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Monopsony

GCE A-LEVEL & IB ECONOMICS

Lesson Structure

- Monopsony
  - Characteristics
  - Conditions for a Monopsony
  - Monopsony in the Labour Market
  - Costs and Benefits to Stakeholders
  - Counteracting Monopsonies
  - Evaluation

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Price of Milk in the UK

Let's watch this video about protests by UK dairy farmers:

https://www.theguardian.com/business/2015/aug/11/milk-price-row-key-questions

What are some reasons that milk is so cheap in the UK?

Why can't farmers influence the price of milk?

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Price of Milk in the UK

To maximise profits, firms tend to minimise cost and reduce pay to suppliers when they have sufficient bargaining power. This helps them maintain their price competitiveness.

Individual farmers are unable to charge higher prices for their milk as they can only sell it to major supermarkets like Tesco, Asda etc. As a result, they have to accept their low prices.

Monopsony

A pure monopsony is when there is only one buyer in the entire market.

In the market for milk, supermarkets that dominate the purchase of milk have monopsony power over its suppliers.

With huge bargaining power, monopsonists can set prices on how much to pay suppliers. The price they set depends on their marginal cost, and marginal revenue from buying one more unit from their supplier.

In general, you can expect monopsonists pay suppliers less when compared to a normal competitive market with more buyers.

Monopsony Examples

amazon.com

Amazon’s Influence

“If you haven’t been following the recent Amazon news: Back in May a dispute between [Amazon and Hachette](), a major publishing house, broke out into open commercial warfare. Amazon had been demanding a larger cut of the price of Hachette books it sells; when Hachette balked, Amazon began disrupting the publisher’s sales. Hachette books weren’t banned outright from Amazon’s site, but Amazon began delaying their delivery, raising their prices, and/or steering customers to other publishers.”

The New York Times

Opinion

Amazon’s Monopsony Is Not O.K.

By Paul Krugman

Oct. 19, 2014

1027

Amazon.com, the giant online retailer, has too much power, and it uses that power in ways that hurt America.

https://www.nytimes.com/2014/10/20/opinion/paul-krugman-amazons-monopsony-is-not-ok.html

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Conditions for a Monopsony

We can see Amazon has other ways to exert monopsony power over book publishers who have little choice than to sell on Amazon for online sales. But where does this power come from?

Conditions for a Monopsony

As a seller, Amazon dominates 42% of the online book sales market and 89% of the e-book market. A monopolist and major distributor, Amazon helps publish a significant amount of books. This means the number of other online book sellers are limited as the market is highly concentrated. Because most people buy the final product from Amazon, suppliers (book publishers) need to work with Amazon to access the market.

Hence we can see when a firm increases their market share to a significant level, or is a monopoly they have more monopsony power over their suppliers.

Monopsony and the Labour Market

Another common monopsony is when there is a sole employer in the labour market.

Labour is a type of factor input (raw material) for a firm to produce goods and services. Hence, industries with only one employer are can be regarded as monopsonists as well.

Can you think of any examples of sole employers in the UK?

Monopsony and the Labour Market

Can you think of any examples of sole employers in the UK?

Conditions for a Monopsony

What conditions are required in order for a sole employer to occur?

