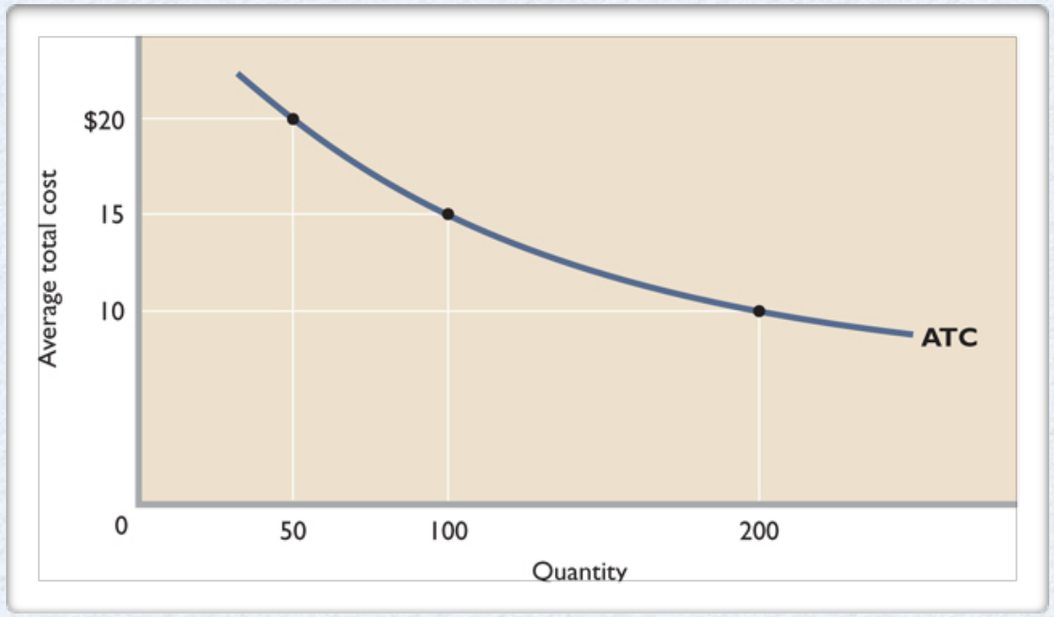
CHAPTER 12

Pure Monopoly

- **Pure Monopoly - exists when a single firm is the sole producer of a product for which there are no close substitutes**
- **Monopoly characteristics**
  - Single seller
  - No close substitutes for the product
  - Price maker, the pure monopolist has a downsloping demand curve
  - Blocked entry into the industry
  - Nonprice competition - standardized or differentiated products advertising
- Examples of monopoly - natural gas and electric companies, water companies, cable companies, telephone companies, ... near monopolies - Intel 80% market share, DeBeers now 55% market control - used to be a monopoly, ...

Barriers to Entry

- **Barriers to entry - The factors that prohibit firms from entering an industry are called barriers to entry**
  - **Economies of scale** - declining ATC with added firm size are extensive. The firm's ATC curve will decline over a wide range of output, hence it is difficult to compete with it.
    - Financial obstacles and risks could be prohibitive - automobile industry
    - In the case where the market demand curve cuts the long run ATC curve where ATC is still declining, the single firm is called a natural monopolist



