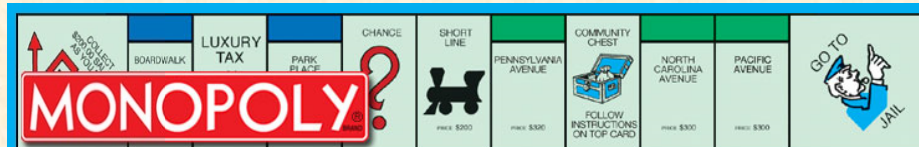


Chapter 10: Monopoly



Wayne Geerling
Monash University

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Christian Finnegan talks “Monopoly”

2

Monopoly

- A monopoly has three main characteristics:
 - Many buyers but few sellers
 - No close substitutes with no good substitutes.
 - Produces in a market with high barriers to entry

Do monopolists always make a profit?

3

Natural Barriers to Entry

- Control of resources:

In the early 1900's, ALCOA owned about 90% of the world's bauxite

De Beers owns nearly 90% of the world's diamond mines

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Natural Barriers to Entry

- Natural monopoly:
 - A monopoly exists because a large firm has costs than any potential competitor.
- Makes it hard for other
- Caused by high & a

5

Government-Created Barriers to Entry

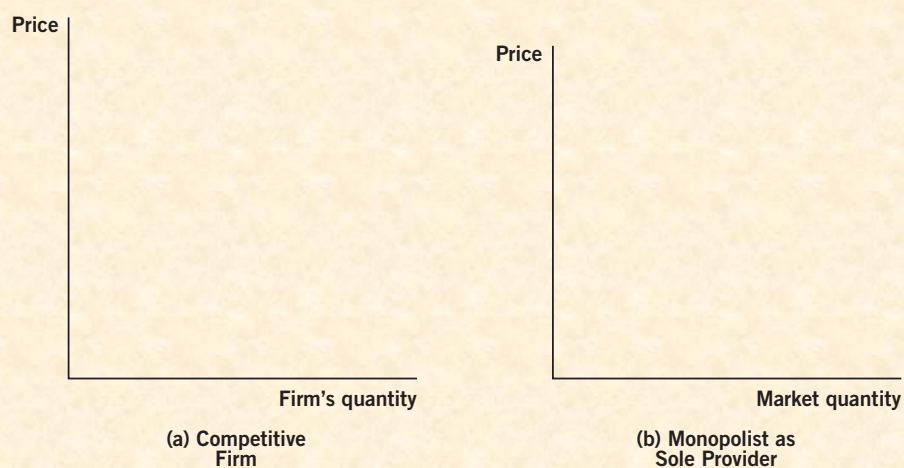
6

Monopolist's Pricing & Output Decisions

- Perfectly competitive firms
 - Price _____, cannot affect
 - Each firm faces a _____ demand
- Monopoly firm
 - Price _____ the price by choosing output level
 - Faces the _____ demand curve for the entire industry

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Comparing Demand Curves



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Profit-Maximizing Rule for Monopoly

