Monopsony

# Presentation 1 - Intro and Equilibrium

Take notes. Your notes should cover the following questions:

* What is meant by a Monopsony?
* What is the impact of a monopsony in the market? Diagram?
* What are the limitations of the analysis of the impact of monopsony?

# Article Task: Model Economic Models

**Instructions:**

* Read, highlight and annotate the article
* Complete the table with the positive and negative impacts of Monopsony you find.

**Article:**

*The Apple iEconomy: a positive or negative development?*

The iPod: the new standard. It used to be cars –even refrigerators or air-conditioning that was the common measure of household standards. Now, with [51% of American households (that’s 55 million homes!) owning at least one Apple product](http://www.cnbc.com/id/46857053), it seems that having any device created by Steve Jobs is quickly becoming the new standard. Since Apple Inc. was [first incorporated](http://investor.apple.com/faq.cfm?FaqSetID=6) on January 3rd, 1977in Cupertino, California, the company has grown to become one of the most powerful and successful companies in the world, achieving a pace of innovation nearly unmatched in modern history. Apple’s line of computers and consumer electronics, including the iPhone and the ubiquitous line of iPods, have revolutionized our interaction with technology so much so that the company has been [named as the most admired in the world  for the past five consecutive years](http://money.cnn.com/magazines/fortune/most-admired/2012/snapshots/670.html?iid=splwinners) by Fortune magazine. The problem with Apple’s success however, is that it seems to be achieving it like many other successful companies: outsourcing labour to the cheaper Asian markets and maximizing profits by cutting expenses to the bare minimum. We’ve heard this story many times before; big powerful company wants lower costs so big powerful company applies pressure to their suppliers who, in turn, exploit their workers.  But what’s Apple’s story?

If anyone was searching for evidence to counter the benefits we have received from Apple’s products, they really could just follow the company’s supply chain, a feat made easier now that Apple has released it’s list of [2011 suppliers](http://images.apple.com/supplierresponsibility/pdf/Apple_Supplier_List_2011.pdf). It all [starts](http://query.nytimes.com/gst/fullpage.html?res=9C02E2D71438F935A15752C0A9649D8B63&ref=charlesduhigg&pagewanted=all) when officials from companies around the world arrive in Apple’s Cupertino offices, or invite Apple executives to visit their foreign factories. These companies are all vying for one goal: to become a supplier. The process can be broken down into two parts: suppliers specify the costs of their labour and the parts, and then Apple calculates how much it will pay for each part. Most suppliers are allowed only the slimmest of profits. As a result, suppliers often try to cut corners in order to maximize *their*profits and keep their lower-cost business model competitive and attractive to Apple. With so many suppliers clamouring for a piece of Apple’s pie, the company has the power to ensure that these suppliers are giving them the lowest price possible, lest they pick another supplier who could offer an better and cheaper alternative.

With its market power and ability to dictate terms to its electronic components suppliers, Apple can be thought of as a monopsonist. If you merely mention that Apple’s production operates in an imperfectly competitive form, any economist can automatically tell you that the company is not operating in a way that achieves the highest possible gain to society. Instead of paying for a quantity that would be considered socially optimal, Apple purchases less from its manufacturers than what it need to match the demand for Apple products. At this quantity (Q\*), the company should be paying its suppliers at PA, but they instead pay the lowest price they can – P\*. That economically dreaded triangle that forms, called deadweight loss, is the clearest indicator of economic inefficiency; further transactions that could have occurred do not and supplier and buyer welfare is not maximized. All of this is done because Apple wants to maximize its profits, and since they are preventing mutually beneficial trade with its suppliers from occurring, Apple has generated a market failure.