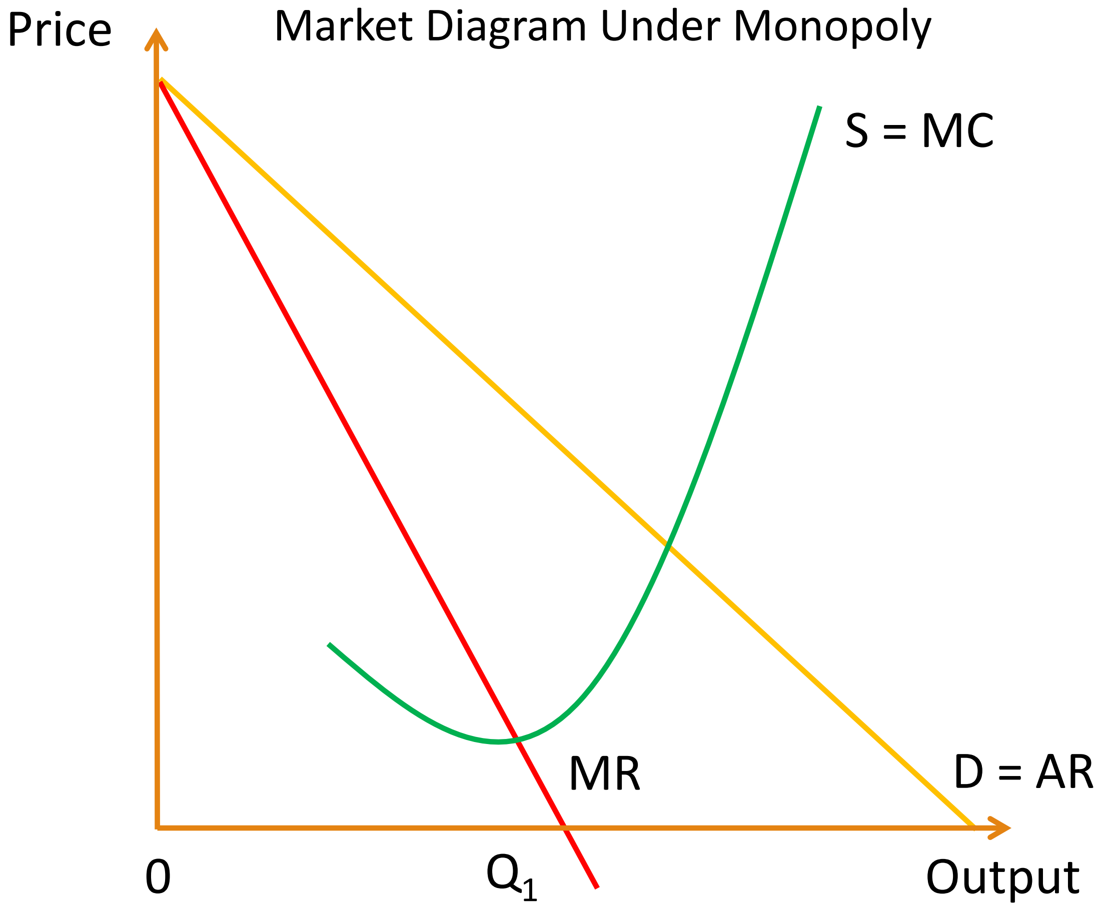
The government is a monopsony when hiring government-related jobs as we can see in the previous example. For example, the UK Army and congress is the only body that hires soldiers and MPs.

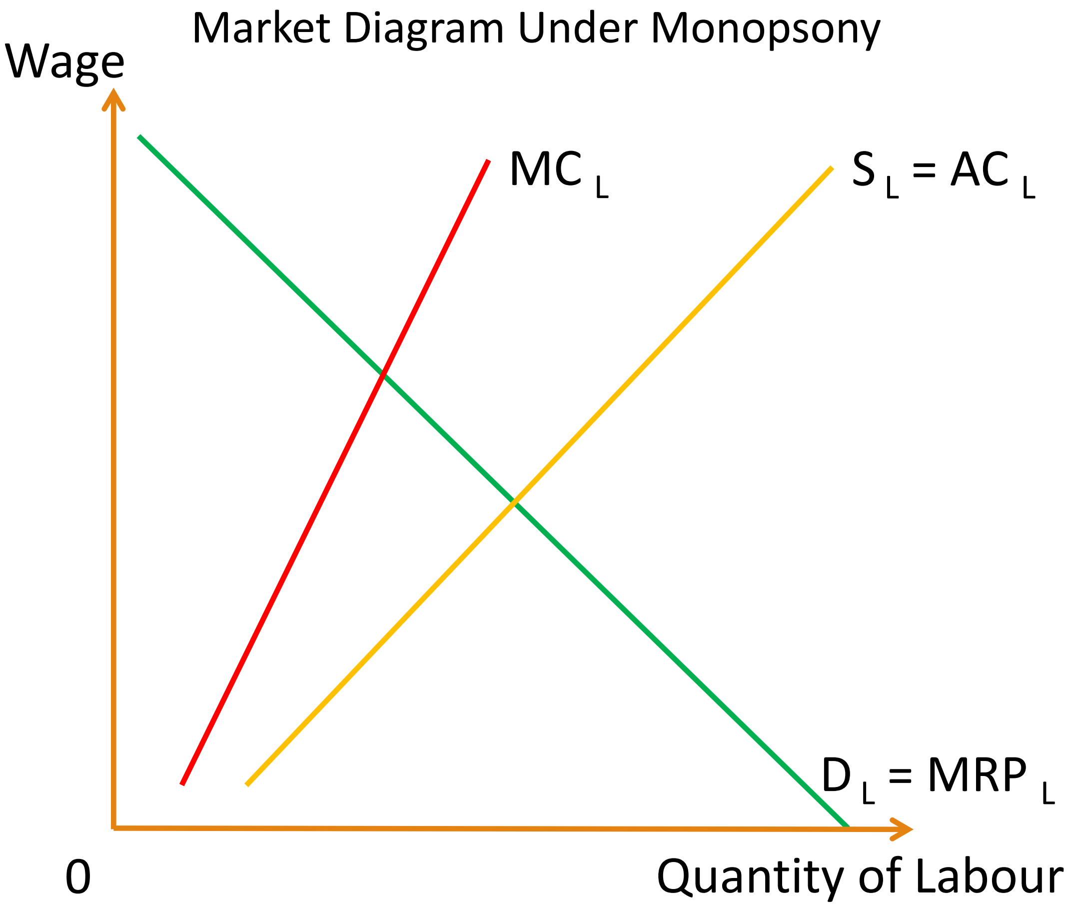
Geographical immobility is another factor – there may only be one Thai restaurant hiring curry chefs if you live on Easter Island, and cannot move elsewhere (or it may be too costly to).

