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Pure Monopoly

McGraw-Hill/Irwin

Four Market Models

Characteristics of the Four Basic Market Models

Characteristic	Pure Competition	Monopolistic Competition	Oligopoly	Monopoly
Number of firms	A very large number	Many	Few	One
Type of product	Standardized	Differentiated	Standardized or differentiated	Unique; no close subs.
Control over price	None	Some, but within rather narrow limits	Limited by mutual inter-dependence; considerable with collusion	Considerable
Conditions of entry	Very easy, no obstacles	Relatively easy	Significant obstacles	Blocked
Nonprice competition	None	Considerable emphasis on advertising, brand names, trademarks	Typically a great deal, particularly with product differentiation	Mostly public relation advertising
Examples	Agriculture	Retail trade, dresses, shoes	Steel, auto, farm implements	Local utilities

An Introduction to Pure Monopoly

- Single seller – a sole producer
- No close substitutes – unique product
- Price maker – control over price
- Blocked entry – strong barriers to entry block potential competition
- Non-price competition – mostly PR or advertising the product

Public utility companies	Near monopolies	Professional sports teams
• Natural Gas • Electric • Water	• Intel • Wham-O	

Barriers to Entry

- Barrier to entry: a factor that keeps firms from entering an industry
  - Economies of scale
  - Legal barriers: patents and licenses
  - Ownership of essential resources
  - Pricing

Monopoly Demand

- The pure monopolist is the industry
- Demand curve is the market demand curve
    - Downsloping demand curve
- Marginal revenue is less than price