At this point, I don’t think any of you are clutching your iPods in despair over the deadweight loss that this device has incurred, which makes sense since no one is really going to start a protest accusing the whole institution of impeding the global economy because the company stole its suppliers’ theoretical economic surplus. If anything *has* riled up consumers against Apple, it would be the recent string of news regarding injuries, suicides, and [factory explosions](http://news.yahoo.com/shady-dust-explosions-apple-factories-135842358.html) which have all exposed the public to the troubling practices inside many of Apple’s suppliers. Fifteen Foxconn workers threatened a mass suicide in order to protest the working conditions of the factory. If you own an Apple product, chances are [it got its start](http://www.foreignpolicy.com/articles/2010/06/28/the_geopolitics_of_the_iphone?page=full)  in one of the Chinese factories owned by Foxconn, a Taiwanese tech company who work closely with Apple to assemble the iPhone, the iPad, and various Macintosh computers. Compared to our standards, [conditions in these factories are dismal](http://query.nytimes.com/gst/fullpage.html?res=9C02E2D71438F935A15752C0A9649D8B63&ref=charlesduhigg&pagewanted=all). The 230,000 employees often work 12 hour days, 6 days a week. The average worker earns less than $17 a day, and over a quarter of these employees live in the cramped company barracks. As workers fulfil their various jobs, assembling the numerous i-gadgets or cleaning screens, aluminium dust fills the air. The lack of proper ventilation only adds to the health problems of the workers, and was the reason behind the two aluminium dust explosions in Foxconn and another Apple supplier.

To Apple’s credit, they are doing some part to deal with these issues. They recently launched a supplier responsibility initiative, which is why the list of suppliers was released in the first place. This initiative involves the implementation of their [supplier code of conduct](http://www.apple.com/supplierresponsibility/) which details standards on labour issues, safety protections and other topics. Apple audits its suppliers regularly and when abuses are discovered, the company demands corrections. According to the company, these audits have found consistent violations of Apple’s [code of conduct](http://query.nytimes.com/gst/fullpage.html?res=9C02E2D71438F935A15752C0A9649D8B63&ref=charlesduhigg&pagewanted=all). In 2007, two-thirds of the thirty-six plus audited suppliers indicated that employees regularly worked more than 60 hours a week. In extreme cases, 15 year-olds were hired, and records were falsified. Over the next three years, Apple conducted more than 300 audits, and each year, more than half indicated that employees were working extended overtime. Last year, of the 229 audits conducted, 93 facilities still had workers exceeded the 60-hours-a-week work limit.

Notice a pattern? This lack of change might be [explained](http://query.nytimes.com/gst/fullpage.html?res=9C02E2D71438F935A15752C0A9649D8B63&ref=charlesduhigg&pagewanted=all) by a former executive involved in Apple’s supplier responsibility group: ”Noncompliance is tolerated, as long as the suppliers promise to try harder next time.” For the suppliers, following Apple’s supplier’s code obviously means higher expenses. Since the code isn’t enforced strongly, there’s no incentive for suppliers to change their ways except maybe for the sake of morality. Oftentimes in business, that’s hardly a strong enough incentive. ”The only way you make money working for Apple is figuring out how to do things more efficiently or cheaper,” [states](http://query.nytimes.com/gst/fullpage.html?res=9C02E2D71438F935A15752C0A9649D8B63&ref=charlesduhigg&pagewanted=all) an executive at one company that helped bring the iPad to market. ”And then they’ll come back the next year, and force a 10 % price cut.” This only perpetuates the working conditions as companies replace expensive chemicals with cheaper and more toxic alternatives, and force employees to work faster and longer.

Working conditions aren’t the only underlying issues with Apple’s supply chain system.  For Americans, it’s the fact that, of all the people needed to engineer, build, and assemble Apple’s products; barely any of them work for the United States since they are all outsourced to the cheaper Asian factories like Foxconn. For the U.S., that’s [700,000 jobs](http://www.nytimes.com/2012/01/22/business/apple-america-and-a-squeezed-middle-class.html?pagewanted=all)  that could alleviate its job crises and high unemployment levels

But does all this information and statistics actually show that Apple has done more harm to the global economy than it has done good? The benefits that Apple has provided to the world and its economy is more obvious than the drawbacks. We can not deny that Apple has transformed our relationship with technology. The multi-functioning aspects of Apple’s products have given its consumers greater convenience and functionality, raising our standards for what we expect from any of our electronic devices. Music and media interaction has evolved into a whole other level; iPods and iTunes have changed the *way* in which we listen to music by adding the feature of instant access. Visual communication production was changed when the Mac computers allowed typesetting, retouching, illustration, and film editing to become available to the average consumer.

