

Government Intervention

Governments intervene in markets to **promote competition, prevent the abuse of market power and protect consumers, suppliers and employees.**

Government Intervention to Control Mergers

The **Competition and Markets Authority (CMA)** is the UK's main competition regulator. Its role is to promote competition and prevent firms gaining excessive market power that could harm consumers through **higher prices, reduced choice or lower quality.**

One way of controlling monopoly power is therefore to **prevent it developing in the first place.**

Merger Control

The CMA monitors mergers and takeovers that could significantly increase a firm's market power. A key concern is whether a merger would result in a **substantial lessening of competition (SLC).**

The CMA pays particular attention to where a merger could create or strengthen a firm with significant market power, with **25% market share** acting as an important benchmark.

Market concentration $\uparrow \rightarrow$ competition $\downarrow \rightarrow$ market power $\uparrow \rightarrow$ prices potentially $\uparrow$ + choice/quality $\downarrow \rightarrow$ consumer welfare $\downarrow$

The CMA can:

- **Approve the merger** if there are no significant competition concerns
- **Block the merger** if it is likely to substantially reduce competition
- **Approve with conditions**, such as requiring the firm to sell assets to limit its market power

This allows potentially beneficial mergers to take place while limiting their anti-competitive effects.

For example The CMA blocked the **Sainsbury's and Asda** merger because the combined entity would hold a **31.4% national grocery market share** .

Government Intervention to Control Monopolies

Governments may regulate existing monopolies to prevent the **abuse of monopoly power.**

Without intervention, a profit-maximising monopoly may restrict output and charge higher prices, reducing consumer surplus and overall economic welfare.

Price Regulation

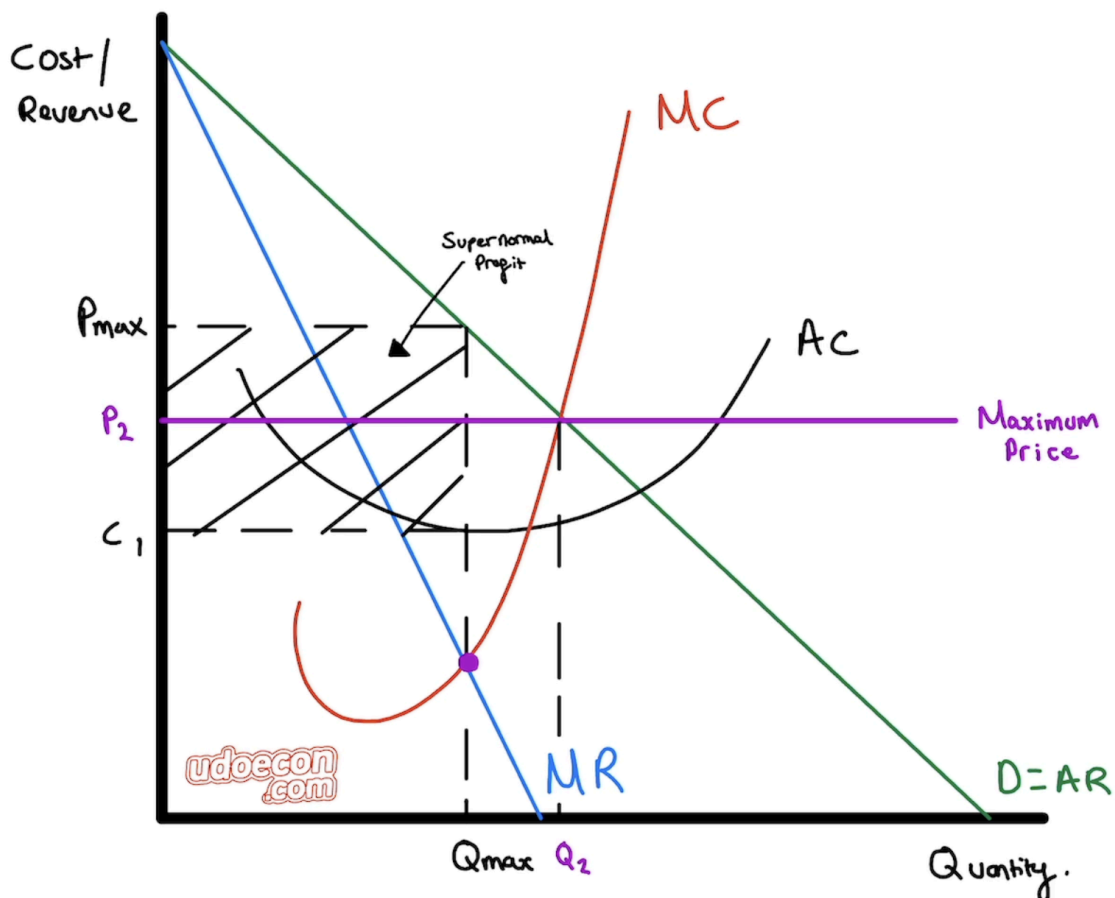
A regulator can impose a **maximum price** on a monopolist to prevent excessive prices.