Barriers to Entry

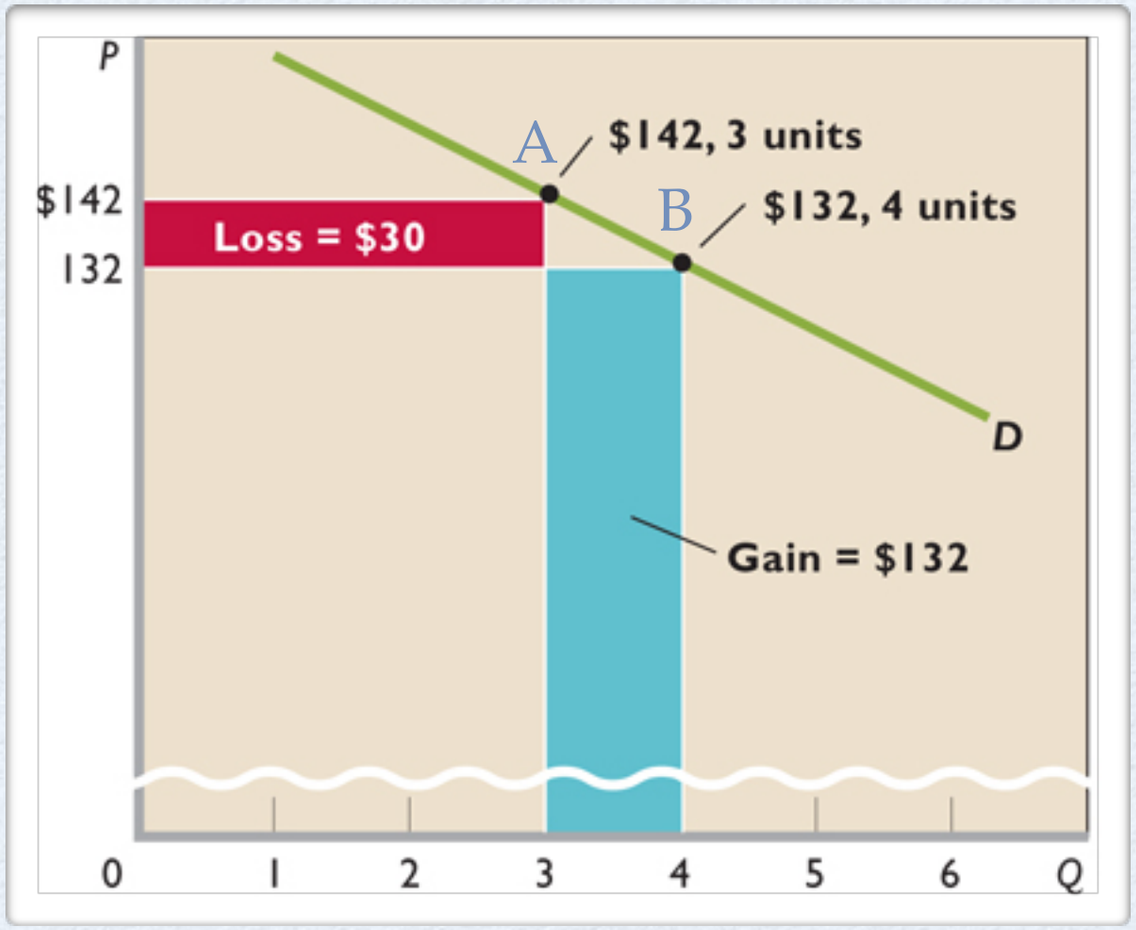
- **Legal barriers to entry: patents and licenses**
  - **Patents** - an exclusive right of an inventor to use, or allow another to use, his or her invention
    - Life of the patent - 20 years
    - R & D is prime candidate
  - **Licenses** - government uses it to limit entry into certain industries, for example, cabs, liquor, ...
- **Ownership or control of essential resources**
  - Ownership of private property - Nickel Co. of Canada owned 90% of the world's nickel reserves
- **Pricing and other strategic barriers to entry**
  - In case of a new potential entrant, the monopolist can lower its price to prevent new entry into the industry

Monopoly Demand

- ***Assumptions***
  - *Patents, economies of scale, resource ownership exists*
  - *No government regulations*
  - *The firm is a single price monopolist - it only charges one price*
- In the case of pure monopoly, the firm's demand curve is the industry demand curve as well