Apple’s innovations and designs have paved the way for further technological development –either through the competition generated or the firm’s own motivation to outdo themselves, that has benefited society as a whole. These spill over benefits created indicate that there are not enough Apple products out in the market to meet the amount that society wants. With all that’s said and done, we still demand more of their products because they’ve truly made our lives better. The cheap labour and the pressure placed on suppliers where the biggest criticism of Apple lies? That [sounds an awful lot like what other companies such as Walmart is doing](http://www.pbs.org/wgbh/pages/frontline/shows/walmart/view/)), and the [millions of Walmart’s daily consumers](http://www.npr.org/2011/09/13/140430202/is-walmart-a-magnet-for-american-mayhem) are all snapping up the lower-cost products without consideration for any of the implications. In terms of Apple’s manufacturing process, the company also doesn’t stray to far from its less mighty, but still successful competitors. It’s estimated that [40% of the world’s consumer electronics are produced in Foxconn’s factories](http://www.economist.com/blogs/freeexchange/2012/01/supply-chains), including products from brands such as Amazon, Dell, Hewlett-Packard, Nintendo, Nokia and Samsung. So why are we all so hung up on Apple’s misgivings? Maybe the answer is because Apple *is* good for the economy. So we expect it to do better; in short, we expect Apple to achieve maximum greatness for the world. With recession-proof [annual earnings of $108 billion](http://www.apple.com/pr/library/2011/10/18Apple-Reports-Fourth-Quarter-Results.html), all of Apple’s success seems to oblige them to do even more, especially for their home economy. That’s because Apple is “[the quintessential example of the Yankee magic](http://www.theglobeandmail.com/report-on-business/commentary/chrystia-freeland/americas-apple-economy-widens-the-winner-loser-gap/article2082436/) that everyone from Barack Obama to Michele Bachmann insists will pull America out of its job crisis.” Apple may be a technological pioneer, but that doesn’t mean it’s holding the key to saving the American economy, waiting for the perfect moment to release the ultimate iSolution, perhaps through a press conference in San Diego.

First off, just as the previous graph indicates, the positive externalities generated from the firm’s products means Apple needs to supply more of its gadgets, and they are already having [trouble meeting that current demand](http://www.computerworld.com/s/article/9224931/Expect_shortages_of_new_iPad_say_analysts). Given that Asia, with it flexible labour and environmental rules, and bountiful population of unskilled workers can’t churn out enough suppliers or workers to meet up with the demand, there’s not much to be said about the U.S.  Even if Apple was able to find hundreds of thousands of workers willing to work a low-skill job, the only logical move in opening *some* manufacturers in the U.S. is to move the *entire* supply chain there, which is not easily replicable in the short-run. A supply chain in America would increase labour and production costs, which would ultimately jack up the price of any Apple product. Now, you’ll actually have a protest accusing the whole institution of impeding the global economy.

Since we’re evaluating Apple’s contribution to the world’s economy, it actually doesn’t matter that there’s a lot of foregone job possibilities in the U.S. Other countries have those jobs and opportunities, and that benefits the global economy through theirs instead. Of course, conditions at most of these manufacturers are far from ideal, but this negative development can’t be entirely blamed on Apple. Other companies employ either the same factories, or other manufacturer that use similar tactics. Apple’s fault does not lie in the fact that they are mistreating their workers, it’s more because they are not using their full market power to make other companies, like their suppliers, change their ways. At the end of the day, no matter how an Apple product is created, the output from these suppliers still contribute something to the economy, even if some of these conditions are less than ideal.

As the iPod travels through its production & supply chain, it attributes value to each of the countries that its 451 parts come from. When the [research](http://www.tuaw.com/2012/04/02/how-america-benefits-from-apple/) was conducted, the $299 U.S. retail value of the iPod can be broken down like this: $73 from Toshiba’s hard drive, $20 from the display module, $13 for the video/multimedia processor and controller chip, and the assembly at $4. Countries where any of Apple’s devices are created and assembled, like Japan, China, and Korea, all have extra value added into their economy because of Apple. The U.S. benefits the most from this; with the iPod, $163 of its value was captured by Apple’s conception and design of the product, and the distribution, retail, and domestic components from other American companies and workers.

