DEFINITION, CAUSES & PRICING

CHAPTER 15

Monopoly

Market Characteristics

- One Seller
- Unique Product—no substitutes
- Difficult/Impossible to enter or leave industry
- Limited Information
- Great deal of price control— **Price Setters**

Barriers to Entry

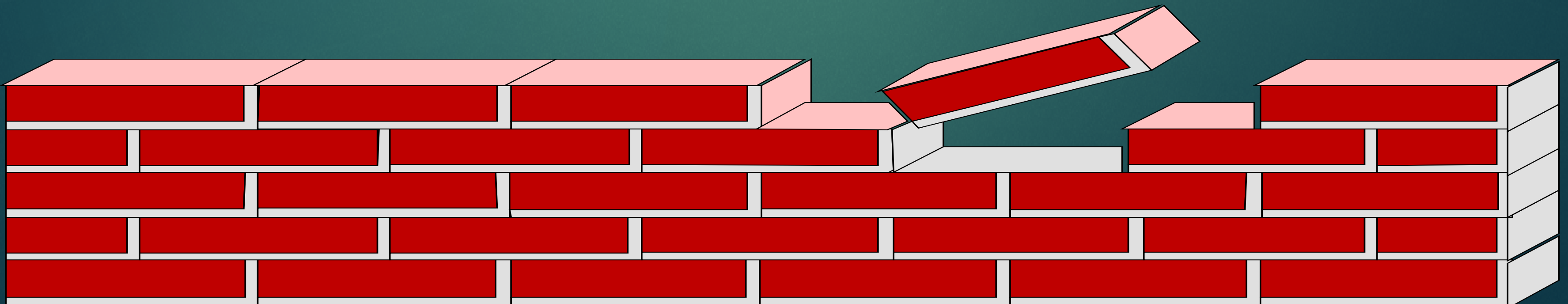
- The fundamental cause of monopoly is **Barriers to Entry**

- 3 primary sources of **Barriers to Entry:**

  1) **Ownership** of a key resource

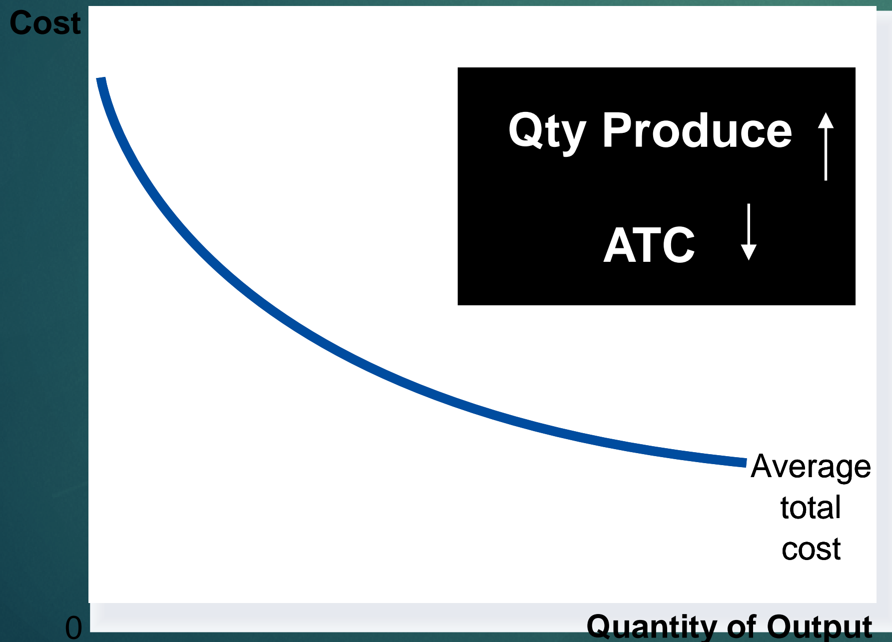
  2) **Government** gives one firm the exclusive right to produce

  3) **Costs of production** make a single producer more efficient



Natural Monopolies

- **natural monopoly-** when a single firm can supply a good or service at a lower cost
  - Develop in industries with large **economies of scale**



Examples

Utilities:
Electricity, Gas & Water

Government Regulation

- **Antitrust laws (1890)** - a collection of statutes aimed at curbing monopoly power by:
  - Breaking up companies
  - Preventing mergers
  - Regulating pricing

Monopoly **vs.** **Perfect Competition**

- Monopolies charge a **higher price** & provide **lower Qty**
- Monopoly charges a **Price > MC**
  - Competitive firms: Price = MC
- Monopolies create **deadweight loss** to society
  - Competitive firms: no deadweight loss

Profit Maximization

- <u>All</u> profit-maximizing firms set: **MR =MC**
- **Competitive firms**: **P = MR = MC**
- **Monopoly firm** = **P > MR = MC**

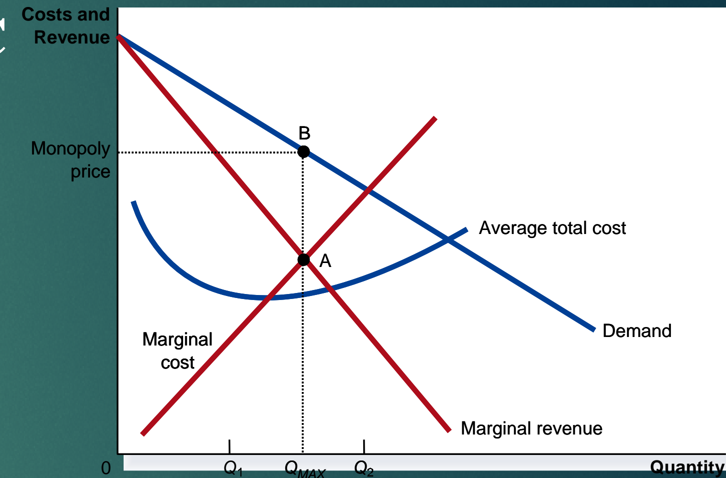
Collusion & Cartels

- **Collusion**
  - An agreement among firms about Qty to produce or price to charge
  - **Antitrust laws** prohibit this behavior in USA

