Monopoly

Chapter 11-1
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.

Economies of Scale

A large firm producing along ATC can produce output much less expensively per unit than a small firm operating along ATC. The large firm, therefore, can set a price that is below the minimum point of the small firm's average total-cost curve but still earn profit. Any price between P1 and P2 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.