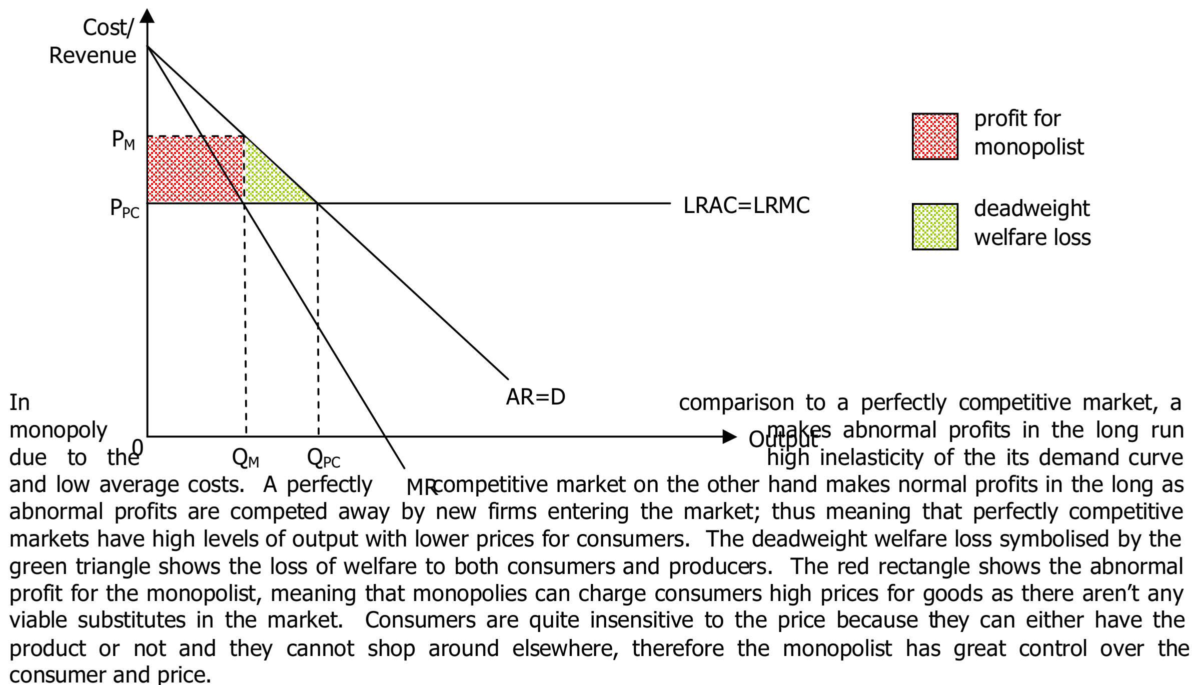
To what extent do you consider monopolies to be in the public interest?

A monopoly refers to a market in which there is a single seller of a good or service for which there are no close substitutes. The demand curve for the firm is the same as the demand curve for the market. Monopolies will profit maximise in the short and long run, however they may choose other pricing strategies to maintain market share or profit levels in the long run.



In comparison to a perfectly competitive market, a monopoly makes abnormal profits in the long run due to the high inelasticity of the its demand curve and low average costs. A perfectly competitive market on the other hand makes normal profits in the long as abnormal profits are competed away by new firms entering the market; thus meaning that perfectly competitive markets have high levels of output with lower prices for consumers. The deadweight welfare loss symbolised by the green triangle shows the loss of welfare to both consumers and producers. The red rectangle shows the abnormal profit for the monopolist, meaning that monopolies can charge consumers high prices for goods as there aren't any viable substitutes in the market. Consumers are quite insensitive to the price because they can either have the product or not and they cannot shop around elsewhere, therefore the monopolist has great control over the consumer and price.

However, a monopoly will find it hard to sustain such levels of abnormal profit in the long run simply because profits are a signal to other competitors that the current market being monopolised is one worth investing in. Firms wishing to diversify their range of products or to integrate horizontally into another market would be looking for companies making abnormal profits. If they had the sufficient financial capabilities to invest they would try and compete away the existing abnormal profits. An example of this is when Virgin entered the satellite television market to compete with Sky, whilst being a leading passenger flight carrier across the transatlantic. Virgin was a dominant player in an oligopolistic market until air transport rules changed to allow new airlines to obtain landing slots at popular airports; after which Virgin have diversified into the mobile, media and train market.