Control of natural resources (land) - when DeBeers owned most diamond mines in the world, then they are likely the only company hiring diamond miners… this tends to happen in developing countries when MNCs extract the natural resources there, of which they have ownership

Monopsony Diagram

*Not specifically required for Edexcel, but needed for AQA





The monopsony diagram is just the monopoly diagram with Demand and Supply switched around!

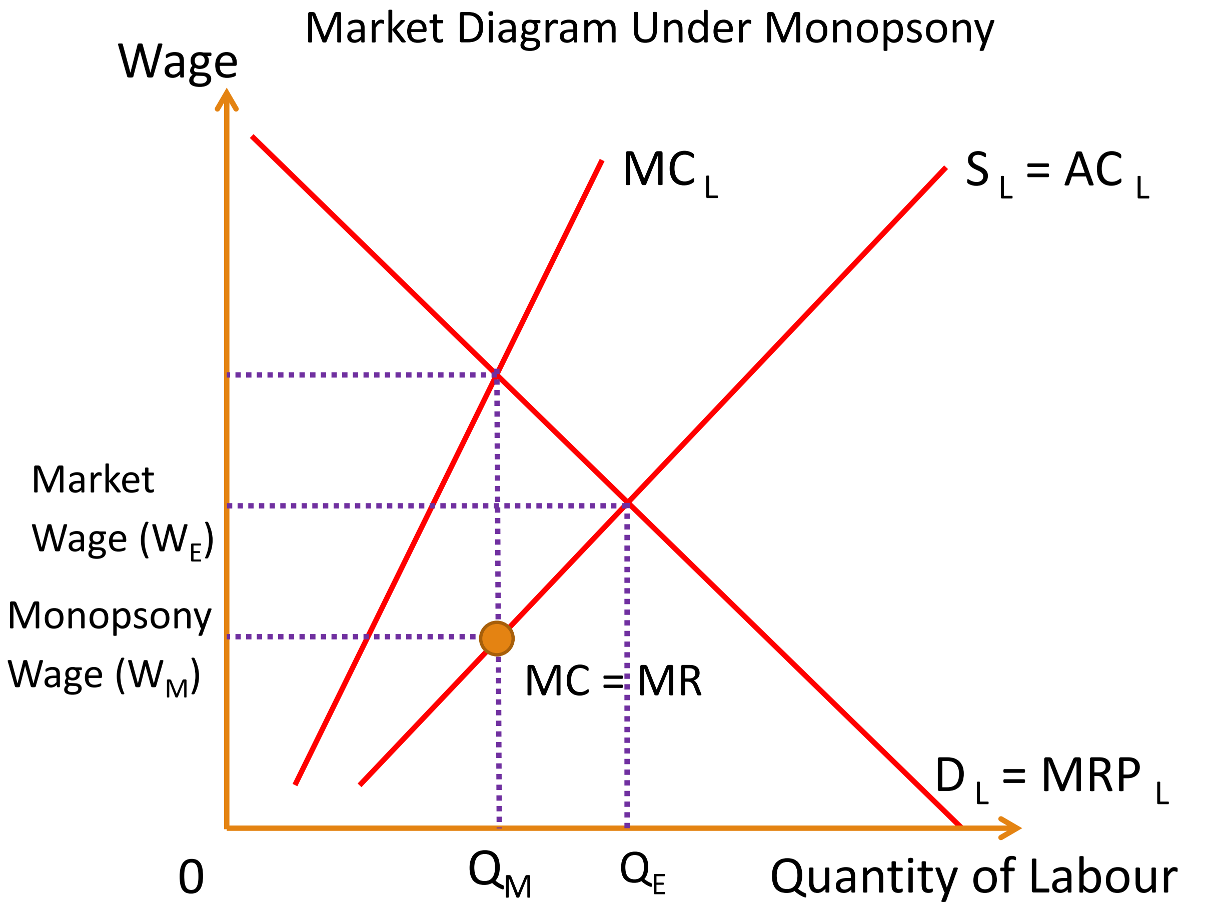
Monopsony Diagram

*Not specifically required for Edexcel, but needed for AQA

Our labour market notes will look into the demand for labour (D_L), supply for labour (S_L), and the marginal cost of labour (MC_L) in more detail, with a numerical example.

