Ch 14. Monopoly

Types of Market Structure

# of Producers	Prod. Differentiation: No	Prod. Differentiation: Yes
One	Monopoly	NA
Few	Oligopoly	
Many	Perfect Competition	Monopolistic Competition

Monopolist : sole supplier of the good

It has market power : ability to raise the price

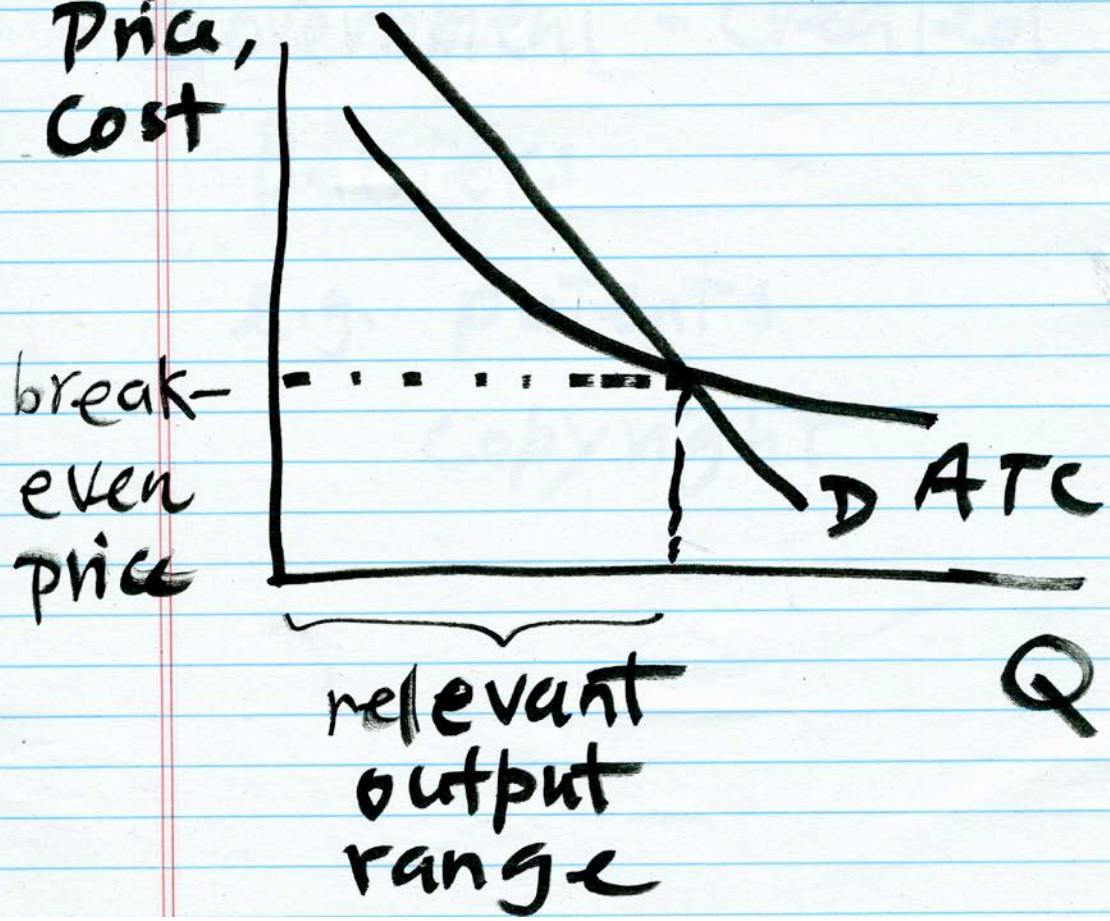
For profitable monopoly to persist, they need barriers to entry

4 barriers to entry

- Control of a scarce Resource or Input
- Increasing returns to scale
  ⇒ generate "natural monopoly"

e.g. local utilities — water, gas, electricity, land-line phone service

Natural monopoly:
average total cost
is falling over the
relevant output range



- Technological Superiority
  (but "network externalities")