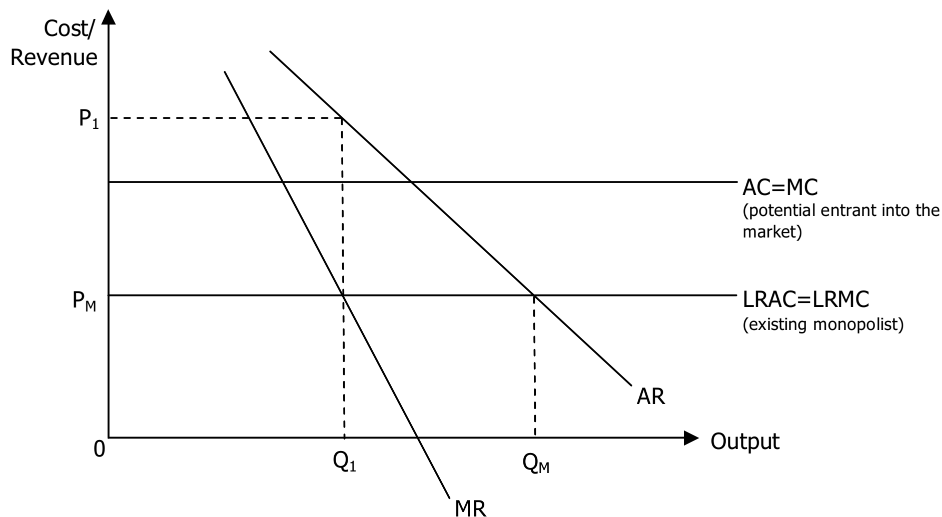
High barriers to entry are designed to block potential entrants from entering a market profitably. They seek to protect the power of existing firms and maintaining the abnormal profits. George Stigler, 1982 winner of the Nobel Prize for Economics, defined a barrier to entry as "a cost of producing that must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry." Some of these barriers occur naturally, whereas others are strengthened by monopolies in order to maintain or enhance their market position.

In a competitive industry, a single price is set to all of its consumers unless different price targeting strategies are employed. Yet, monopolists not only have the ability to charge a higher price than competitive firms supplying the same product, but they also have the ability to charge significantly different prices to different customers for the same product. By operating under such policies a monopolist can maximise its profits by charging a separate profit-maximising price for each type or group of customers, i.e. those on different income levels, professions, geographic locations or education levels. A prime example of this is how Transport for London subsidises local transport and buses for those in full time education and those who have an oyster card. This price discrimination arises with respect to a person's ability and willingness to pay.

Nonetheless, the ability to successfully engage in price discrimination depends on the degree of separation of markets, which measures how difficult and expensive it is for buyers to trade a product in between themselves. If a product is easy for buyers to resell, then buyers would have an incentive to buy in bulk and resell, opening up a new market with a price lower than what the monopolist was offering. One way of attempting to stop this new market from forming would be by cutting prices, so that there would be no incentive to undermine the price set by the monopolist. This way, consumers would benefit from a smaller loss in consumer welfare as well as lower prices. The monopolist would capture a larger market share as well as being able to maintain its market power.

The recent dispute broke out between Russia and Ukraine, when Russian gas monopoly Gazprom said it would cut gas supplies to neighbouring Ukraine unless a $1.3 billion is paid by the end of October. Previous such disputes had led to cuts in gas deliveries to Europe. This instance proves that large monopolies not only have control over consumers in their own country but could have an effect over a large number of countries. With a monopoly in a natural resource that is so widely used and needed, a monopolist could even force governments into submission.

Even though a monopolist can charge high prices to consumers to make abnormal profits, there are many reasons as to why a monopoly can be beneficial to the public. A monopolist is better positioned to exploit economies of scale such as research and development as it has large abnormal profits. Such improvements in existing products would allow it to continually maintain its market share by keeping consumers loyal with new cutting edge technology. Apple was in this position in 2005 when it had launched the iPod as well as legal music downloads – iTunes. Apple could enjoy monopoly profits – Apple's profits increased ten-fold from $137 million in 2003 to $1.3 billion in 2005 - without worrying about competition undercutting their prices or losing brand loyalty. Customers would happily buy their products as they would have nothing to compare prices with and would rather have the trend-setting gadget. Usurping their monopoly power and making abnormal profits would allow Apple to invest in research and development which is vital in an industry that is always changing with a high turnover of ideas. They would benefit from returns of scale as they would keep costs low which would please customers as that could be translated in lower prices.