- **Cartel**
  - A group of firms acting in unison
  - Example: OPEC

Allocative Efficiency

- Total Welfare is maximized only when **MC = MB** for society
  - Since **MB = Price** => only when **Price** = MC



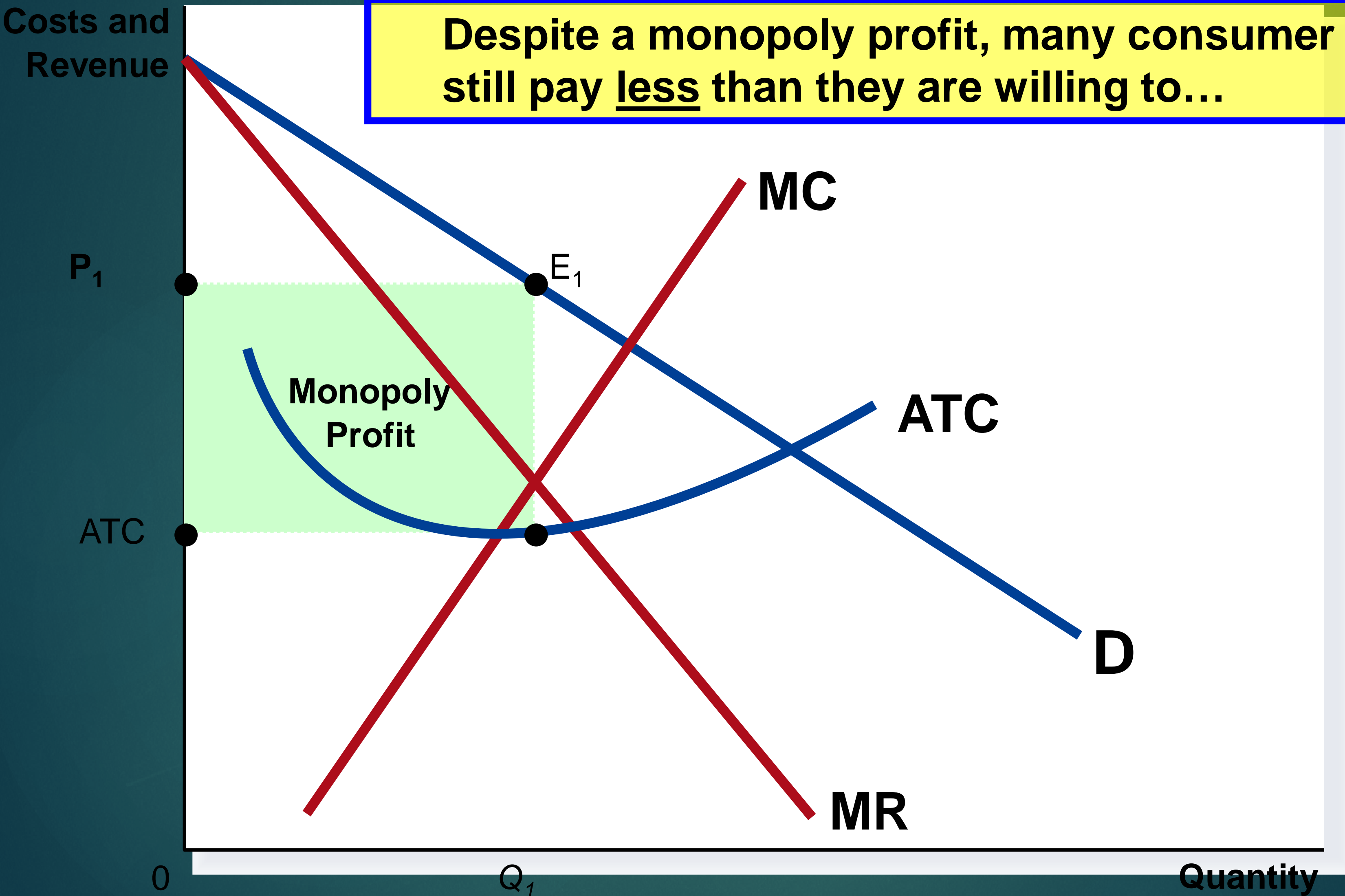
- **Allocate efficiency** is when **P** = MC

- Any other production point produces **deadweight loss**
  - Monopolies are not **allocatively efficient** (P > MC)
  - Competitive firms are (P = MC)

PRICE DISCRIMINATION

- **Price discrimination** is the business practice of selling the same good at different prices to different customers
- For a Firm to price discriminate it must:
  - have some **market power** (some price control)
  - be able to identify & separate groups of consumers
  - be able to prevent resale between consumers

Single Price Monopoly



"Imperfect" Price Discrimination

- It always raises monopolist **profits**
  - By charging higher prices to some customers
- It can lower **deadweight loss**
- It can raise, lower or leave **Total Welfare** unchanged

Imperfect Price Discrimination