**06 Govt. Intervention & Govt. Failure**





1. Monopoly
2. Externalities
3. Public Goods
4. Labour Immobility
5. Inequality

**1. MONOPOLY**

**Ofcom tells BT to open up cable network to rivals**

* BBC Article (25 February 2016)

**Communications watchdog Ofcom has said BT must open up its cable network and allow competition to improve UK internet connections.**

The regulator has so far stopped short of demanding a complete break-up of BT, but said this was still an option. BT welcomed the report and said it was happy to let other companies use its network, if they were keen to invest.

[**Ofcom also said**](http://media.ofcom.org.uk/news/2016/digital-comms-review-feb16/) there was a digital divide in the UK between those with the latest technologies, and those without. It has proposed that decent, affordable broadband should be a universal right. Rivals had called for a split between BT and its Openreach operation, which runs its cables, fibre and network infrastructure. Companies such as Sky, Vodafone and TalkTalk, who pay to use the network, say that BT underinvested in Openreach, leading to a poor service with interruptions and slow speeds. Now BT will be told to allow easier access for rivals to lay their own fibre cables along Openreach's telegraph poles and in its underground cable ducts.

**Tougher rules**

Ofcom also says it intends to introduce tougher rules on BT's faults, repairs and installations. It says Openreach should be governed at arm's length from BT, with greater independence in taking its own decisions on budget, investment and strategy. It adds that a complete split between Openreach and BT "remains an option".

**'Monopoly provider'**

[**BT's shares**](http://www.bbc.co.uk/news/business/market_data/shares/3/87084/intraday.stm) were up more than 4% following the publication of the report. A BT spokesman said: "Openreach is already one of the most heavily regulated businesses in the world but we have volunteered to accept tighter regulation.

"We are happy to let other companies use our ducts and poles if they are genuinely keen to invest very large sums as we have done."

But Ofcom's report says that the evidence "shows Openreach still has an incentive to make decisions in the interests of BT, rather than BT's competitors". BBC technology reporter Jane Wakefield said: "That will be something rivals, from big players like Sky to small internet service providers that are attempting to bring broadband to areas not yet served by BT, will recognise all too well, and Ofcom's decision that the two should stay together for now will be seen as a blow."

A spokesperson for Vodafone said: "BT still remains a monopoly provider with a regulated business running at a 28% profit margin.

BT's Openreach division is the biggest force in British broadband - and critics say it's not used that power to good effect. The likes of TalkTalk and Sky, which rely on Openreach to connect most of their customers, charge it with poor service and failing to invest enough in the fast fibre network Britain needs.

Ofcom's report shows that it shares many of their concerns - but it's stopped short of the radical action they wanted. BT will not be forced to sell Openreach in the short term - though that threat remains in the regulator's back pocket if it doesn't see the changes it wants.

Much of the criticism of BT has centred on its continued reliance on old copper cables to carry fast broadband connections into homes from its fibre network - rather than laying fibre right into homes. Ofcom's Sharon White told me "fibre is the future" - and compared the UK unfavourably with countries like Japan in hooking up homes and businesses to ultrafast connections.

"2.4 million households and small businesses (around 8% of all UK premises) cannot yet access a decent broadband speed of 10Mbits per second," the report said.

**Core Questions**: Answer the following questions is the space provided overleaf

1. Define a legal monopoly
2. Identify the characteristics of a monopoly market structure
3. Explain the market failure associated with monopolies
4. Draw the market failure on a diagram
5. Identify the ways in which monopolies can beneficial for the economy (market success)
6. Identify ways government intervene to reduce monopoly power monopolies
7. Identify the Govt. failures associated with monopolies (how might Govt. intervention go wrong?)

**Ext**:

1. Why do you think BT’s share price rose by 4% following the publication of Ofcom’s report?
2. Are BT’s competitors happy with Ofcom’s demands of BT? Why/why not?

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# BT Openreach deal aims to shakeup UK broadband

* BBC article (10th March, 2017)

Ofcom boss Sharon White told BBC Radio 4's Today programme that "we can now expect better service from Openreach".

Openreach controls the fibre connections, ducts and pipes behind the UK's broadband infrastructure and sells access to BT's rivals, such as TalkTalk and Sky. The regulator had threatened to force BT to legally separate Openreach.

However, Ofcom said on Friday that the company had agreed to all of the changes needed to address its competition concerns.

"As a result, Ofcom will no longer need to impose these changes through regulation. The reforms have been designed to begin this year."

