Monopoly

Chapter 15-5
Comparison of Perfect Competition & Monopoly

Comparing Monopoly and Perfect Competition

- Because the monopolist’s marginal revenue is below its price, price and quantity will not be the same.
- The monopolist’s equilibrium output is less than, and its price is higher than, for a firm in a competitive market.

The Welfare Loss from Monopoly

- People’s purchase decisions don’t reflect the true cost to society because monopolies charge a price higher than marginal cost.
### The Welfare Loss from Monopoly

- The marginal cost of increasing output is lower than the marginal benefit of increasing output.

### Barriers to Entry

- Natural Ability
  - A firm is better at producing the good than anyone else
- Economies of Scale
  - Natural monopoly is when a single firm can produce at a lower cost than can two or more firms
- Government-Created Monopolies
  - Patents, licenses, and franchises
- If there were no barriers to entry, profit-maximizing firms would always compete away monopoly profits

### A Natural Monopoly Graph

- One firm producing $Q_1$ has average cost $C_1$
- If two firms share the market, each produces $Q_{0.5}$ and has average cost $C_{0.5}$
- If three firms share the market, each produces $Q_{0.33}$ has average cost $C_{0.33}$

### The Welfare Loss from Monopoly

- The welfare loss of a monopolist is represented by the triangles $B$ and $D$.
- The welfare loss is often called the deadweight loss or welfare loss triangle.
A Natural Monopoly Graph: Profit and Regulation

• A natural monopolist produces Q_M and charges P_M, therefore earning a profit
• If there is government regulation and a competitive solution where P = MC is required, the monopolist produces Q_C and charges P_C, therefore earning a loss

Normative Views of Monopoly

• Monopolies are unjust because they restrict freedom to enter business
• Monopolies transfer income from “deserving” consumers to “undeserving” monopolists
• Monopolies cause potential monopolists to waste resources trying to get monopolies
  • Rent-seeking activities

Government Policy and Monopoly: AIDS Drugs

• A few companies have patents for AIDS drugs that enable them to charge high prices because demand is inelastic

Policy Options
• Government regulation where price = marginal cost benefits society, but discourages research
• Government purchase of the patents and allowing anyone to produce the drugs so their price = marginal cost. This is expensive for taxpayers.