Monopoly Demand

- **Marginal revenue is less than price**



A = TR = 3 * $142 = $426

B = TR = 4 * $132 = $528

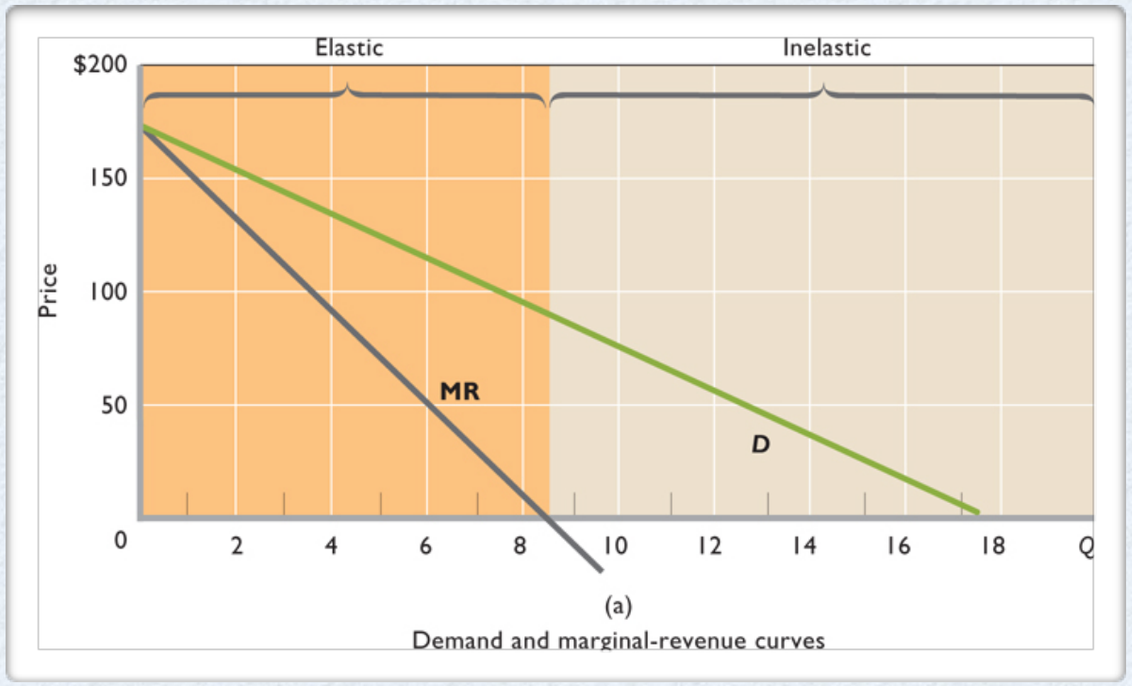
ΔTR = $102

MR = $102 < P = $132