If that value-added wasn’t enough and the U.S. still wants to complain about the fact that Apple hasn’t been an effective driver of job growth at home, they should look at it this way: Apple has still generated 46,000 direct jobs in their home country. Indirectly, the iOS app economy has created about [210,000 jobs](https://www.tuaw.com/2012/04/02/how-america-benefits-from-apple/). Add in the figures from the huge number of accessory manufacturers that have sprung up in the U.S., and the employment impact is even greater. So really, if you combine their technological innovations, employment generation, massive sales, and you know, the fact that they have allowed you to listen to music without hauling a boombox on your shoulder (a reduction in muscle strain injuries does benefit the economy in some form), Apple has been a positive development for the world.

We may be holding on to the negative aspects of Apple’s growth because we consider Apple the modern variation of the American dream, just reformatted into a glossier, sleeker, and cleaner package. The Apple logo conjures up an image of thinkers and entrepreneurs that have used innovation to propel us further into the future than we ever thought possible. And because of this idea, we also expect them to champion a human rights labour movement and reconstruct the American manufacturing industry. Whether they do so or not, you can’t deny that they have impacted our lives and the economy at a greater degree than any of the negative developments the company is associated with. And that’s clearly the anodized-aluminium case with the iPod you pop in your earphones to listen to music with.

**Impacts of Monopsony**

|  |  |
| --- | --- |
| Positive | Negative |
|  |  |

# Presentation 2 – Responses to Monopsony

Take notes. Your notes should cover the following questions:

* How might suppliers and workers respond to monopsony power?
* How can governments intervene in the case of a monopsony?

# Pairs Task: Reducing Monopsony Power

**Instructions:**

* Work in pairs to summarise the articles and how the power of monopsonies can be reduced

**Articles:**

1. **Supermarket suppliers get new adjudicator for disputes**

*An adjudicator to resolve disputes between supermarkets and their suppliers is to be established under plans announced by the government.*

The Groceries Code Adjudicator (GCA) is an independent office within the Department for Business, Energy and Industrial Strategy. but will be independent, the government said. It will investigate complaints from UK and overseas suppliers about the way they are treated by supermarkets. Food suppliers can complain anonymously about:

* Supermarkets demanding price cuts to keep contracts
* Suppliers being asked to fund price promotions such as BOGOF
* Firms having to pay a lump sum in order to keep their products on shelves
* Late payments
* Unsold products being returned to the supplier, unpaid for

But retailers argue that shoppers will end up paying for the new body. The move follows a recommendation from the Competition Commission in 2008. Following a long-running investigation into the grocery market, it argued that the power of the large supermarkets was having an adverse impact on suppliers and consumers. The government hopes to have set up the GCA within the next 18 months to two years, the Department for Business, Innovation and Skills told the BBC.

*Protecting consumers*

Food suppliers who make complaints will be allowed to remain anonymous. "We want to make sure that large retailers can't abuse their power by transferring excessive risks or unexpected costs onto their suppliers," said Consumer Minister Edward Davey. "These sorts of pressures are bad for producers and bad for consumers - ultimately they can lead to lower quality goods, less choice and less innovation." He said the GCA would "safeguard the consumer interest". The new body will be funded by the supermarkets. It will enforce a new code of practice governing relations between grocers and suppliers that came into force in February, called the Groceries Supply Code of Practice.

*'Unnecessary costs'*

But one business group dismissed the GCA as an "unnecessary quango" that would increase the price of goods to consumers. "An adjudicator will just add unnecessary costs," said Stephen Robertson, director general of the British Retail Consortium. "With an independent budget and no direct reporting line to the OFT or government, this is a quango. Quango's cost. This will reduce the efficiency of the supply chain and customers will pay the price." The National Farmers' Union (NFU) gave the new body a cautious welcome, saying it should lead to fewer instances of "flagrant bully-boy tactics" by the supermarkets. It was, however, disappointed that the adjudicator would not be in place until 2012 and that it has fewer powers than the NFU had called for. NFU President Peter Kendall said he was concerned about how effective the adjudicator's powers to name and shame supermarkets who broke the code would be. But he added: "I am pleased to see that there are plans to reserve powers to the Minister to introduce fines for breaches of the code if naming and shaming is not sufficient to ensure the supermarkets play ball."