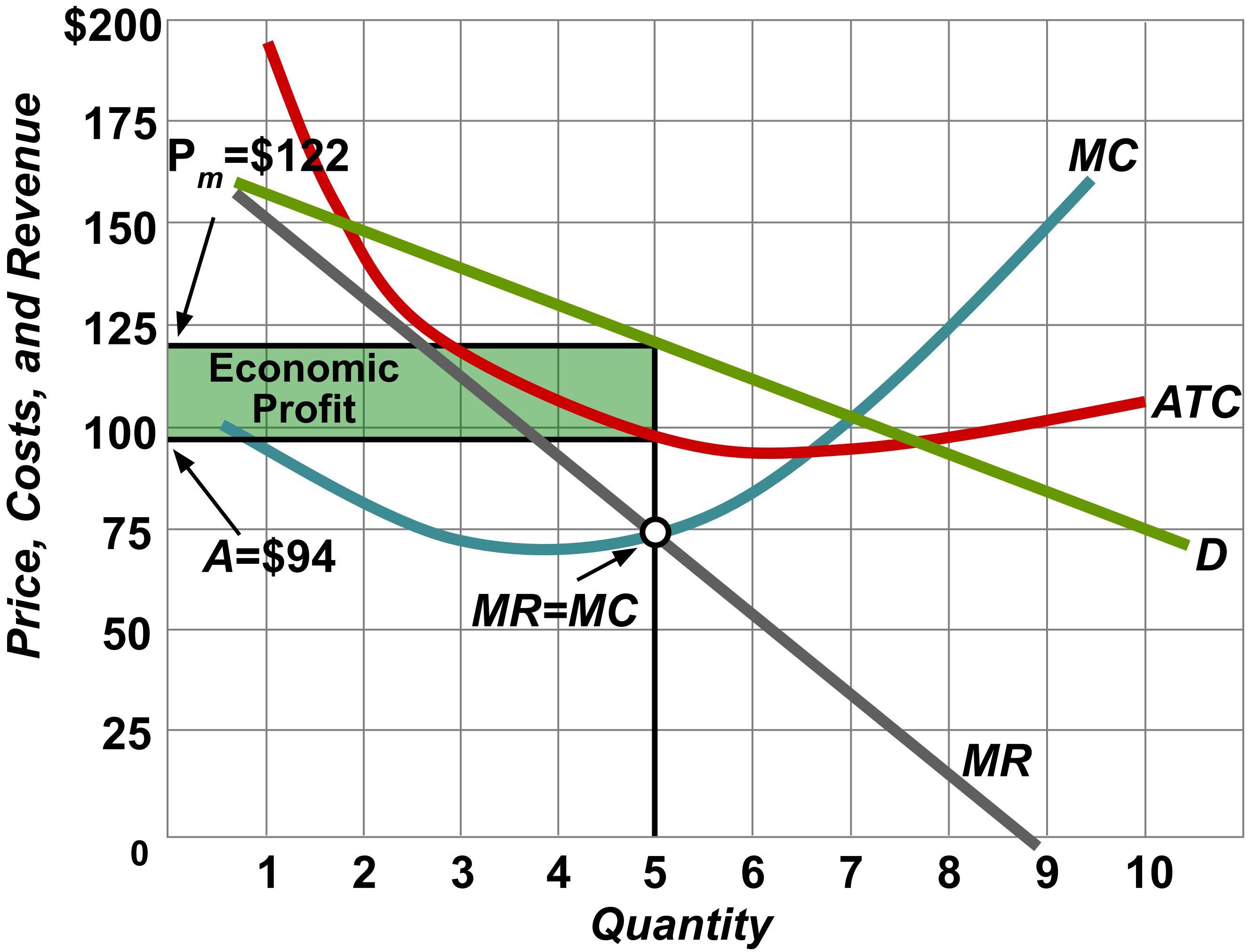
Monopoly Demand

- Marginal revenue < price
- Monopolist is a price maker
- Monopolist sets prices in elastic region of demand curve

Output and Price Determination

Steps for Graphically Determining the Profit-Maximizing Output, Profit-Maximizing Price, and Economic Profits (if Any) in Pure Monopoly	
Step 1	Determine the profit-maximizing output by finding where MR=MC.
Step 2	Determine the profit-maximizing price by extending a vertical line upward from the output determined in step 1 to the pure monopolist's demand curve.
Step 3	Determine the pure monopolist's economic profit by using one of two methods:
	Method 1. Find profit per unit by subtracting the average total cost of the profit-maximizing output from the profit-maximizing price. Then multiply the difference by the profit-maximizing output to determine economic profit (if any).
	Method 2. Find total cost by multiplying the average total cost of the profit-maximizing output by that output. Find total revenue by multiplying the profit-maximizing output by the profit-maximizing price. Then subtract total cost from total revenue to determine the economic profit (if any).