Monopoly power $\rightarrow$ profit maximisation at $MC = MR \rightarrow$ output restricted + price $\uparrow \rightarrow$ consumer surplus $\downarrow$ + allocative inefficiency

The regulator could set a maximum price at the **allocatively efficient level where $MC = AR$**

For example Ofgem Energy Price Cap, Ofgem sets a maximum price per unit of gas and electricity for over 20 million households.

Maximum price $\downarrow \rightarrow$ price $\downarrow$ + output $\uparrow \rightarrow$ consumer surplus $\uparrow \rightarrow$ allocative efficiency $\uparrow$



For natural monopolies, regulators may use **RPI - X price-cap regulation**:

Maximum price increase = $RPI - X$

For example, if inflation (RPI) is 5% and $X = 2\%$, the firm can increase its price by a maximum of **3%**.

Price caps can also encourage firms to reduce costs:

Costs $\downarrow$ by more than $X \rightarrow$ profit $\uparrow \rightarrow$ incentive to improve productive efficiency

For example Ofcom Telecoms RPI – X Regulation . Ofcom applied RPI – X price caps to BT's Openreach network infrastructure, forcing broadband wholesale prices to fall by up to **10% in real terms annually** .

Profit Regulation

Regulators may directly limit the **supernormal profit** a monopoly is allowed to earn.

Profit regulation → supernormal profit restricted → exploitation of consumers ↓

Quality Standards

Monopolies face limited competitive pressure and may increase profits by reducing the quality of their goods or services.

Regulators can therefore impose **minimum quality standards** that firms must meet.

Quality standards → ability to cut quality ↓ → consumer protection ↑ → service quality maintained

For example Ofcom sets a legal quality standard requiring **93% of First Class mail** to arrive within one working day, fining Royal Mail **£5.6 million** when performance dropped .

Performance Targets

Regulators can set measurable **performance targets** to improve the quality and reliability of services.

For example, NHS Target for **95% of emergency department patients** to be seen within 4 hours .

Government Intervention to Promote Competition and Contestability

Governments can increase competition by **reducing barriers to entry and encouraging new firms to enter markets**.

Greater contestability → threat of entry ↑ → competitive pressure on incumbent firms ↑ → prices ↓ + efficiency/quality ↑

Promotion of Small Businesses

Governments can support **small and medium-sized enterprises (SMEs)** through:

- Tax incentives and subsidies
- Improved access to finance
- Reduced regulation and red tape

Support for SMEs ↑ → barriers to entry ↓ → new entrants ↑ → competition ↑ → market power of incumbent firms ↓

For example, the UK's Start Up Loans scheme lent by **over £1 billion to more than 100,000 SMEs** that were rejected by high street banks.

Deregulation

Deregulation involves reducing or removing government rules and restrictions within an industry.

Deregulation → barriers to entry ↓ → contestability ↑ → threat of entry ↑ → incumbent firms forced to become more competitive

For example, removing Royal Mail's legal monopoly enabled challenger firms (like DPD and Evri) to enter, capturing **over 40% of the UK parcel market**.

Competitive Tendering

Competitive tendering occurs when private firms compete to win contracts to provide goods or services on behalf of the government.

Competitive tendering → firms compete for contract → incentive to reduce costs + improve quality → productive efficiency ↑ → government expenditure potentially ↓

For example the NHS uses competitive tendering to push down prices for services such as cleaning and catering .

Privatisation

Privatisation is the transfer of assets or firms from the **public sector to the private sector**.

Private firms face a greater profit incentive and potentially greater competitive pressure.

Privatisation → profit incentive ↑ + competition potentially ↑ → incentive to cut costs ↑ → productive efficiency ↑

Competition may also encourage firms to better respond to consumer preferences, potentially increasing **allocative efficiency and quality while reducing prices**.

For example, **BT was privatised in 1984**.

Advantages:

- Profit motive → stronger incentive to cut costs → productive efficiency ↑
- Greater competition → prices ↓ + quality ↑
- Greater incentive to innovate → dynamic efficiency ↑
- Sale of state-owned firms → one-off government revenue ↑ . For example The UK Treasury raised **£1.98 billion** in a single year from selling off state shares in the postal service.

Disadvantages:

- Privatisation may simply create a **private monopoly** → market power remains → prices ↑ + output ↓
- Profit maximisation may come at the expense of **service quality or social welfare**
- Cost-cutting may involve **job losses or lower wages**
- Government loses future profits from the firm after receiving only a **one-off payment** from its sale

Government Intervention to Protect Suppliers and Employees

Governments may intervene where firms possess **monopsony power**, allowing dominant buyers to exploit suppliers or workers.

Protecting Suppliers from Monopsony Power

A **monopsony** is a market where a buyer has significant buying power.