Marginal revenue product of labour $MRP_L = D_L$ as the monopsony is only willing to buy one more unit of labour if it can produce the same amount of revenue or more. The cheaper the wage rate, the more labour they can demand.

$S_L = AC_L$ as all labour cost in the market is incurred by the monopsony firm



Monopsony Diagram

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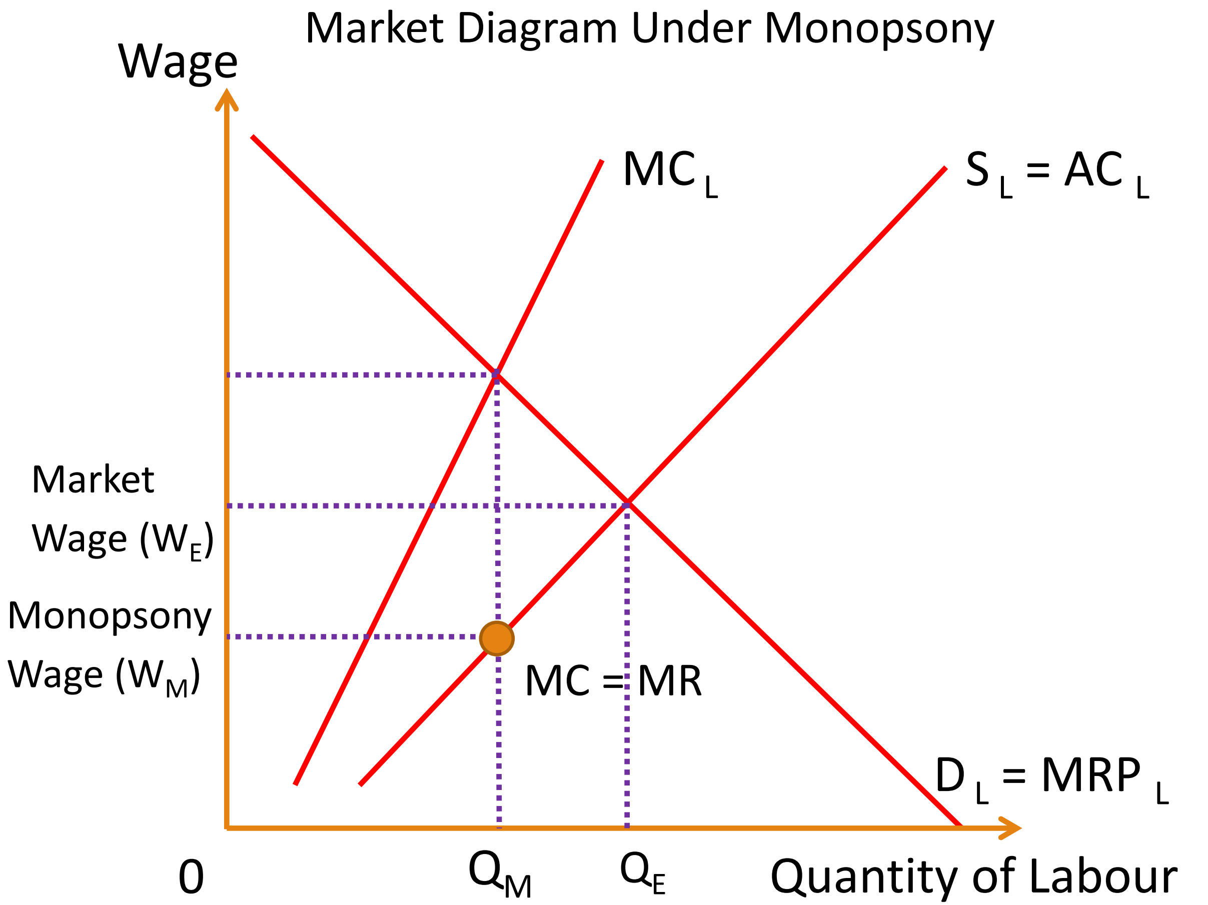
MC_L is rises more quickly than the average cost of labour (AC_L) as raising the wage to employ additional workers mean increasing wages for existing workers as well, pulling up the cost of acquiring one additional unit of labour quickly.