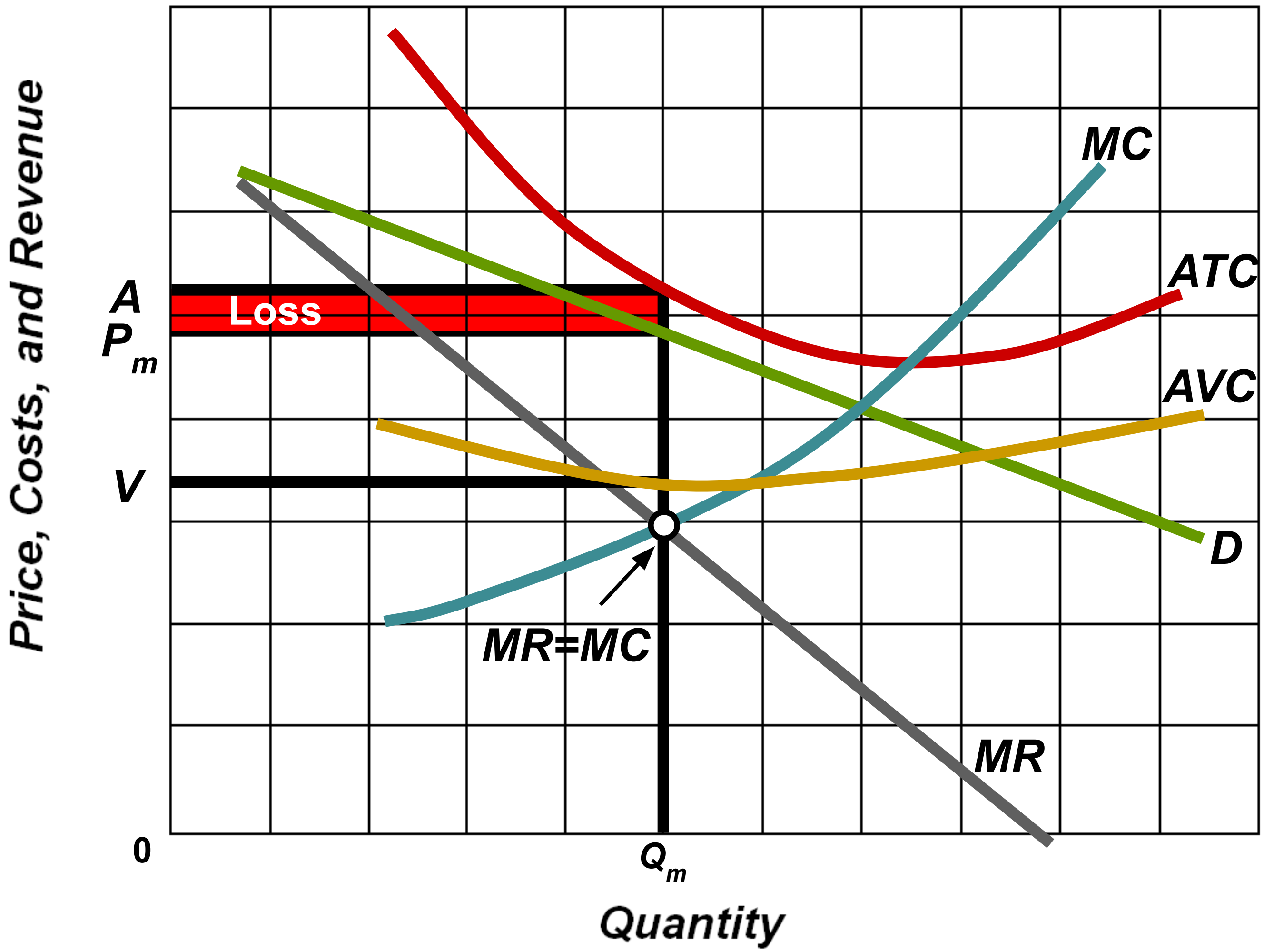
Output and Price Determination



Misconceptions of Monopoly Pricing

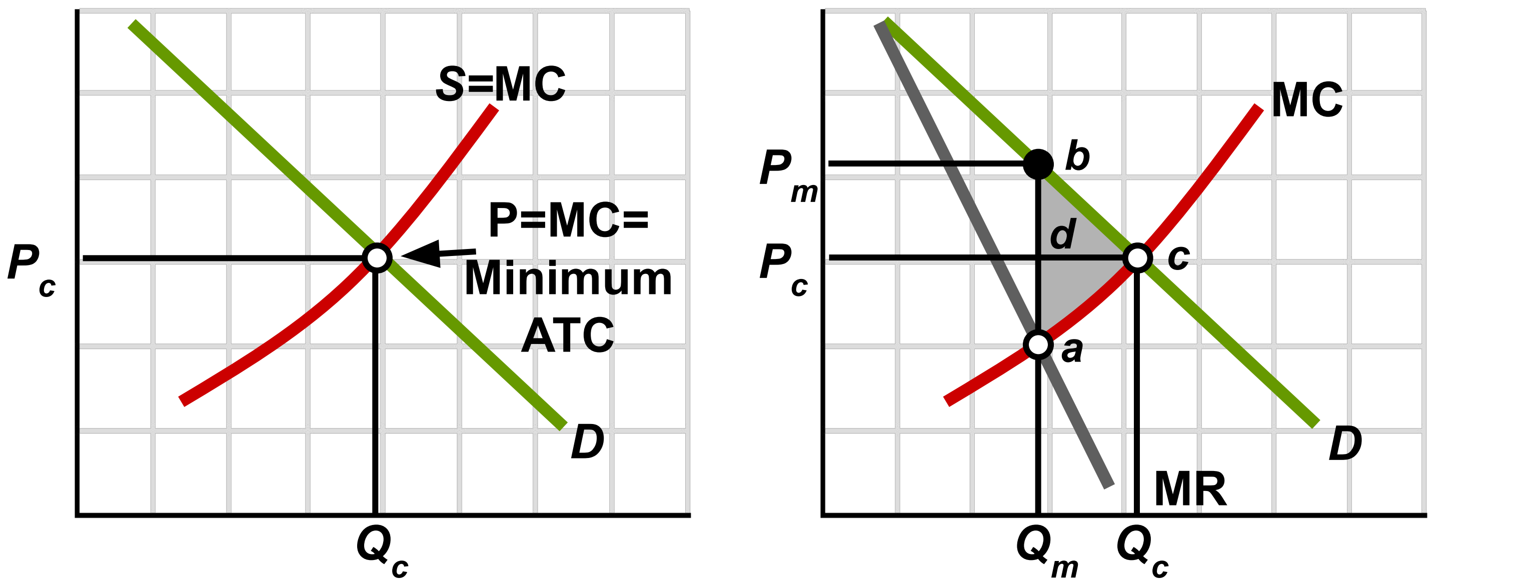
- Not highest price
- Total profit
- Possibility of losses