Monopsony power ↑ → buyer able to negotiate lower prices from suppliers → supplier revenue/profit ↓ → potential exploitation

Governments can protect suppliers through:

- Regulators monitoring buying practices . For example The UK GCA regulates top supermarkets penalising non compliance with fines up to **1% of turnover**.
- Minimum prices that buyers must pay . E.G Supermarket Minimum Milk Price Cap .

Protecting Employees

Firms with monopsony power in labour markets may be able to pay workers **below the competitive equilibrium wage**.

Governments can protect workers through:

- National Minimum Wage legislation For example in 2024 set at £11.44/hr .
- Rules on working hours and employment conditions For example 48 hour working week

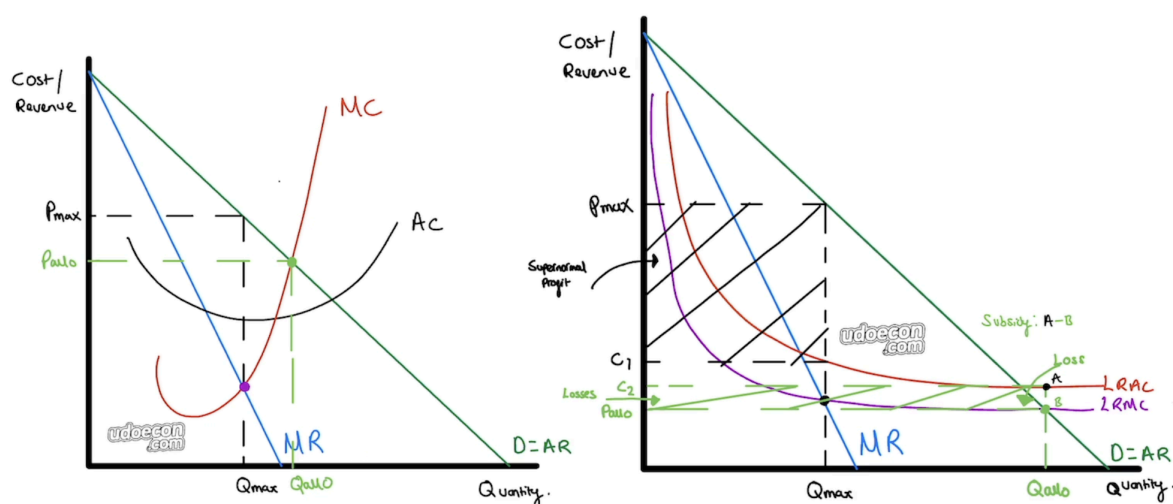
Nationalisation

Nationalisation is the transfer of a privately owned firm or industry into **public sector ownership**, giving the government control over its operation.

A major argument for nationalisation is that the firm's objective can shift away from **profit maximisation towards social welfare**.

Private monopoly → profit maximises at $MC = MR$ → higher P + lower Q

Nationalised firm → greater focus on social welfare → output moves towards $MC = AR$ → price ↓ + output ↑ → allocative efficiency ↑



On a monopoly diagram, the private profit maximising firm operates at **Q_{max} , P_{max}** , where $MC = MR$. A nationalised firm may instead operate at **Q_{allo} , P_{allo}** , where $AR = MC$ and allocative efficiency is achieved.

On a natural monopoly diagram, the private profit maximising firm operates at **Q_{max} , P_{max}** , where $MC = MR$. A nationalised firm may instead operate at **Q_{allo} , P_{allo}** , where $AR = MC$ and allocative efficiency is achieved. This will therefore mean the nationalised firm is operating at a loss thus to prevent shutting down it will require a subsidy per unit of $A-B$.

For example the nationalization of British Rail in 1948.

Advantages of Nationalisation

- **Social welfare prioritised over profit** → government can increase output from **Q_{max} to Q_{allo}** → price falls from **P_{max} to P_{allo}** → consumer surplus ↑
- At **Q_{allo} , $AR = MC$** → **allocative efficiency achieved** → deadweight welfare loss eliminated
- Essential services can be maintained even where they are **not profitable** → accessibility ↑ . E.G NHS
- Natural monopolies remain as a single provider → avoids **wasteful duplication of infrastructure** E.G Network rail preventing parallel railway tracks .
- Government can account for **positive externalities**, e.g. greater public transport provision → congestion + pollution ↓

Disadvantages of Nationalisation

- At **Qallo**, the diagram shows **AC > AR** → firm makes a loss → Burden on govt finances
- Government may therefore need to provide a **subsidy equal to the gap between AC and AR** → government spending ↑ → opportunity cost ↑
- Weaker **profit motive** → incentive to minimise costs ↓ → **X-inefficiency** ↑ + **productive efficiency** ↓ **E.G BT pre 1984 (Pre-privatization)**
- Less competitive pressure and lower supernormal profit → incentive to innovate/invest ↓ → **dynamic efficiency may** ↓