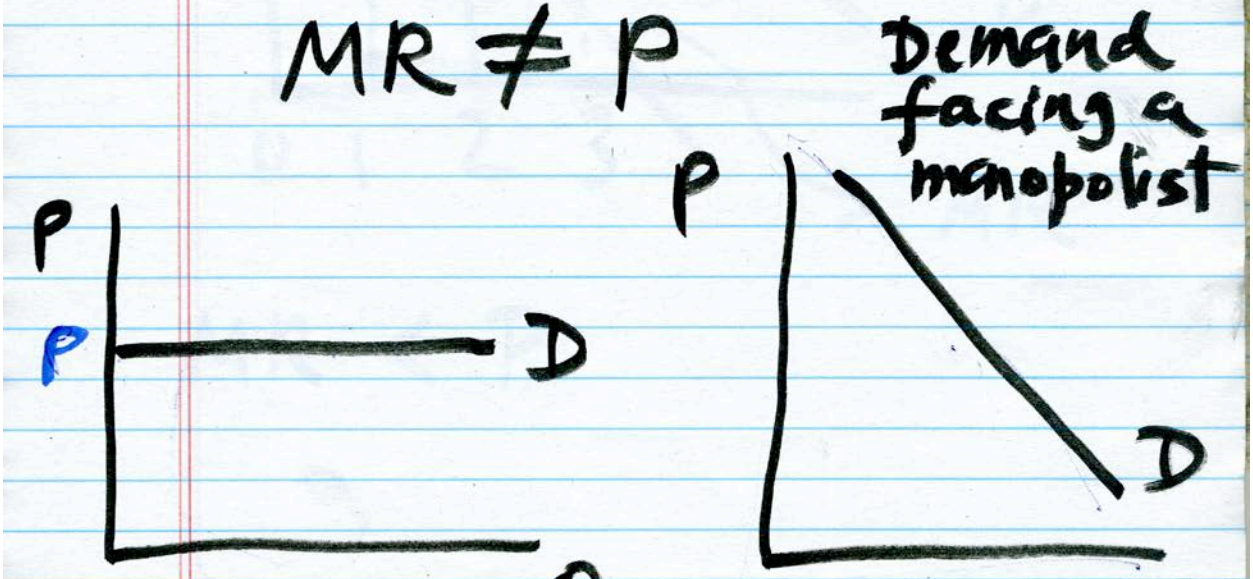
- Government-Created Barriers
  e.g. patents
  copyright