Misconceptions of Monopoly Pricing



Economic Effects of Monopoly

Pure competition is efficient
Monopoly is inefficient



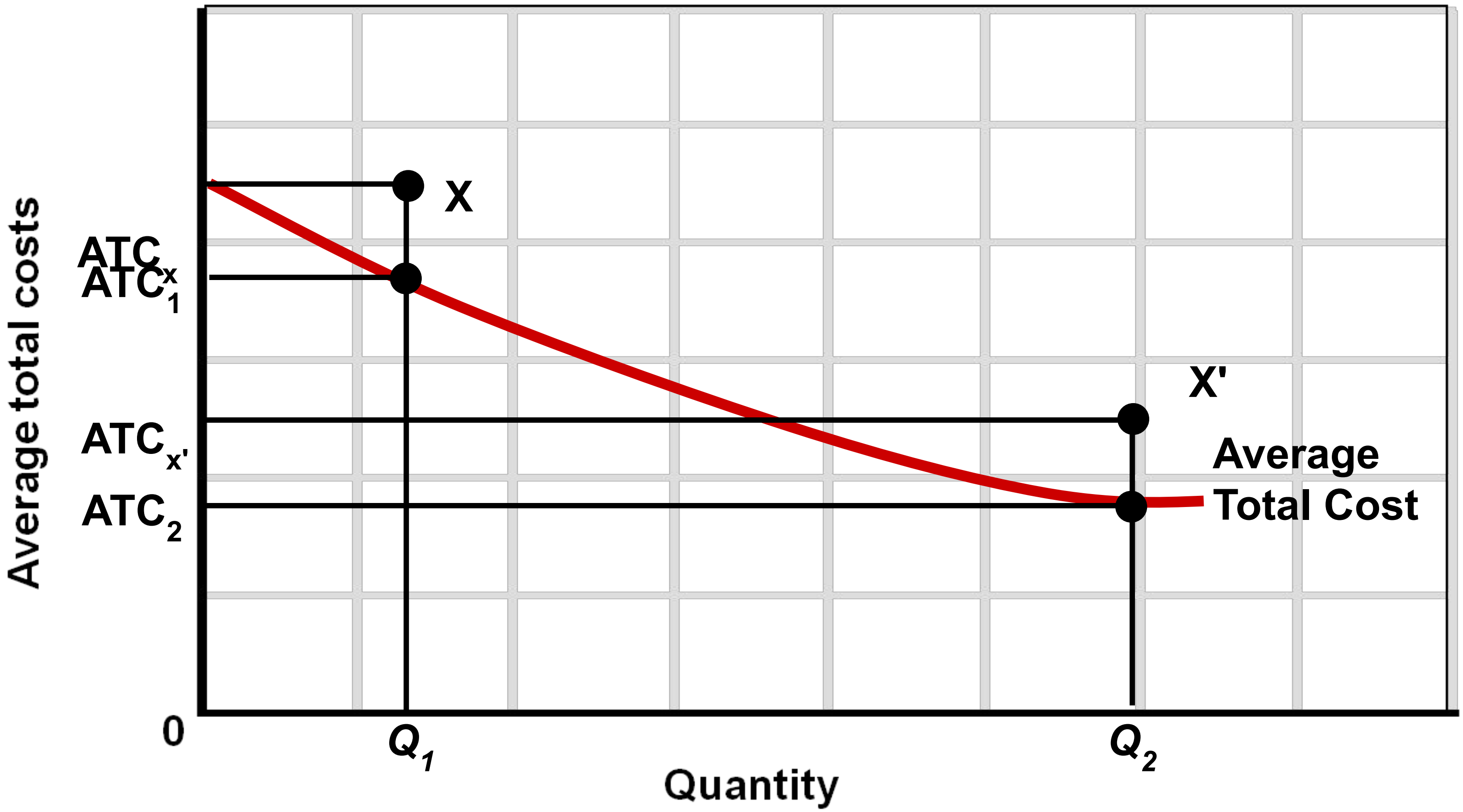
(a)
Purely Competitive Market

(b)
Pure Monopoly

Economic Effects of Monopoly

- Income transfer
- Cost complications
  - Economies of scale
  - X-Inefficiency
  - Rent seeking expenditures
  - Technological advance

X-Inefficiency



Price Discrimination

- Price discrimination
  - Charging different buyers different prices
  - Price differences are not based on cost differences
  - Examples: business travel, electric utilities, movie theaters, golf courses, railroad companies, coupons, international trade

Price Discrimination

- Conditions for success:
  - Monopoly power
  - Market segregation
  - No resale

Regulated Monopoly

- Natural monopolies
- Socially optimal price
  - Set price = marginal cost
- Fair return price
  - Set price = ATC

Regulated Monopoly