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1. **Extracts from Joseph Rowntree Foundation Report (2001)**

Recent legislation has provided trade unions with a right to recognition by employers in certain circumstances. Use of the statutory procedure may help to slow down the decline in union representation that has occurred over the past two decades. But what impact have unions had recently at the workplace? This study examines the effects of unions upon the employment levels of workplaces and upon the pay of their employees. Neil Millward, John Forth and Alex Bryson analysed the recent Workplace Employee Relations Survey and found that:

* Workplace closures were more likely among unionised plants than non-union plants in manufacturing between 1990 to 1998.
* One exception was plants with a comprehensive bargaining agenda. For these the likelihood of closure was no greater than for non-union workplaces.
* There was no difference in closure rates between union and non-union workplaces in the service sector.
* In the economy as a whole, non-union workplaces grew on average by 1.4 per cent per annum between 1990 and 1998, whereas unionised workplaces shrank on average by 1.8 per cent.
* This difference remained significant when other factors, such as the size, activity and age of workplaces, were taken into account.
* In 1998 trade unions did not, on average, negotiate higher pay for the employees they represented, when other factors affecting wages levels were allowed for.
* But in the private sector, unions did achieve higher pay where they bargained for a sizeable majority of the workforce, or where multiple unions were involved.
* Pay settlements in 1998 were similar, whether negotiated by unions or not. But pay increases were lower where union negotiations covered most employees, suggesting a long-term decline in the ability of unions to enhance pay.

Where pay-setting arrangements covered at least 70 per cent of employees in the workplace. These circumstances apply to about a half of employees covered by union bargaining or about 15 per cent of all private sector employees. Typically their pay was 9 per cent higher than for similar employees in comparable, non-union workplaces. The direct impact of union bargaining affected a mere 6 or 7 per cent of employees at the bottom end of the pay distribution. The most extensive impact of unions was for people being paid between £5 and £10 per hour - at least a quarter of them benefited directly from union bargaining. At higher pay levels the direct effect of unions was less widespread. But the indirect impact was at its most extensive in this upper section of the pay distribution - at £10 an hour or more, over 15 per cent of employees benefited from the spill-over from union bargaining on behalf of, not themselves, but other employees at their own workplace. The benefits studied were enhanced sick-pay benefits and employer-provided pensions.

Employment in the typical unionised workplace in the private sector declined at a rate of 1.8 per cent per annum, whilst employment in the average non-union workplace grew at a rate of 1.4 per cent per annum. This difference persisted after controlling for other factors known to have an impact upon employment levels - thus union recognition restricted the growth of continuing workplaces in the private sector over the 1990s. This negative effect of unions on employment growth was slightly larger in service industries than in manufacturing. However, it was confined to cases in which unions negotiated over wages, but had no role in determining staffing levels or recruitment. The rate of employment growth among service sector workplaces where unions negotiated over wages and employment was no different to that seen among workplaces without recognised unions.

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1. **Labour markets: Raise the floor? Add this article to your reading list by clicking this button**

FOR a long time, the economics of the minimum wage was easy to grasp and provided ample reason to dislike wage floors. In competitive labour markets workers should earn their marginal product, and a government intervention that forced employers to raise wages would lead immediately to falling employment. Raise minimum wages if you like, economists warned governments, but don't expect them to help low-income workers.

Over time, economists developed a more nuanced view of the question, however. Labour markets probably aren't perfectly competitive. Various frictions—like the cost to a worker of trying to find a different job at a firm that's also willing to hire him—can give employers some [monopsony](http://en.wikipedia.org/wiki/Monopsony) power, allowing them to appropriate some of the producer surplus that might otherwise be captured by workers. A minimum wage could, in that case, raise wages without much of an employment effect. Other research suggests that the employment and wage consequences of a minimum wage depend on the reaction to the policy. If firms and workers respond by increasing training in order to raise productivity, then a minimum wage could actually boost wages for workers up the income scale.