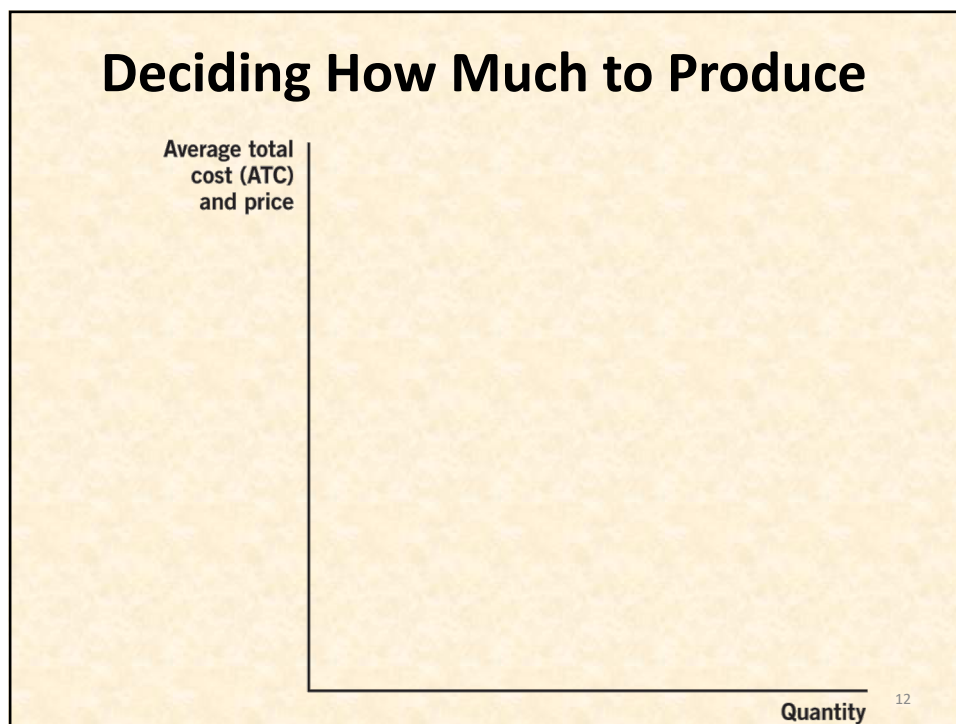
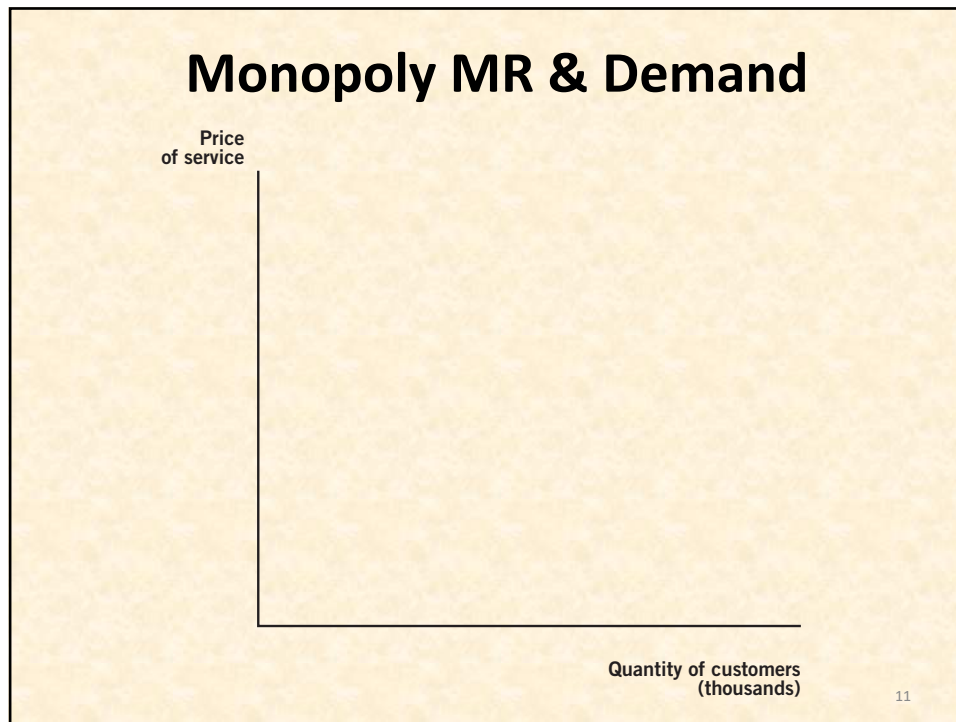
- Profit-maximizing rule for firm:
 - $MR = MC$
- Under perfect competition: $P = MR$
- With a monopoly: $P > MR$

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Monopoly Marginal Revenue

- When the monopoly decreases its price in order to sell more output units, two things happen:
 - The price effect:
 - The output effect:

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The Monopolist's Profit

Average total
cost (ATC)
and price

Quantity

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The Monopolist's Loss

Average total
cost (ATC)
and price

P = \$50

MC

D

MR = MC

MR

Q = 1,000

Quantity

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Contrasting Competition & Monopoly

Competitive Markets	Monopoly
Many firms	One firm
Produces efficient level of output (since $P = MC$)	Produces less than the efficient level of output (since $P > MC$)
Cannot earn long-run economic profits	May earn long-run economic profits
Has no market power (is a price taker)	Has significant market power (is a price maker)

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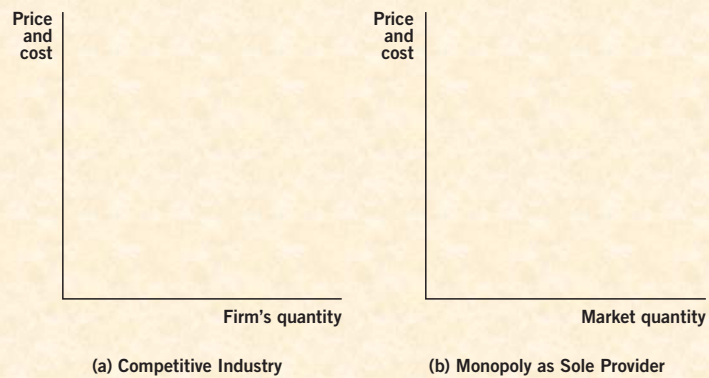
Problems with Monopolies

