Monopolies

MONOPOLY

• opposite market situation of perfect competition
• only 1 seller
• Pure Monopoly this occurs when there exists a single seller of a product that has no close substitutes
• Why is no close substitutes important?

Pure Monopolies

• Why are pure monopolies rare??

1) most goods have substitutes
2) more than 1 firm exists

So we are more concerned about firms with monopoly power
Monopoly Power

- **Monopoly Power** this is the ability of a firm to influence the market price of a good by controlling the supply of the product available to the consumer.
- Example: DeBeer’s

Maintenance of A Monopoly

- recall that there are no barriers to entry in perfect competition - this is NOT the case when dealing with monopolies
- Types of barriers
  1) Legal barriers
  2) Owning the entire supply of the resource
  3) Unique ability/talent
  4) Cost advantages of large scale production

Legal Barriers

- public franchise
- government license
- patent/copyright
- Monopolies that arise from this are called LEGAL MONOPOLIES
Natural Monopolies

- Monopolies that arise from (4) are called NATURAL MONOPOLIES

- **Natural Monopoly** single seller exists because of cost/technological advantages that lower the average cost of production (One firm can supply the market at a lower price than 2 or more firms can)

DEMAND AND SUPPLY

- Monopolist’s output = entire market supply
- Demand for monopolist’s product = entire market demand

- NOTE:
  1) Demand for a monopolists product is NOT PERFECTLY INELASTIC
  2) Monopolists are PRICE SETTERS (can influence price)

Example of Monopoly

<table>
<thead>
<tr>
<th>P</th>
<th>Q</th>
<th>TR</th>
<th>MR</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>0</td>
<td>0</td>
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<tr>
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Monopoly Example

• What is the relationship: 1) between TR and MR?
• 2) between P and MR?

1) TR is maximized when MR = 0
   Since TR rises while P falls ===> Demand is elastic

2) MR does not equal P as it does in perfect competition
   MR < P always in a monopolist setting

Using these 2 facts, what is the monopolists profit maximizing output?

Monopoly Example

• RESULTS
  1) optimal output determined by MR = MC
  2) Price is set at the level at which this optimal output is consumed (ie. by the demand curve)
  3) Profit = (P-AC)Q

PRICE DISCRIMINATION

• Price discrimination this occurs when firms charge a different price to different consumers for the same good, given that good has a given quality and cost
• examples - movies, museums, airlines, coupons
Price Discrimination

- Firms can do this if:
  1) it can control the price of the product
  2) good cannot be resold
  3) it can determine the willingness to pay for the product

- Firms will discriminate against:
  1) groups of consumers
  2) units of the good purchased

- Monopolists will do this if price discrimination leads to higher profits

**MONOPOLY/ PERFECT COMPETITION COMPARISON**

<table>
<thead>
<tr>
<th>Perfect Comp</th>
<th>Monopoly</th>
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</thead>
<tbody>
<tr>
<td>1) $P_C = MC$ at optimum (Since $P_C = MR$)</td>
<td>$P_M &gt; MC$</td>
</tr>
<tr>
<td>2) $Q_C = Q^*$ (efficient)</td>
<td>$Q_M &lt; Q^*$</td>
</tr>
<tr>
<td>3) LR Normal Profit</td>
<td>LR + Profit</td>
</tr>
<tr>
<td>4) No price discrimination</td>
<td>Can price Discriminate</td>
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