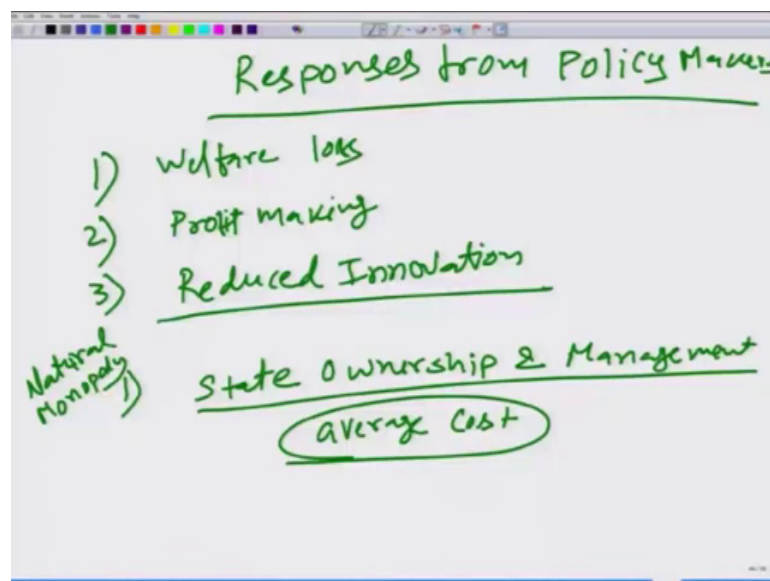


**An Introduction to Microeconomics**  
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**Lecture – 135**  
**Responses from Policy Makers**

This is the last topic in this chapter called monopoly. And here we are going to talk about Responses from Policy Maker.

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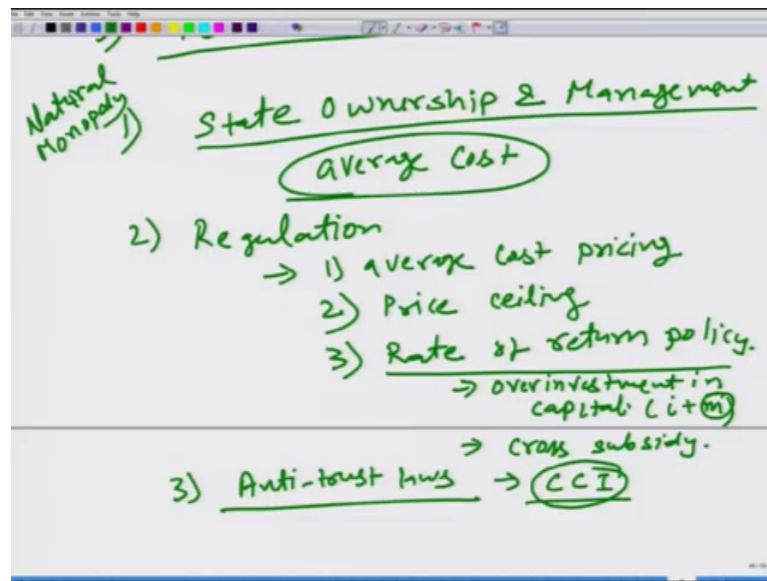
So, what we have seen that there is clearly welfare loss in the case of monopoly. The society is not operating at efficient level when we have monopoly. Another problem that also we should think about that people are worried the voters or the vote because policy makers they respond to voters demand, voters are worried about profit making potential of monopoly; third thing that we also that the problematic is that in the case of monopoly we see reduced innovation. Why do we say that reduced innovation? Why do we get reduced innovation? The reason is very simple the monopoly is not competing against any other form. So, they have less incentive to innovate and cut the prices.

So, our policymakers have responded in several different ways and some of these important one of some of these important ways we would learn in this particular segment. So, one is state ownership and management. So, state takes over the monopoly and of course, this is more relevant in case of natural monopoly we will context talk in

context of natural monopoly that a state takes over the monopoly and sells its product typically at average at a price which is equal to the average cost.

What is the problem in the state ownership? And in India we have seen state ownership of different business venture and we all are familiar with the inefficient handling of these ventures. Bureaucrats running these monopoly they become more concerned with their department budget then achieving the efficiency. So, that is quite problematic.

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Second is regulation, we have seen different kind of regulation again here also the state can simply tell the monopoly to price their product at average cost. So, we can say average cost pricing.

Also state can simply say, simply impose some sort of price ceiling telling monopolies that you cannot have a price higher than this particular level. Third which is most popular is called rate of return policy. What happens that the monopolist are allowed to earn whatever is the interest rate prevailing in the market plus a markup, this is called rate of return policy and of course, the monopoly has to get it approved from the government to have that particular price. The problem with this is that typically we see over investment in capital, the reason is very simple because the monopoly is returned depends on the amount of capital because they are going to earn the normal interest rate which is prevailing in the market and plus a markup let us say  $m$ . So, if they over invest they will have higher markup. So, this gives them incentive to do over investment.

Other problem that we see when the market is segmented and the firms are operating in different market and let us say one of the market is purely competitive market. What these firms would like to do is to sell their product even at the lower price, ok. So, that they can justify having more capital because the more capital means having more return. So, cross subsidy is another problem that we see in such sort of market, ok.

The third is antitrust laws. Antitrust laws almost all countries have some sort of antitrust laws the aim is to promote more competition in the market. In India what we have is called CCI, Competition Commission of India; they are tasked with maintaining the healthy competition in the market. So, they regularly look at these firms involved in monopoly practices or the firms colluding together and working as a monopoly and they time to time they direct them in to behave in a particular manner which will bring more competition in the market.

So, these are the few ways through which state responds to or the policymaker responds to the solid that the problem of or the situation of monopoly.

Thank you.