Profit Maximization by a Monopolist

produce until MR = Mc

but with a Monopolist,

MR ≠ P

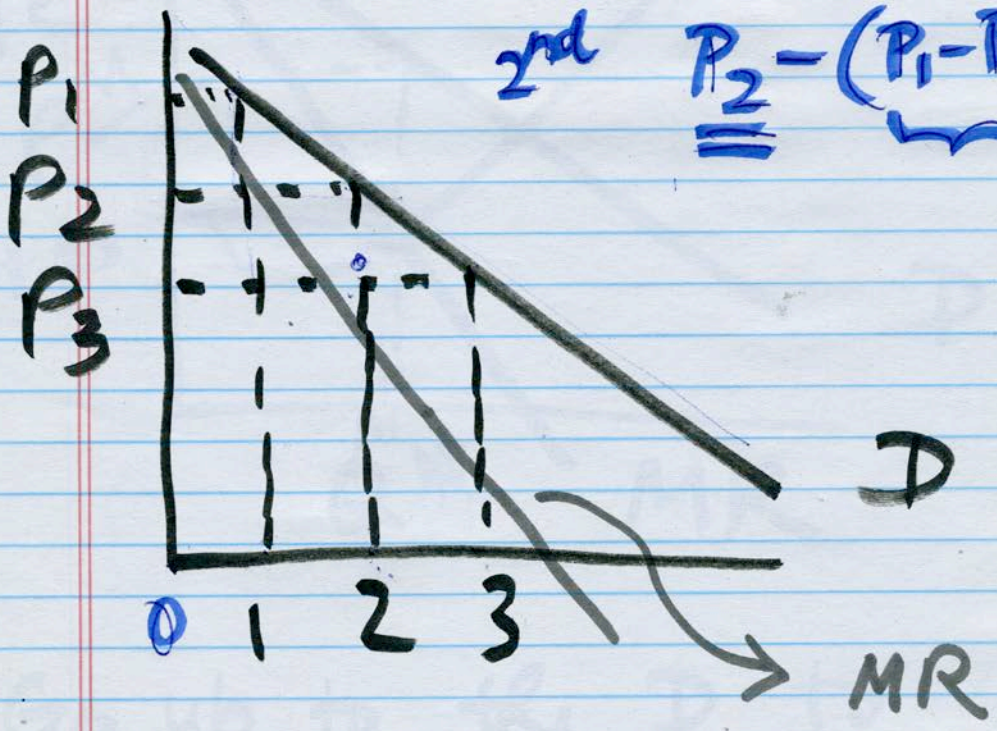


Demand facing a perfectly competitive firm

$MR = \Delta TR / \Delta Q$

MR

2nd $P_2 - (P_1 - P_2)$



$MR < P$

Monopoly

Profit maximization

special Case in Krugman:

Constant (horizontal) marginal cost, no fixed cost

Each additional unit costs say $5

No fixed cost, so ATC = AVC since ATC = AVC + AFC and AFC = 0

Since MC is constant,

AVC = MC

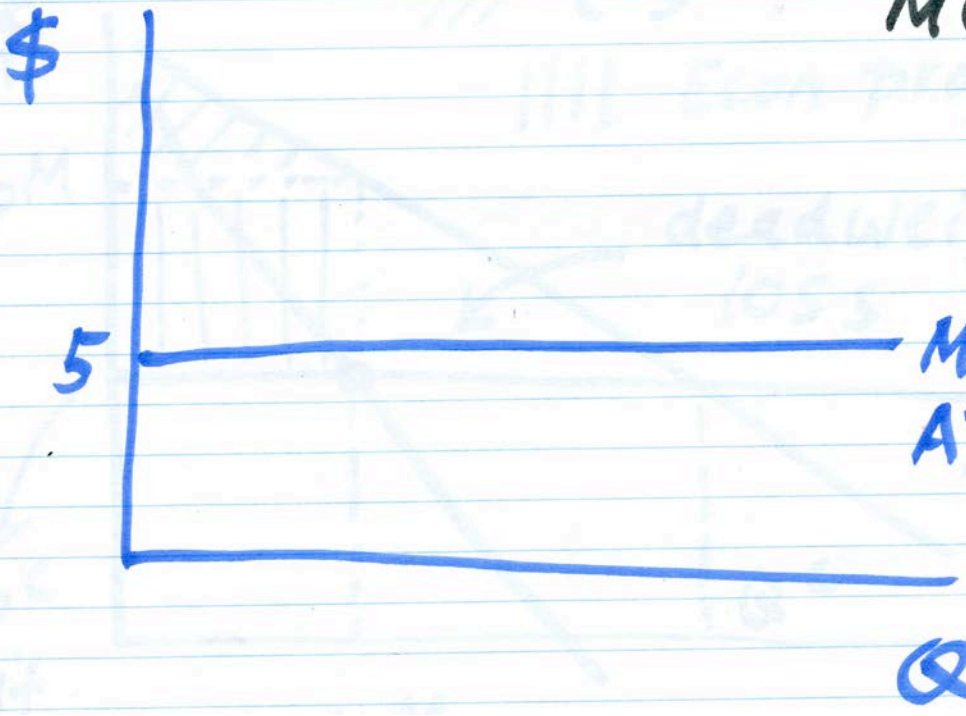
but AFC = 0

so ATC = MC

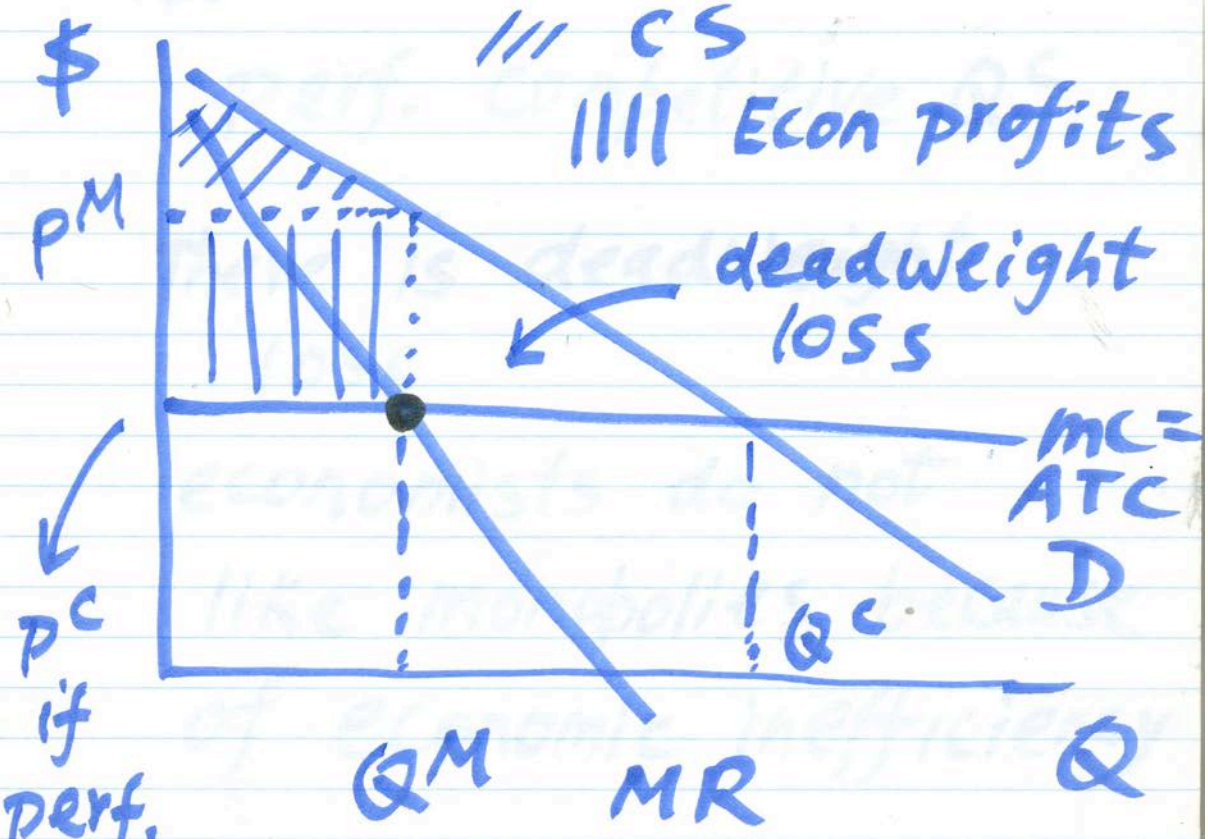
ATC = AFC + AVC

AFC = 0

AVC = MC



Profit Maximization of a Monopoly with the special case of constant MC and no fixed cost