Media captionSharon White tells Today that Openreach will be legally separate from BT

BT's rivals such as Sky, TalkTalk and Vodafone, which use Openreach's network to offer broadband to consumers, have long complained of high charges, poor service and failure to invest in the division.

Ms White called it a "significant day" for phone and broadband users and pledged to "carefully monitor" how the revamped Openreach performs.

Sky welcomed the announcement: "A more independent Openreach is a step towards delivering better service to customers and the investment that the UK needs. It's important that today's agreement is now implemented by BT in good faith and without delay."

Dido Harding, chief executive of TalkTalk, said: "We hope this is the start of a new deal for Britain's broadband customers, who will be keen to see a clear timetable from Openreach setting out when their services will improve."

Vodafone said it is "an encouraging start".

Culture Secretary Karen Bradley said: "Now we need to see this deal implemented, along with significant improvements to Openreach's service standards, and increased investment by Openreach in the country's digital infrastructure."

BT chief executive Gavin Patterson said the deal, reached after two years of negotiations with Ofcom, meant Openreach would have its own board and make its own investment decisions. However, he admitted that BT would set the overall budget.

He told BBC Radio 4's Today programme: "The BT board will set the annual budget. As the 100% shareholder, the owner of the company that's not unreasonable."

He said BT's rivals could criticise Ofcom for not pushing for structural separation, but they should see Ofcom's efforts to engage with the European Commission as "a partial victory".

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# Ext: Tesco to buy Budgens and Londis owner Booker in £3.7bn deal

* The Guardian, Friday 27 January 2017

Tesco has agreed a £3.7bn deal to buy Booker, the cash and carry giant behind the [Londis and Budgens](https://www.theguardian.com/business/2015/may/21/booker-buy-londis-budgens-supermarkets-40m) convenience chains, in a move that will tighten its grip on the UK’s £195bn food market. The deal is expected to be scrutinised by the competition authorities as [Tesco](https://www.theguardian.com/business/tesco) is already the country’s biggest retailer, with more than 3,500 stores and control of close to 30% of the grocery market.

The proposed acquisition would turn Tesco into a major supplier to small retailers, serving 125,000 independent convenience stores as well as 468,000 restaurants and pubs. Analysts estimate the deal – if cleared by regulators – will hand Tesco another 2% of UK grocery sales courtesy of the Premier, Londis and Budgens chains that Booker supplies.

The deal is the first major corporate move by Tesco since it was run by Sir Terry Leahy, who quit in 2011. In the years since, the grocer has been battered by the discounters and by the move to online and convenience shopping. Leahy’s successor, Philip Clarke, was forced to step down after a series of profit warnings and the grocer was then engulfed in an [accounting scandal](https://www.theguardian.com/business/2016/nov/29/sfo-will-not-charge-former-tesco-boss-over-accounting-scandal) that is still the subject of a Serious Fraud Office investigation.

# Why is Tesco buying Budgens' owner – and will it affect shoppers?

The retail giant has launched a £3.7bn takeover of wholesaler Booker, but could face competition hurdles. Tesco’s current boss, Dave Lewis, who was parachuted in from Unilever to replace Clarke, said the Booker deal was good news for shoppers and the grocery industry. “The feedback we have had from our suppliers has been very positive, as they see a bigger, broader market opportunity,” he said.

Booker chief executive Charles Wilson added that the independent shopkeeepers he worked with were also enthusiastic: “They think this will help them provide a better offer to their customers.” Lewis and Wilson batted away suggestions the [Competition and Markets Authority](https://www.theguardian.com/business/competition-commission) would be wary of a deal that reinforces Tesco’s dominant position in UK retail. “We are a wholesaler rather than a retailer,” said Wilson, while Lewis highlighted that it was not acquiring convenience stores as the outlets served by Booker are owned by independent retailers. Booker’s 200-strong cash and carry chain generates £3.2bn of its £5bn turnover.

Retail experts nevertheless said Tesco’s biggest challenge would be convincing regulators that competition in the convenience store market was not being lessened by the combination, as in some neighbourhoods it is possible that Tesco will either run or supply every grocery outlet.

James Lowman, chief executive of the Association of Convenience Stores, said opinion would be divided: “Some retailers will welcome this news, others will be concerned about competing with stores supplied through the merged Booker and Tesco business, and some will be uneasy at the prospect of working in partnership with one of their biggest historical competitors.”