In the diagram above, we assume that the incumbent monopolist has benefited from economies of scale such that its own long run average costs are lower than that of a potential entrant. If the monopolist maintains a profit maximising price of P_1, a market entrant could compete away the abnormal profits since its costs are lower than the prevailing price; at any price below P_M the potential entrant will make a loss. However, this assumes that monopolists are willing to pass on their benefits from economies of scale as lower prices for consumers. Yet, to stop potential entrants from undercutting their price, a monopolist would drop their price to just below the average costs of the potential entrant to ensure market share. Thus meaning consumers would always get a lower price than the original price set by a potential entrant.

Although monopolies have the means to invest in research and development, they might opt out of pushing the boundaries of technology and restrict innovation. One example is when Microsoft, who control 97% of the home operating systems market, buy out new ideas and shelf them rather than producing them. They essentially dictate the progression in technology for their market as they decide which ideas are put forward and made or which ones are shelved. Nevertheless restricted innovation is better than no technological progression because in a perfectly competitive market firms would be making a normal profit therefore they wouldn't have the means to invest in research and development, thus leaving the market stagnant and unable to move forward. At least with a monopoly, new products are consistently being made to satisfy demand.

A firm may have substantial domestic monopoly power but faces intensive competition from overseas producers, which limits their market power and helps keep prices down for consumers. Steel producer, Corus Steel which was

taken over by Indian group Tata Steel, is the biggest in the UK, however in terms of the global market, its net income in 2005 was a mere 13.4% of Mittal Steel's net income. Mittal Steel had sufficient funding to gain from inorganic economies of scale by merging with Arcelor to become Arcelor Mittal, the world's largest steel producer. Therefore a monopoly has to be taken in terms of the global market rather than its relative position in domestic market. With globalisation becoming ever more apparent as even tax returns are now being outsourced to large centres in India, global competition is fierce. A strong global competitor would have better implication for the macroeconomic outlook of the economy in terms of aggregate demand. There would be greater foreign direct investment in a thriving market in the UK increasing the investment component of aggregate demand. Exports would also increase as the demand for the products increased and the exports minus imports component of aggregate demand would also increase.

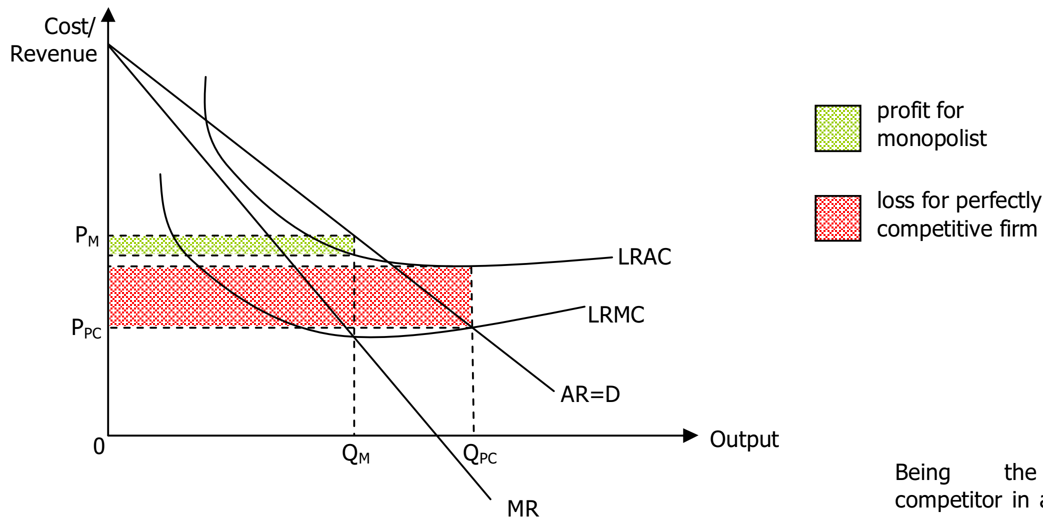
Monopolies were conventionally seen to be a market form in which government intervention was needed, until the Revolution in Monopoly theory was set out by American economist William Baumol in the 1980s. Baumol suggested that monopolistic players in contestable markets would be acting in their best interests by being as competitive as possible. When an idealised contestable market exists, the number of firms participating in the industry is irrelevant; firms, even monopolistic ones, are forced to act almost like they were in a perfectly competitive environment. The one major flaw with this argument is that a contestable market, regardless of the number of incumbents has an ease of entry and exit in the market, yet, this is not the case for a monopoly.