Arindrajit Dube at the University of Massachusetts-Amherst and Michael Reich of the University of California at Berkeley have generalised the case-study approach, comparing restaurant employment across all contiguous counties with different minimum-wage levels between 1990 and 2006. They found no adverse effects on employment from a higher minimum wage. They also argue that if research showed such effects, these mostly reflected other differences between American states and had nothing to do with the minimum wage. Messrs Neumark and Wascher have published stacks of studies (and a book) purporting to show that minimum wages hit jobs. In a forthcoming paper they defend their methods and argue that the evidence still favours their view. But even they are no longer blanket opponents. In a 2011 paper they pointed out that a higher minimum wage along with the Earned Income Tax Credit (which tops up income for poor workers in America) boosted both employment and earnings for single women with children (though it cost less-skilled, minority men jobs).

Britain’s experience offers another set of insights. The country’s national minimum wage was introduced at 46% of the median wage, slightly higher than America’s. A lower floor applied to young people. Both are adjusted annually on the advice of the Low Pay Commission. Before the law took effect, worries about potential damage to employment were widespread. Yet today the consensus is that Britain’s minimum wage has done little or no harm. The most striking impact of Britain’s minimum wage has been on the spread of wages. Not only has it pushed up pay for the bottom 5% of workers, but it also seems to have boosted earnings further up the income scale—and thus reduced wage inequality. Wage gaps in the bottom half of Britain’s pay scale have shrunk sharply since the late 1990s. A new study by a trio of British labour-market economists (including one at the Low Pay Commission) attributes much of that contraction to the minimum wage. Wage inequality fell more for women (a higher proportion of whom are on the minimum wage) than for men and the effect was most pronounced in low-wage parts of Britain.

Of course, recklessly large or clumsily implemented minimum wage increases are almost certainly bound to harm employment. America's relatively hefty and infrequent increases seem calculated to generate nasty knock-on effects. In Britain, by contrast, a low-pay commission recommends small, annual increases. Minimum wages, darlings of left-leaning politicians, aren't going away. Hopefully, economics research can figure out how best to implement them to avoid costly employment effects.

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1. **Turn it off: American regulators should block Comcast’s proposed deal with Time Warner Cable**

Add this article to **your reading list** by clicking this button



IN “OUTLAW”, a drama that aired on NBC, a Supreme Court justice leaves the bench to join a law firm. In real life he might have begun working for Comcast, America’s largest cable company, which owns NBC. Many of Washington’s top brass are on Comcast’s payroll, including Margaret Attwell Baker, a former commissioner of the Federal Communications Commission (FCC), America’s telecoms regulator, who in government had helped approve Comcast’s takeover of NBCUniversal in 2011. Even Barack Obama has Comcast ties. “I have been here so much, the only thing I haven’t done in this house is have seder dinner,” he quipped at a fundraiser hosted last year at the home of David Cohen, Comcast’s chief lobbyist.

It helps to have influential friends, especially if you are seeking to expand your grip on America’s pay-TV and broadband markets. Last month Comcast announced that it would buy Time Warner Cable (TWC), the largest provider of TV and broadband after Comcast, for around $45 billion. In the coming weeks the Department of Justice and FCC will begin to review the merger. They should be sceptical. The deal would create a Goliath far more fearsome than the latest ride at the Universal Studios theme park (also Comcast-owned). Comcast has said it would forfeit 3m subscribers, but even with that concession the combination of the two firms would have around 30m—more than 30% of all TV subscribers and around 33% of broadband customers. In the cable market alone (ie, not counting suppliers of satellite services such as DirecTV), Comcast has as much as 55% of all TV and broadband subscribers.

