

MICROECONOMICS AT WORK EXERCISE

THE WORKINGS OF A MARKET

REFERENCE: 'Builders win in insurance backdown' and 'Breaking up a monopoly' (by Annabel Stafford), *The Australian Financial Review*, 27 January 2005, p.1, 45.

CHAPTERS RELEVANT TO THIS EXERCISE: 3, 7, 10

CONTEXT

A *market* (or industry) is the term used to refer to the context in which a particular product is produced. The nature (or structure) of the market will determine the way in which consumer demands for the product are satisfied by producers (what the specifications of the product are, the range of choice within the broadly specified product that is offered to consumers, and its/their price).

These articles (which somewhat strangely repeat each other) are about 'producing' the service of *home warranty insurance*, i.e. the provision of insurance to home builders. Builders are required to have such insurance in case they die or go bankrupt (or, rather quaintly, 'disappear') ultimately as a protection against loss in these circumstances for subcontractors they employ and buyers of their building services. There is therefore a market for the provision of these services, consisting of buyers (builders) and sellers (insurance companies who produce and sell these services). Governments have the legal power to control the nature and structure of this market (or in the Australian context '*these markets*', because it is *state* governments which have the power). In the 1990s most states, which had hitherto provided the insurance service *themselves*, privatised this industry i.e. let the service be provided by private insurance companies.

These articles refer to the way that the industry has operated subsequently and some of the issues that have arisen about how well the market works to deliver the product to consumers.

QUESTIONS

1. Explain what is meant by 'privatising' the provision of home warranty insurance and why this was done.
2. How and why did a 'monopoly' develop in the insurance after privatisation?
3. Explain the complaints of buyers (and commentators), cited in the article, that 'lack of competition' in the market has led to higher prices and poorer quality of service.
4. Comment on the (defensive) comment of the CEO of the insurance company charged with being a 'monopolist' that the private market is 'settling down and we've got to give it a go'.
5. Explain and discuss the headlines to the two articles ('Builders win in insurance backdown' and 'Breaking up a monopoly').