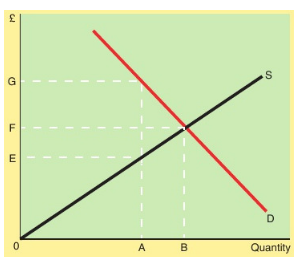
Chapter 51: Monopsony 2016-Nov-1

- *Monopsony*: only one buyer in the market
  - *few* monopsonists in UK
  - Example: Network Rail (maintenance of rail track), Government for hiring teachers
- *Characteristics* of a monopsonistic market
  - all characteristics of *monopolistic* market except the difference between buyers and sellers
  - sellers in the market are not able to sell their product outside the market
  - in this chapter, monopsonists are assumed to be *profit maximisers*
- Equilibrium price and output
  - *economic theory* suggests that monopsonists will pay *lower prices* to suppliers than in a *competitive market* $\Rightarrow$ suppliers will supply *less* to the market
  - with monopsony, *equilibrium price* and *quantity* will be *lower* than if the market were perfectly competitive



  - in market was *perfectly competitive*, equilibrium would be at $S = D$ (equilibrium price would be OF, equilibrium quantity would be OB)
  - in a *monopsonistic market* (e.g., monopsonistic supermarket chain) consumer may *beat down the prices* (price is set at OE, and qunatity offered by suppliers is at OA) (*see* example in book on organic parsnips)
  - the *amount* that the monopsonist will buy is determined by the $MC = MR$ rule
  - if supply curve is *upward sloping*, the monopsonist has to pay a higher average price if it wants to buy more from market
  - the MC of buying more is higher than the average price or cost (see Table 1 p 291)

  - increase in price leads to large increases in total costs for the supermarket

Table 1

Quantity of organic parsnips Million tonnes	Average price or cost £	Total cost £ million	Marginal cost per unit £
0	0		
1	2		
2	4		
3	6		

Table 1

Quantity of organic parsnips Million tonnes	Average price or cost £	Total cost £ million	Marginal cost per unit £
0	0	0	
1	2	2	2
2	4	8	6
3	6	18	10

  - the MC per unit rises from 2 pounds for the first one million units to 6 pounds for the second million units and 10 pounds for the third million units ⇒ *MC rises much faster than AC*

- Costs and benefits (of monopsony to both firms and consumers)
  - *monopsonist*
    * gains *higher profits* by being able to buy at lower prices
    * reduces its *costs* of production, leading to an *increase* in overall output (because of a shift downwards in its marginal cost curve)
    * while output is likely to increase, *supply of inputs over which the firm has monopsony power* will fall
  - *suppliers*
    * *loose out* from a monopsony: prices paid for their goods & services will fall
    * Examples: farmers supplying to (monopsonistic) supermarket, workers supplying their services to (monopsonistic) employers
    * Consequences: farmers may be *forced out of market*
  - *customers*
    * impact on customers depends on *many factors*
    * *lower costs* on monopsonist may be passed on to customers in *lower prices*
    * *restrictions in supply* may occur (*price elasticity of supply* will play a role)
  - *employees*
    * impact on employees is *uncertain*
    * monosponist will purchase *less goods and services* from the market ⇒ unclear whether *more*, *fewer* or *same* employees will be employed by the monopsonist

- *Bilateral monopoly*: case where a monopsonist faces a *monopolist* in the market (one buyer and one seller in the market)
  - Example: single *buyer of labour* (government for teachers) faces a single *seller of labour* (trade union representing all teachers)

  - *economic theory* predicts that prices and quantity demanded and supplied will be higher than in a market where a monopsonist faces *many sellers*

- *Monopsony power*: when monopsonist has large enough buyer in the market to be able to change the price at which they buy buy from suppliers
  - the more a firm buys (as share of total sales) the more monopsony power it is likely to have
  - the more a firm buys from a single supplier, the greater its monopsony power
  - the greater the monopsony power, the less able are suppliers to find other customers

- Review questions (pick the right answer and explain in detail!):
  - Severn Trent Water is a local monopoly supplier of water in the Midlands. In 2008 it was fined by Ofwat, the water regulator, and required to reduce its planned charges. The most likely effect of this decision would be to
    - ☐ increase producer surplus
    - ☐ substantially lessen competition
    - ☐ increase monopsony power
    - ☐ satisfy the shareholders
    - ☐ increase consumer surplus
  - Two petrol stations located on the same main road are struggling to stay in business in the face of aggressive competition from local supermarkets. They tacitly agree not to compete on price but offer loyalty schemes. Which **one** of the following conditions would make their survival more likely?
    - ☐ Increasing willingness of consumers to use loyalty schemes rather than respond to price alone
    - ☐ Tighter government regulation to prevent collusion
    - ☐ Increasing monopsony power over petrol suppliers by local supermarkets
    - ☐ Demand for petrol becoming more price elastic
    - ☐ Reductions in barriers to entry into the petrol retailing market