The ambitious plan was not met with universal enthusiasm by Tesco directors. Lewis admitted that [Richard Cousins, the boss of catering group Compass who abruptly quit](https://www.theguardian.com/business/2017/jan/03/richard-cousins-resigns-tesco-board-directors-compass-group) as Tesco’s senior independent director earlier this month, had resigned over the deal, which took a year to negotiate. Cousins told the Financial Times he was “very much against the deal”. He added: “Tesco is in the middle of a price war that could last for years. They need to make the business simpler, not more complex.”

Lewis said the board had a “good debate” over the merits of the deal which was “good governance”. He said that the rest of the Tesco board had backed the tie-up. Some analysts suggested Lewis was biting off more than he could chew. Since taking the reins in 2014, he has been restructuring Tesco following the accounting scandal and turning around the performance of its core UK supermarkets. Earlier this month, the grocer unveiled [a strong Christmas performance](https://www.theguardian.com/business/2017/jan/12/tesco-sales-festive-season).

John Colley, a professor of practice at Warwick Business School, said Cousins’ departure was significant: “Compass has stuck to what it knows very successfully and shunned diversification as their shareholders will agree. Tesco seems to be chasing distractions before the job is finished in the supermarket grocery business.” Tesco shares closed up 9% at 206p, while Booker shares leapt 16% to 213.4p. Tesco’s shares were also boosted by its promise to resume dividend payments in the 2017-18 financial year.

Wilson ruled out large-scale job losses, arguing that the savings would come from greater efficiency and procurement. He was confident that Booker’s brand names Londis, Budgens, Premier and Family Shopper would remain. Under the terms of the deal, each Booker shareholder will receive 0.861 Tesco shares and 42.6p in cash, worth 205.3p a share. Booker shareholders will own 16% of the combined business.

The deal has been recommended by both boards, but needs approval from regulators and both sets of shareholders.

“The initial gut reaction, which is usually the best one, is that it may be sound for Tesco but far from compelling for Booker shareholders,” said Shore Capital analyst Clive Black.

“Tesco is not a business without a lot to do fixing the UK stores, trying to make online sustainably profitable, rebuilding profitability in central Europe and generally deleveraging. Whether or not the integration of Booker is an ideal strategic step is subject to debate to our minds.” Black added that the non-Booker independent and wholesale trade would be “up in arms” at this proposed merger. “So it could be a very messy process,” he said.

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**Question:** “*Using the data and your economic knowledge, evaluate the view that regulators should intervene to correct the market failure arising from monopolies, such as BT and Tesco.”*

|  |
| --- |
| **Intro** = K + C + S |
| K: | C: | S: |
| **An 1** =  |
| **Ev 1:** |
| **An 2 =**  |
| **Ev 1:** | **Ev 2:** | **Ev 3:** |
| **An 3** =  |
| **Ev 1:** | **Ev 2:** | **Ev 3:** |
| **Conclusion** = state position + justify position + defend position |
| State Position: | Justify Position: | Defend Position: |

**2. EXTERNALITIES**

**Generic Essay Structure:**

Intro

* K =
* C =
* S =

**An 1** = Sometimes markets work (free markets could be seen as allocatively and productively efficient

* Explain why free markets are ALLOCATIVELY EFFICIENT
* Explain why are free markets PRODUCTIVELY EFFICIENT
* Ext: Explain the functions of the price mechanism (signalling, rationing, incentive)

**Ev 1** = However, sometimes markets fail (explain the MF using the phrase ‘misallocation of resources’ include a diagram)

**An 2** = One way that Govt. can reduce the MF is by… (POLICY 1) [Explain how policy addresses the MF]

**Ev 2** = On the other hand, sometimes Govt. intervention fails (GF) [Ev policy x 3]

**An 3** = One way that Govt. can reduce the MF is by… (POLICY 2) [Explain how policy addresses the MF]

**Ev 3** = On the other hand, sometimes Govt. intervention fails (GF) [Ev policy x 3]

**Conclusion** = State position + justify position + defend position

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**A) Negative Production Externalities**

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| --- |
| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |

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**B) Positive Production Externalities**

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| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |

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**C) Negative Consumption Externalities (Demerit Goods)**

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| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |

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**D) Positive Consumption Externalities (Merit Goods)**

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| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |

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**3. PUBLIC GOODS**

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| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |

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**4. LABOUR IMMOBILITY**

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| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |

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**5. INEQUALITY**

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| --- |
| **i)** Identify the MF: |
| **ii)** Ap = provide an example of the MF in action: |
| **iii)** Draw the MF on a diagram | **iv)** With reference to the diagram, explain the MF |
| **v)** An = Explain a Govt. intervention to reduce the MF (can you show the impact on a diagram?) |
| **vi)** Ev 1 | Ev 2 | Ev 3 |



