Monopoly

Chapter 15-5
Comparison of Perfect Competition & Monopoly

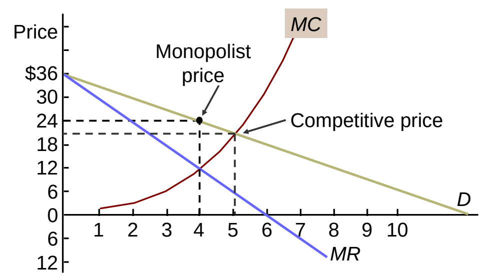
Comparing Monopoly and Perfect Competition

- Equilibrium output for both the monopolist and the competitor is determined by the

  ***MC = MR* condition.**

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.



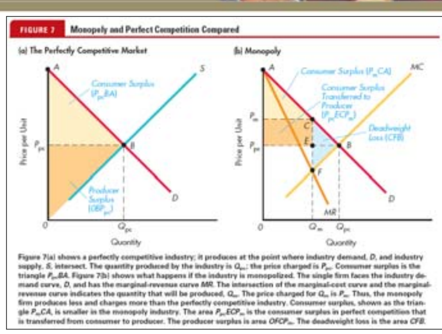


Figure 7(a) shows a perfectly competitive industry; it produces at the point where industry demand, D, and industry supply, S, intersect. The quantity produced by the industry is Q_{pc}; the price charged is P_{pc}. Consumer surplus is the triangle $P_{pc}BA$. Figure 7(b) shows what happens if the industry is monopolized. The single firm faces the industry demand curve, D, and has the marginal-revenue curve MR. The intersection of the marginal-cost curve and the marginal-revenue curve indicates the quantity that will be produced, Q_m. The price charged for Q_m is P_m. Thus, the monopoly firm produces less and charges more than the perfectly competitive industry. Consumer surplus, shown as the triangle $P_m CA$, is smaller in the monopoly industry. The area $P_{pc}ECP_m$ is the consumer surplus in perfect competition that is transferred from consumer to producer. The producer surplus is area $OFCP_m$. The deadweight loss is the area CFB.

The Welfare Loss from Monopoly

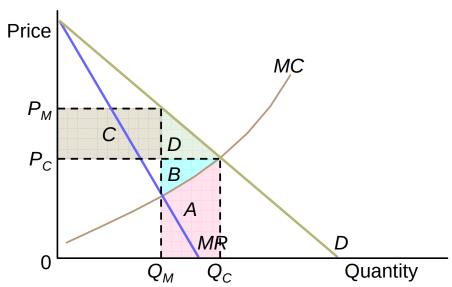
- People's purchase decisions don't reflect the true cost to society because monopolies charge a price higher than marginal cost.

The Welfare Loss from Monopoly

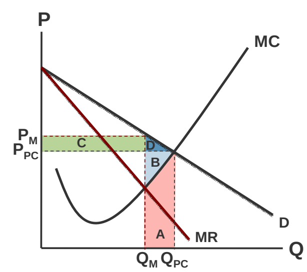
- The marginal cost of increasing output is lower than the marginal benefit of increasing output.

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.



The Welfare Loss from a Monopoly

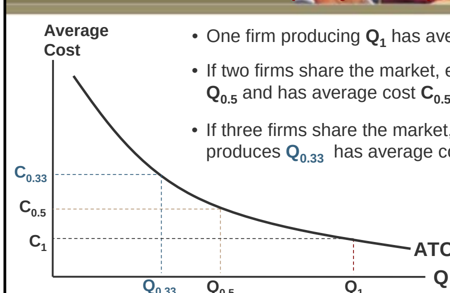


- The welfare loss from a monopoly is represented by the triangles **B** and **D**
- The rectangle **C** is a transfer of surplus from the consumer to the monopolist
- The area **A** represents the opportunity cost of diverted resources, which is not a loss to society

Barriers to Entry

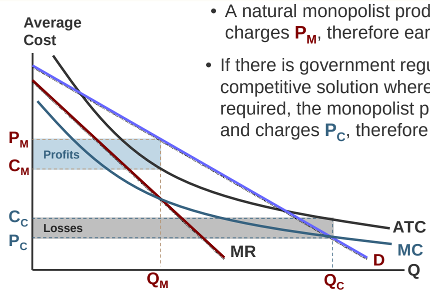
- Natural Ability
  - A firm is better at producing the good than anyone else
- Economies of Scale
  - **Natural monopoly** is when a single firm can produce at a lower cost than can two or more firms
- Government-Created Monopolies
  - Patents, licenses, and franchises
- If there were no barriers to 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 $C_{0.33}$

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

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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

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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.

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