Monopoly

Chapter 15-1

The market structure of Monopoly

What is a Monopoly?

- A **monopoly** is a market structure in which there is a single supplier of a product.
- The **monopoly firm (monopolist)**:
  - May be small or large.
  - Must be the **ONLY** supplier of the product.
  - Sells a product for which there are **NO** close substitutes.
- Monopolies are fairly common: U.S. Postal Service, local utility companies, local cable providers, etc.

Introduction

- ***Monopoly*** is a market structure in which a single firm makes up the entire market.
- Monopolies exist because of barriers to entry into a market that prevent competition.

The Creation of Monopolies

- Monopolies often arise as a result of barriers to entry.
- **Barrier to entry**: anything that impedes the ability of firms to begin a new business in an industry in which existing firms are earning positive economic profits.
- There are three general classes of barriers to entry:
  - Natural barriers, the most common being **economies of scale**
  - **Actions by firms** to keep other firms out
  - **Government (legal) barriers**

Economies of Scale

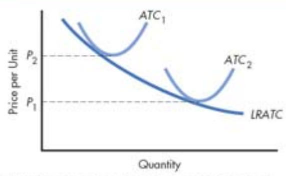
- In some industries, the larger the scale of production, the lower the costs of production.
- Entrants are not usually able to enter the market assured of or capable of a very large volume of production and sales.
- This gives incumbent firms a significant advantage.
- Examples are electric power companies and other similar utility providers.

A Monopolistic Market

- **Monopoly** is a market structure in which one firm makes up the entire market
- Barriers to entry into the market prevent competition
- Barriers to entry can be:
  - Legal
  - Sociological
  - Natural
  - Technological
- There are no close substitutes for the monopolist's product

Economies of Scale

FIGURE 1 Economies of Scale



A large firm producing along ATC_2 can produce output much less expensively per unit than a small firm operating along ATC_1. The large firm, therefore, can set a price that is below the minimum point of the small firm's average-total-cost curve yet still earn profit. Any price between P_1 and P_2 will provide a profit for the large firm and a loss for the small firm.

Actions by Firms

- Entry is barred when one firm owns an essential resource.
- Examples are inventions, discoveries, recipes, and specific materials.
  – Microsoft owns Windows, and has been challenged by the U.S. Dept. of Justice as a monopolist.

Government

- Governments often provide barriers, creating monopolies.
- As incentives to innovation, governments often grant **patents**, providing firms with legal monopolies on their products or the use of their inventions or discoveries for a period of 17 years.

Not in your book but another way to look at barriers

- ***Legal barriers***, such as patents, prevent others from entering the market.
- ***Sociological barriers*** – entry is prevented by custom or tradition.

- ***Natural barriers*** – the firm has a unique ability to produce what other firms can't duplicate.
- ***Technological barriers*** – the size of the market can support only one firm.

Types of Monopolies

- **Natural monopoly**: A monopoly that arises from economies of scale. The economies of scale arise from natural supply and demand conditions, and not from government actions.
- **Local monopoly**: a monopoly that exists in a limited geographic area.
- **Regulated monopoly**: a monopoly firm whose behavior is overseen by a government entity.
- **Monopoly power**: market power, the power to set prices.
- **Monopolization**: an attempt by a firm to dominate a market or become a monopoly.

Regulated Monopolies

- The **Florida Public Service Commission** exercises regulatory authority over utilities in the state of Florida in one or more of three key areas: rate regulation; competitive market oversight; and monitoring of safety, reliability, and service.