Under competitive conditions, labour markets operate at D = S, meaning market wage for labour (factor inputs) are at W_E , however the monopsony wage is lower at W_M as they maximise profits at MC = MR (like a monopoly).

Note that number of workers hired in a monopsony is also lower at Q_M compared to the competitive quantity Q_E



Monopsony Role Play

Separate into teams of 2 and assume each team represent one of the following groups:

-Amazon consumers

-Amazon shareholders

-Book publishers working with Amazon

-Amazon employees

1. Tell the class how your interests are affected by Amazon's monopsony
2. Give 1 argument to convince others that it should continue or end

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Costs and Benefits to Stakeholders

“*The suppliers were split about the reason for the horse meat crisis, with 53.2pc saying it was down to suppliers being [squeezed by big supermarkets](), but 46.8pc disagreeing*.”

Driving down consumer prices and squeezing supply chains may come back to haunt you.


Daily Mirror
Wednesday January 16, 2013
REAL NEWS. REAL ENTERTAINMENT 50p
The shark whisperer!
More amazing pictures
Sail to France from £1 WITH P&O Ferries
GIANT THRILLER
PLUS
HORSE MEAT IS FOUND IN TESCO BURGERS
Supermarkets clear shelves
Inquiry at supply plants

Costs and Benefits to Stakeholders

As you will expect, monopsonies can cause firms to be more profitable and competitive, but can be detrimental to their suppliers and even drive the out of business.

Lower prices from the firm's cost savings/competitiveness can benefit consumers, but it may be at the cost of product quality so that suppliers can maintain their margins.

Lower supplier costs may mean more profit to be shared among employees, but if the monopsony is in terms of the labour market, it would mean lower wages and less staff being hired. It may also affect staff motivation.

Suppliers may exit the market due to lower profitability, with less research and development, product innovation and hence sacrifice product quality to survive in the market.

Counteracting Monopsonies

What are some ways to prevent or reduce the power of monopsonies?

General Monopsony:

Co-operation between suppliers – by forming an organisation to represent smaller suppliers, this will give them more bargaining power to negotiate with the monopsony with regards to prices

Monopoly power – if there is only one or a few suppliers/sellers in that market, they will be able to bargain better with the sole buyer by using their monopoly power

Government intervention/regulation – the government can again help set standards in the industry and require firms to pay a fair price to their suppliers. For example, the Groceries Code Adjudicator in the UK helps regulate larger supermarkets so they cannot exploit small independent farmers as easily

Counteracting Monopsonies

What are some ways to prevent or reduce the power of monopsonies?

Monopsony in the labour market:

Minimum Wage – helps to ensure workers are not exploited by sole employers, and that they receive a sustainable amount of wages

Trade/Labour Unions – Trade unions can help workers come together and negotiate higher wages or better working conditions for them as a supplier of labour for the organisation. E.g. teachers' union, Transport for London (TfL) union

Government Regulation – There is some degree of government regulation that protects employees of companies, such as ensuring a paid holiday entitlement and sick leave. However, there is currently not enough protection for zero-hour workers that are not recognized as employees.