Monopolists tend to eventually lose their power, often in a surprisingly short time, despite their vigorous efforts to resist such loss. The firms themselves, however, tend to survive much longer, largely as a result of great market share, large production capacity, wealth and power that they accumulated during their period as a monopolist. Just as there are very strong incentives to create and maintain monopolies, strong forces exist to weaken and destroy monopolies. Joseph Schumpeter argued that monopolies are vulnerable to the process of creative destruction. As firms grow and suffer from x-inefficiencies, new competitors will either enter the market or create new products to undermine the monopolies' position. The long run instability of monopolies is evident in the fact that most laissez-faire economists believe that markers are self-regulating and will oscillate around an optimum level of output which is best for consumers. Whether this in achieved in a short time frame as firms flood into a market, or in the long run with new advancements in technology. For instance, BT's position as a monopolist in the telecommunications market has been destabilised by the development of the mobile phone and internet. One of its competitors, Vodaphone, is now a much bigger company than BT in terms of stock value, but didn't exist fifteen years ago.

Mathematician Harold Hotelling theorised that there were cases in which a monopoly can provide benefits to the consumer. In his prime example he noted that if there was a beach where customers are distributed evenly along it, an entrepreneur setting up an ice cream stand would naturally place it in the middle of the beach. A competing ice cream seller would do best to place his competing ice cream stand next to it to gain half the market share, but two stalls right next to each other is not an ideal situation for the consumers on the beach. A monopolist who owns both stalls on the other hand, would distribute his ice cream stalls some distance apart so consumers would have to walk a shorter distance to get their ice cream.

Different types of monopolies have different advantages to consumers. For example, a government monopoly is one in which a government agency is the sole provider of a particular good or service and competition is prohibited by law. In many countries including the UK, the postal system is run by the government with competition forbidden by law in some or all services. It is usually distinguished from a government-granted monopoly in which the government grants a monopoly to a private individual or company. Government-granted monopolies are a form of coercive monopolies like cable television and water providers in many municipalities in the USA, exclusive petroleum exploration grants to companies such as Standard Oil in many countries, and historically, lucrative colonial "joint stock" companies such as the Dutch East India Company, which were granted exclusive trading privileges with colonial possessions under mercantilist economic policy.

A natural monopoly occurs in an industry where long run average cost falls over a wide range of output levels such that there may be room for only one supplier to fully exploit all of the internal economies of scale, reach the minimum efficient scale and therefore achieve productive efficiency. The major utilities such as gas, electricity and water are strong examples because of the huge fixed costs of building and maintaining nationwide networks of cables of pipes. The retail market for the supply of gas and electricity to homes and businesses is fully competitive; however, the businesses which transport gas and electricity to the final consumer are closer to being natural monopolies. The natural monopoly, through exploitation of economies of scale, can in theory undercut any actual or potential rivals purely on the grounds of cost. If the monopolist loses market share, there is a risk that smaller-scale suppliers will produce at a higher average total cost which would represent a waste of scarce resources. Forcing such a company to price at marginal cost would also inflict inevitable losses and threaten the long term financial viability of the supplier.



Being the only competitor in a market can be easily spotted if behaving anti-competitively, as OFWAT, the economic regulator, plans to fine Thames Water, £11.1million (0.8% of 2006-07 turnover) for failing to provide it with robust information and £1.4million (0.1% of 2005-6 turnover) because poor processes and systems meant that customers received poor service. Therefore to ensure that that they aren't fined, monopolists vary their price strategies for different products, by perhaps using a revenue maximising strategy in which they produce at the level of output at which marginal revenue equals zero. Alternatively, they could sales maximise where average cost equals average revenue. Both these strategies would lead to a fall in the price for the consumer.

The essential argument against monopolists is that they are free to charge a high price to consumers and thus make large abnormal profits. Yet, with strict regulation agencies set up, any company can be fined up to 10% of their revenue thus meaning they would be eager to cut prices to keep their consumers satisfied. Even though there aren't any other incumbents in the market, monopolists behave as if they were in a competitively perfect market, investing money into research and development to further the progress of their products. Given that many monopolies do not have a guaranteed run of abnormal profits they would always have to think of new ways to ensure that other competitors cannot join the market. They are the ones in turn that make the major advancements in science and technology, or in fact can buy out good ideas to guarantee that an innovative idea has enough financial backing to be produced.

As said by Milton Friedman, "markets work, governments don't". By leaving a monopoly market to grow by itself means that the consumer will benefit largely in the long run even if they have to pay a slightly higher price in the short run.