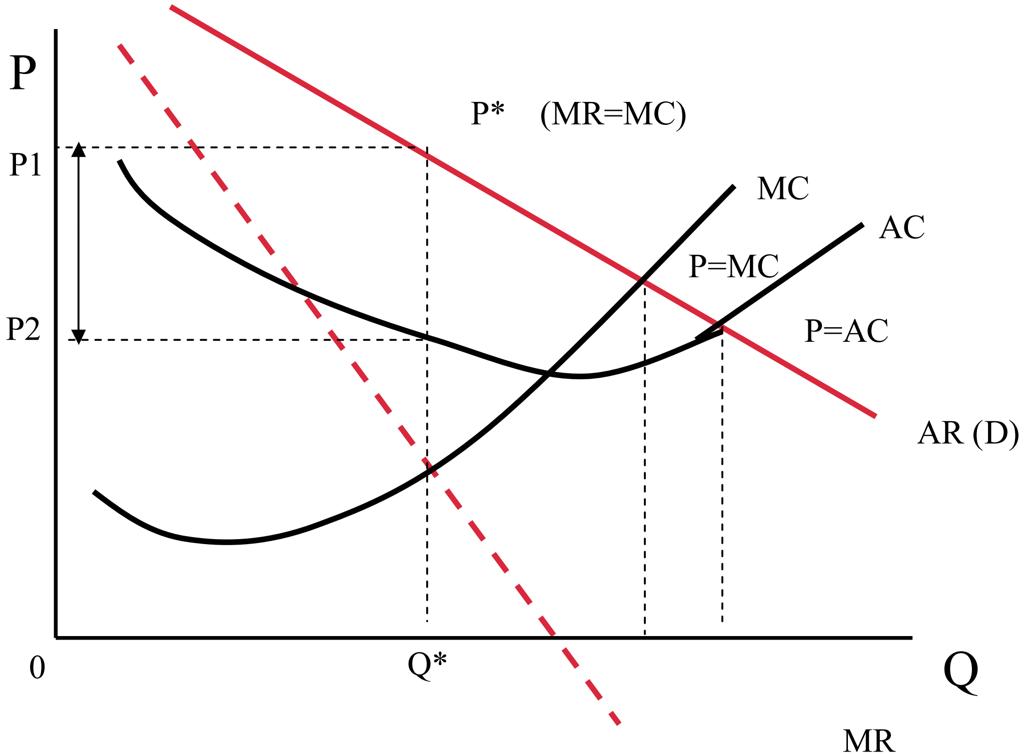
A utility is a good that maximises consumer consumption; therefore a utility industry is an industry that maximises consumer consumption by using that good or service provided. This is likely to be a homogenous good, which is provided by a company like BT or POWERGEN, as both these industries are referred to in the question.

The telecommunications industry has always been a monopoly, as other companies cannot enter the market, for example, other companies are at an immediate disadvantage because they do not have a telephone line in everyone's house. This is because this is a very expensive initial cost and companies are not usually likely to have the resources to be able to afford something like that. This was an important factor, this is why BT was controlled by the government before privatisation (Thatcher, 1970s), to control the monopoly.

This meant that BT had a natural cost advantage over competitors; this also meant that BT was the only firm in its industry (monopoly), which made the company more influential in terms of trading. It would benefit more from trading, because BT could benefit massively from economics of scale, and also other efficient economies.

This brings me to my next point, contestable markets. A contestable market is a monopoly (or as defined by the UK fair trading commission, a company with over 25% of the market share) that is not necessarily disadvantageous for the consumer. As I mentioned previously, the main influence for consumer benefits from a monopoly is the ability for the company to 'pass on' the money saved through economies of scale on the goods/services.

This is unlikely to happen in a monopoly, as entrepreneurs will use the profits, to increase in the profit margin. This is because the company has little or no competition to compete with, so the efficiency is not revealed. This means that monopoly firms will attempt to maximise profits:



As my diagram shows, the excess profit made is (P1 – P2). The profit maximising output is (0Q), where MC=MR.