$P \neq MR = MC$

P^M is higher than perf. competitive price P^C

Q^M is smaller than perf. competitive Q^C

There is deadweight loss

economists do not like monopolies because of economic inefficiency

With a monopolist,

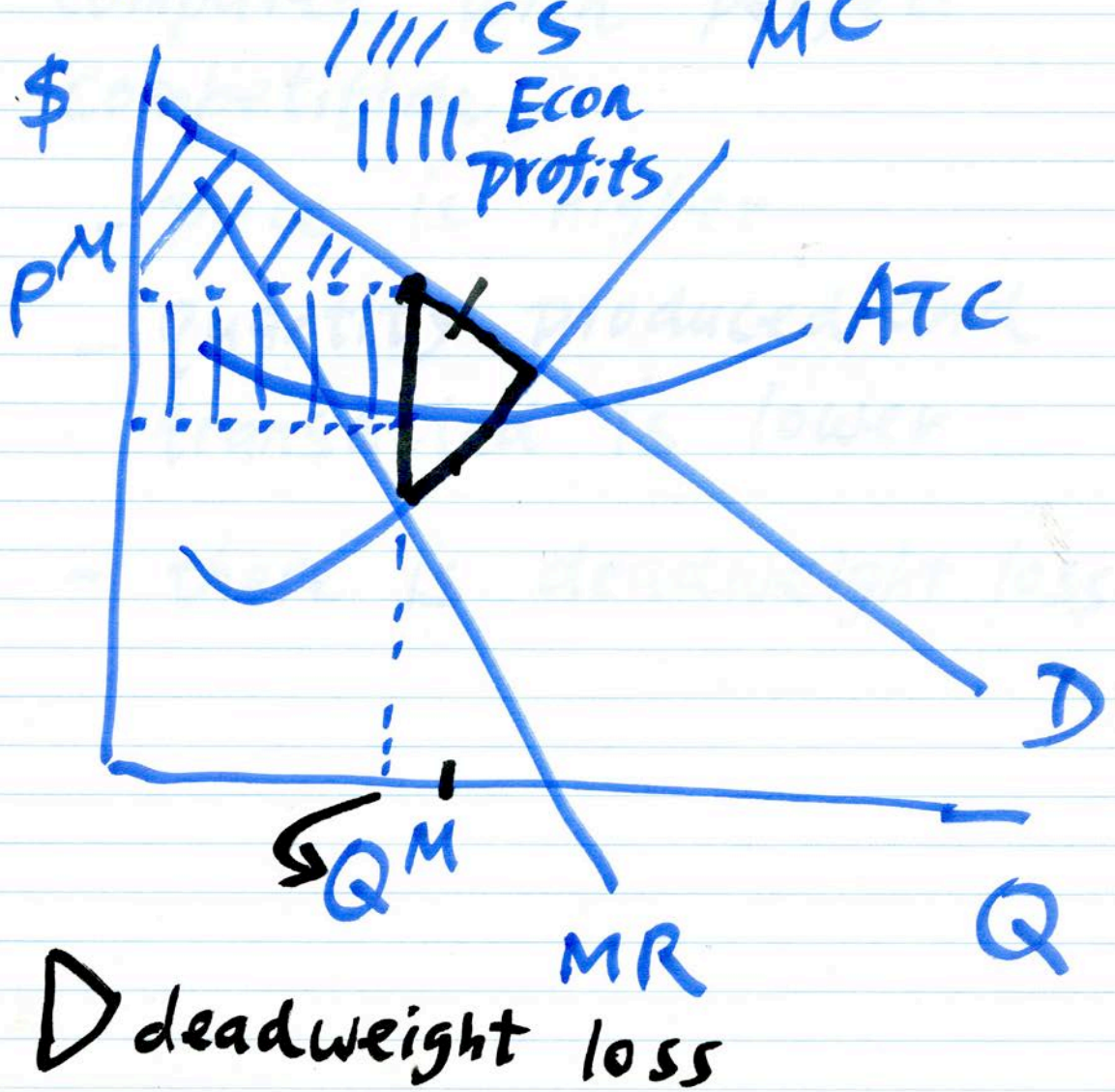
$P^M > MC$

to maximize profits, a monopolist chooses Q^M such that $MR = MC$

$P^M > MC = MR$

Consumer surplus is smaller with a monopolist

The general or standard case with standard MC



Same results as before,

Under a monopoly, as compared with perfect competition,

- price is higher
- quantity produced and transacted is lower
- there is deadweight loss