1. Produce an _____ level of output and charge an price
2. Less choice for consumers
3. Rent-seeking behavior

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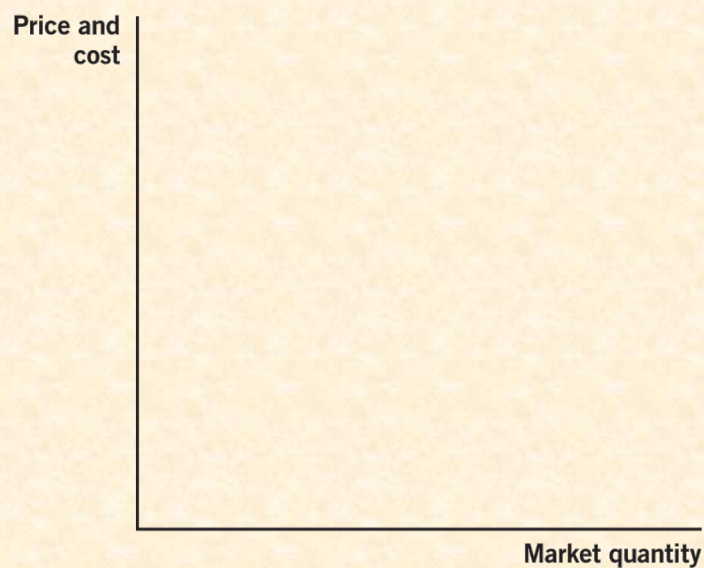
1. Monopolies are Inefficient

1. Prices are _____ and output is _____ than under perfect competition.



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Deadweight Loss of Monopoly



18

Corner the Market

19

2. Less Choice for Consumers

2. A reduction in the competitiveness of a market
to consumers.

There is only ONE seller.

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Monopoly in *The Office*, “Moroccan Christmas”

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3. Rent Seeking

- Occurs when resources are used to secure monopoly rights through the political process.
- Rival firms may compete to become a
- Resources used to monopolise rather than become a more

22

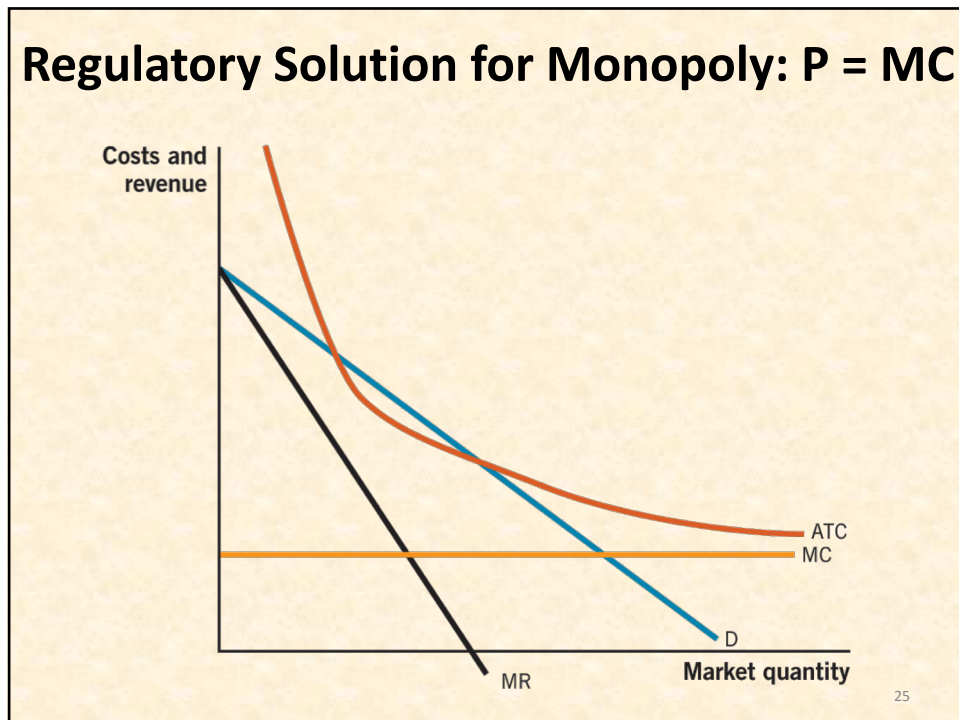
Rent Seeking and Competition in *South Park*

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Solutions to Monopoly

- 1. Break up the monopoly
- 2. Reduce barriers to entry, e.g. foreign competition.
- 3. Regulate the market, e.g. force the monopolist to set $P = MC$ or $P = ATC$

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Regulating Markets: $P = MC$

- At $P = MC$
 - The monopolist experiences a
- Solutions?
 - Government subsidies given to the firm?

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