The more important factors that stop other companies entering the market are:

- Legal requirements – these can be for example in water markets, there is a legal requirement by health and safety which will require certain sanitary procedures during water processing. This would also need to be checked frequently, to ensure consumer safety.
- As I mentioned briefly previously, the high costs to enter 'natural monopoly' markets, which can be the BT market, where already BT has a massive advantage of having a telephone line into everyone's house. This can mean that other companies are not willing to risk the investment to try and get into this market, so it will remain a monopoly.
- Patented, copyrighted products, this may mean that companies that need to enter the market with other industries are not allowed to use certain products to be able to compete fairly. For example, if the Hoover was copyrighted, and meant that other vacuum cleaners were illegal, no-one else could enter the 'Hoover market' for 8 or so years (depending on the duration of the patent).

BT can be linked with these factors, because all of these stages need to be accomplished, before there is any chance of entering the telecommunications industry.

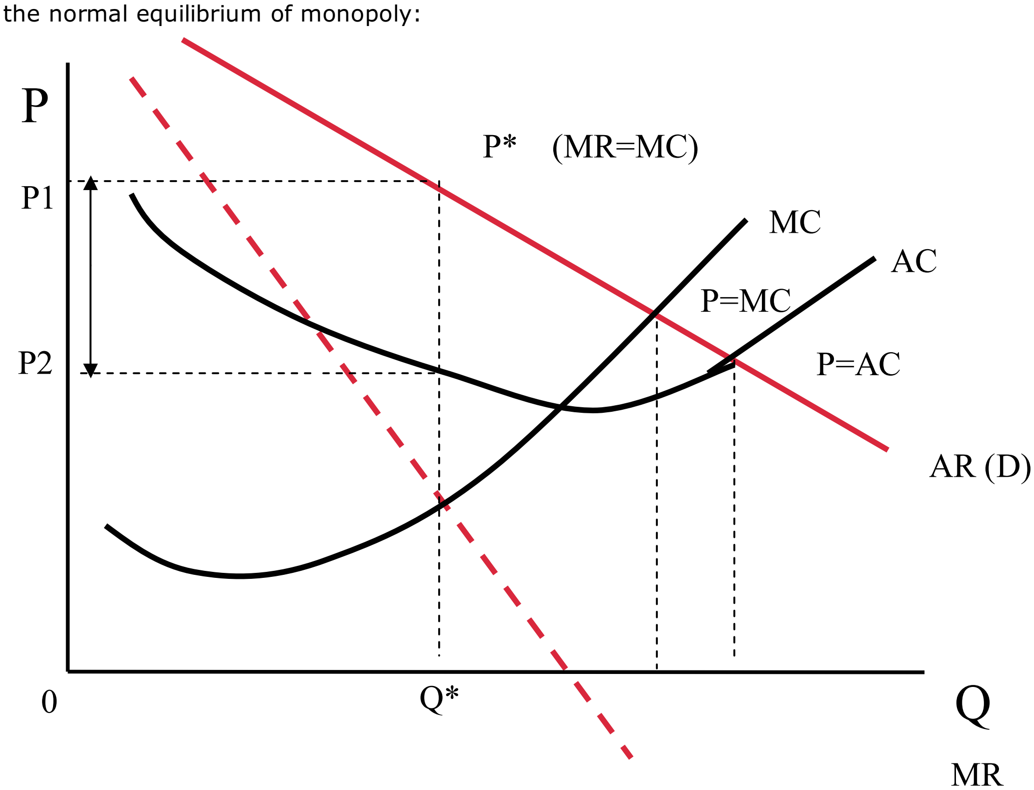
2 b)

Arguments AGAINST abolishing the agency OFTEL or OFWAT, which currently regulate a separate industry, both which has natural monopoly power – which was controlled by the government before privatisation.