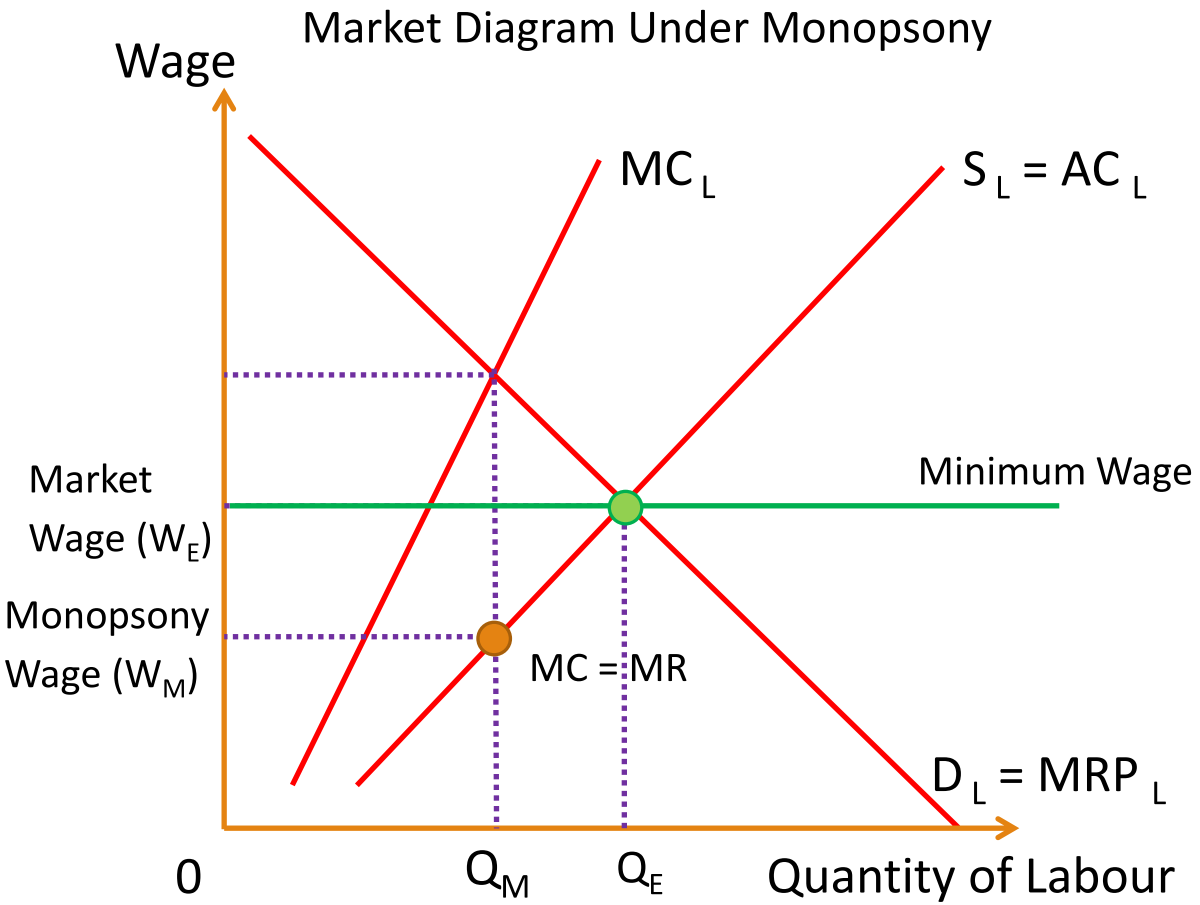
Monopsony Diagram

*Not specifically required for Edexcel, but needed for AQA

If a minimum wage is implemented by the government, or negotiated by the trade union, it can be set at the competitive market wage to rectify the market failure caused by the monopsony.

The market equilibrium will then move from the orange point where MC = MR to the green point where D = S (AC = MRP)

As a result, there will be a higher wage (W_E compared to W_E) for workers and more workers will be hired (Q_E compared to Q_M)



Another Perspective on Monopsonies

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Underlying Economic theory states that monopsonies are bad for suppliers and good for consumers... but is this always the case?

Watch this video regarding the global coffee trade, and let me know your thoughts after discussing with your neighbour.

https://voxdev.org/topic/agriculture/coffee-chain-linking-farmers-global-market

Monopsony and the Global Coffee Trade

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It seems that sometimes monopsonists can build a stronger, exclusive relationship with suppliers in some cases, which incentivizes them to invest in their supply chain partners.

The investment can then generate more stable profits and higher earnings for the specialty suppliers involved. Some suppliers may need this stability, especially if they are exporting from a developing country.

Evaluating Monopsonies

Sustainability:

- Is this monopsony sustainable in the long run? Can suppliers keep their costs low and generate enough dynamic efficiency to do so? Will it cause any potential negative externalities if it is unsustainable?

Stakeholders' interests:

- How are consumers/suppliers/employees/shareholders affected by the monopsony? Will it affect product quality and employee's sense of belonging? Business Objectives:

- Does the monopsony aim to maximise profits? Will they pass on cost savings from suppliers to consumers?

Market Structure:

- Is the market concentration of suppliers high enough to counteract the monopsony? i.e. Are the suppliers of the monopsony a monopoly? Is there a trade union protecting workers?