Comcast will argue that its share of customers in any individual market is not increasing. That is true only because cable companies decided years ago not to compete head-to-head, and divided the country among themselves. More than three-quarters of households have no choice other than their local cable monopoly for high-speed, high-capacity internet. If the takeover is approved, Comcast would control 20 of the top 25 cable markets, according to MoffettNathanson, a research firm. Antitrust officials will need to consider Comcast’s status as a monopsony (a buyer with disproportionate power), when it comes to negotiations with programmers, whose channels it pays to carry. Comcast could refuse to carry certain channels, or use its clout to insist on even greater price discounts or to favour its own content over that of others. For consumers the deal would mean the union of two companies that are already reviled for their poor customer service and high prices. Greater size will fix neither problem. Mr Cohen has said, “We’re certainly not promising that customer bills are going to go down or even that they’re going to increase less rapidly.” Between 1995 and 2012 the average price of a cable subscription increased at a compound annual rate of more than 6%.

*A pipe-dream*

The biggest worry is Comcast’s grip on the internet. Unlike Britain and France, America unwisely has no “common carriage”, allowing for internet service providers to rent cable companies’ pipes and compete on price and speed. Already Americans pay far more than people in other rich countries for slower internet. Comcast will have extraordinary power over what content is delivered to consumers, and at what speed. There is plenty for Mr Obama and Mr Cohen to discuss at their next dinner. But better yet, officials could keep their distance from Comcast, and reject a merger that would reduce competition, provide no benefit to consumers and sap the incentive to innovate.

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# Assignment: Monopsony

**SECTION B**

**Bananas**

**Figure 1 Fruit importers’ profit margins, %**



**Figure 2 Global market share of banana distributors (excluding supermarkets)**



**Extract 1 Supermarket pricing makes merger of Chiquita and Fyffes necessary**

Bananas have become the biggest fruit on the planet in terms of production volume, as consumers eat ever more of them. Global banana production has doubled since 1990 to 100 million tonnes a year. A deal to create the world’s largest banana distributing company was arguably made necessary by the low fresh fruit prices to be found on the shelves of any supermarket. By planning a $1 billion merger, Chiquita of the US and Dublin-based Fyffes are attempting to address a retail price squeeze that is reducing their already low profit margins. Their profit margins have been shrinking: Chiquita’s from 3.5% in 2004 to 0% in 2012, and Fyffes’ from just under 5% to 3.5% over the same period, say their annual reports.

A banana price war between large supermarkets, which often sell the fruit as a loss leader, has hit profit margins for distributors. Large retailers are also using their purchasing power to force producers and distributors to absorb cost increases, which have been made worse by poor weather and crop diseases. Supermarkets are also increasingly sourcing their bananas directly from producers, damaging distributors’ revenues, said Alistair Smith, a campaigner for social and environmental issues relating to the supply of bananas. In the UK, such direct sourcing accounted for more than half of the bananas traded. Smith said “The current low prices are not sustainable for the industry. They are damaging the industry and the people who work in it. The industry has been suffering from overcapacity for the past few years, so a merger of the two major players should resolve some of the volatility in the market.”

Announcing the proposed merger, Ed Lonergan, Chiquita’s Chief Executive, said: “We have always identified Fyffes as a fantastic partner. The tie up makes particular sense now as the banana market is the most competitive I have ever seen – there are so many players bringing bananas into every port in the world.”

A merger is likely to give the combined company more negotiating power with suppliers, although the Fairtrade Foundation warns that the merger would only squeeze banana growers further. The merged company would have combined sales of $4.6 billion. It would distribute about 160 million cases a year in total, compared with 117 million at Del Monte and 110 million at Dole.

Chiquita is the larger company, with annual revenues in excess of $3 billion compared with $1.5 billion at Fyffes. The merged company would have the scale to negotiate better deals with retailers. Chiquita and Fyffes hope to achieve $40 million a year in pre-tax cost savings while gaining share in the melon, pineapple and packaged salads markets. Savings will come from logistics, for example putting more bananas on to fewer boats.

The high profile of these brands makes it likely that regulators will scrutinise the proposed merger as the new company would have almost 30% of the European market.

1. With reference to Extract 1, explain **one** condition necessary for the existence of monopsony power.

[5]

1. Evaluate the likely effects of supermarkets’ monopsony power on banana **distributors**.

[10]

**SECTION C**

1. Critically examine the benefits to both businesses and consumers of a business having monopsony power over its suppliers in an industry of your choice.

[25]

1. Governments can intervene to restrict the monopsony power of large retailers. Assess the costs of such intervention to firms and consumers.

[25]