If the regulator 'liberated' the market, which means that the monopoly market would have become efficient, without actually being in a perfectly competitive market. This would mean that the market would be efficient, and that the consumer would benefit from the use of OFTEL in the telecommunications industry. Examples of benefits are cheaper phone calls, and line charging prices as well as the introduction through development of new technologies such as ADSL and video on demand, which still have to be fully implemented.

OFWAT, if it had been liberated by the regulations, would mainly be cheaper to the consumer, as gas and electricity are homogenous goods, which cannot be improved or changed (theoretically). The single difference would be price to the consumer, and maybe also the level of service in fixing leaks, and also help lines.

Without the use of the regulatory agencies, OFTEL and OFWAT, monopolies would follow the normal equilibrium of monopoly:



As you would expect from a monopoly, there is a large profit excess from (P1-P2), this is because there is no other competition 'sharing' in the profits.

Arguments FOR abolishing agencies such as OFTEL and OFGAS, to start these companies are going to be expensive to the government, (educating and employing people to carry out the stressful work of making companies efficient). This in turn makes the companies involved less efficient, because it causes them time and money, to make sure that this agency is 'pleased', as they have to make sure all information about the company goes through this agency – which can be regarded as extra costs.

Not only do regulators cost money for the industries and government, but they also have the problem of 'regulatory capture'. This is where the regulator is not told all the information by the company, and the company gets away with either doing less work, or charging excess profits.

Monopolies may not always be unbeneficial for the consumer, because of economies of scale. The monopoly being the only supplier can gain huge economies of scale, and pass the profits it makes through efficiency – onto the consumer (which will result in cheaper prices). Monopolies such as BT (regulated by OFTEL) can develop new and improved technologies such as ADSL, which can benefit the consumer by utility (complete consumer satisfaction) – which is definitely positive for the consumer. Also, research and development programs are likely to finish faster, compared to a company in a competitive market, because the monopoly is likely to have more money to spend on such operations- if it does not have to be 100% concerned by low pricing.

These OFTEL, OFGAS, OFGEN, OFSTED agencies all regulate natural monopolies, that were previously owned by the government – which were all initially (and still currently) regulated by the government. It may actually be less efficient to the consumer, if these companies are competing with themselves, as they may not get the extra benefits as I have mentioned in previous points (R+D and economies of scale).

To summarise my arguments, for and against – the argument FOR illiminating such agencies such as OFGAS and OFTEL is weak and theoretical. The likeliness of firms getting more efficient without regulation is unlikely, even if the monopoly is liberated by the regulators. Events occurring after the monopoly is 'let lose', will surely result in small effort in making targets, with general laziness – with likely increased profits obtained. I am very sure that the monopoly will be less efficient without a regulator in the industry, as it will do what it wants, without having the consumer's interest as first priority, which it should. The only real solid assurance of making a monopoly efficient is to introduce more firms into the market, like what happened to British Rail. This is the only guarantee that will benefit consumers, but even these firms still require 'guidance', as there will still only be a few industries in the market.

As I said in my last paragraph, illuminating industries like OFGAS, OFGEN, and OFTEL is absurd. I feel that the continued regulation of these markets is essential, to maintain consumer interests. Monopolies are inefficient, natural monopolies, such as those controlled by these agencies are even less efficient if left on their own as they have barriers to entry. Such industries need to be policed, and make sure competitiveness is maintained within the industry as much as possible.

To conclude my summary, basically regulation should continue in the natural monopolistic markets, to maintain competitiveness and to ultimately benefit the consumer. There is a chance, even though I feel it to be pretty small – that unregulated markets may lead to increased efficiency through the single, major factor of economies of scale.

An alternative viewpoint would be that markets should be left alone, and not interfered in by the government; this theory is supported by the classical economists of pre-Keynesian times. This would mean that the market would be left under market mechanism, and therefore demand would exceed price, and prices would rise, until another firm entered the market, where prices would fall. The more firms entering, the more efficient that industry would be, and eventually the economy as a whole if market equilibrium was the answer.