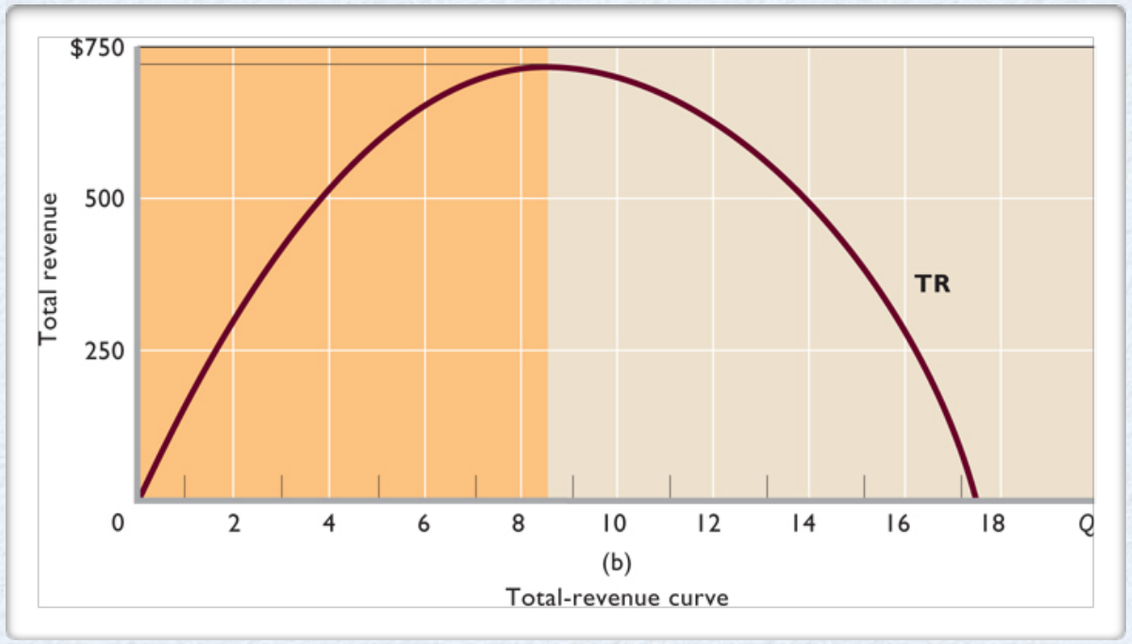
MR curve will be below the demand curve

Monopoly Demand

- **MR < P**



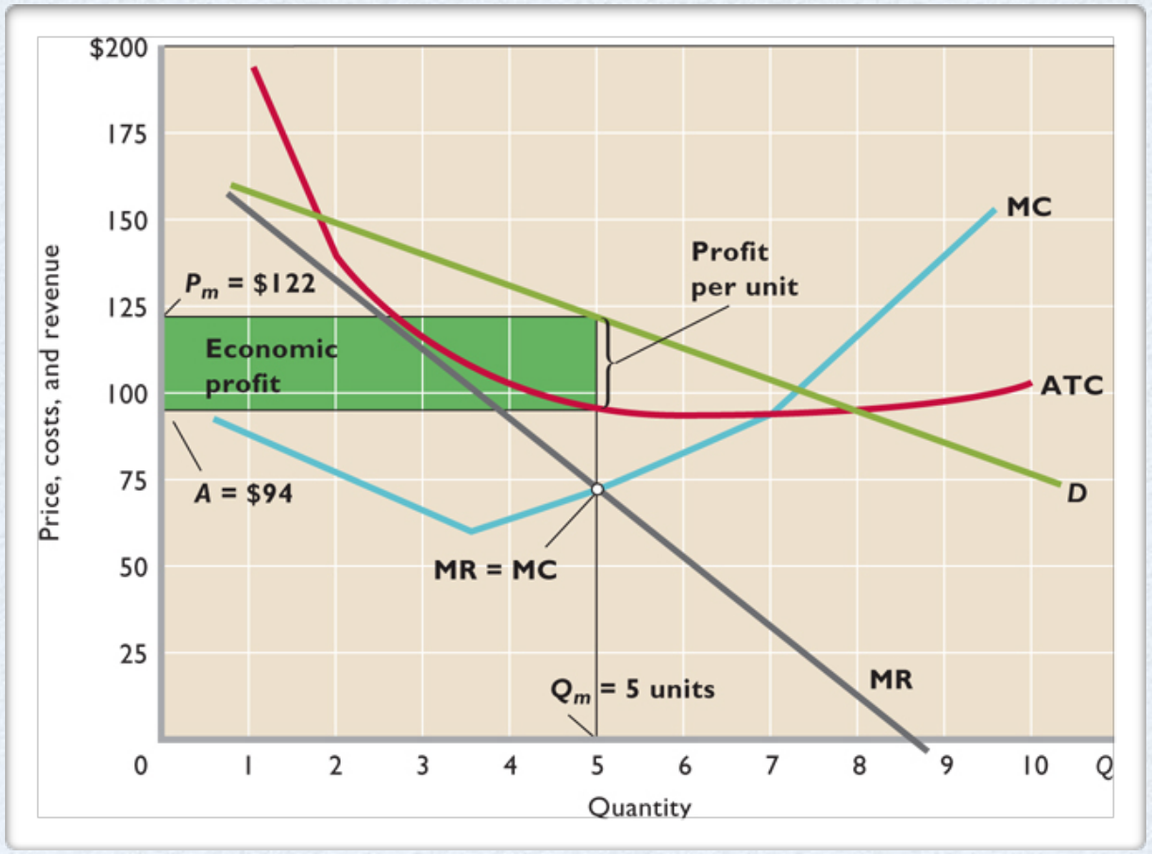
Declining MR indicates that TR increases but at a diminishing rate.

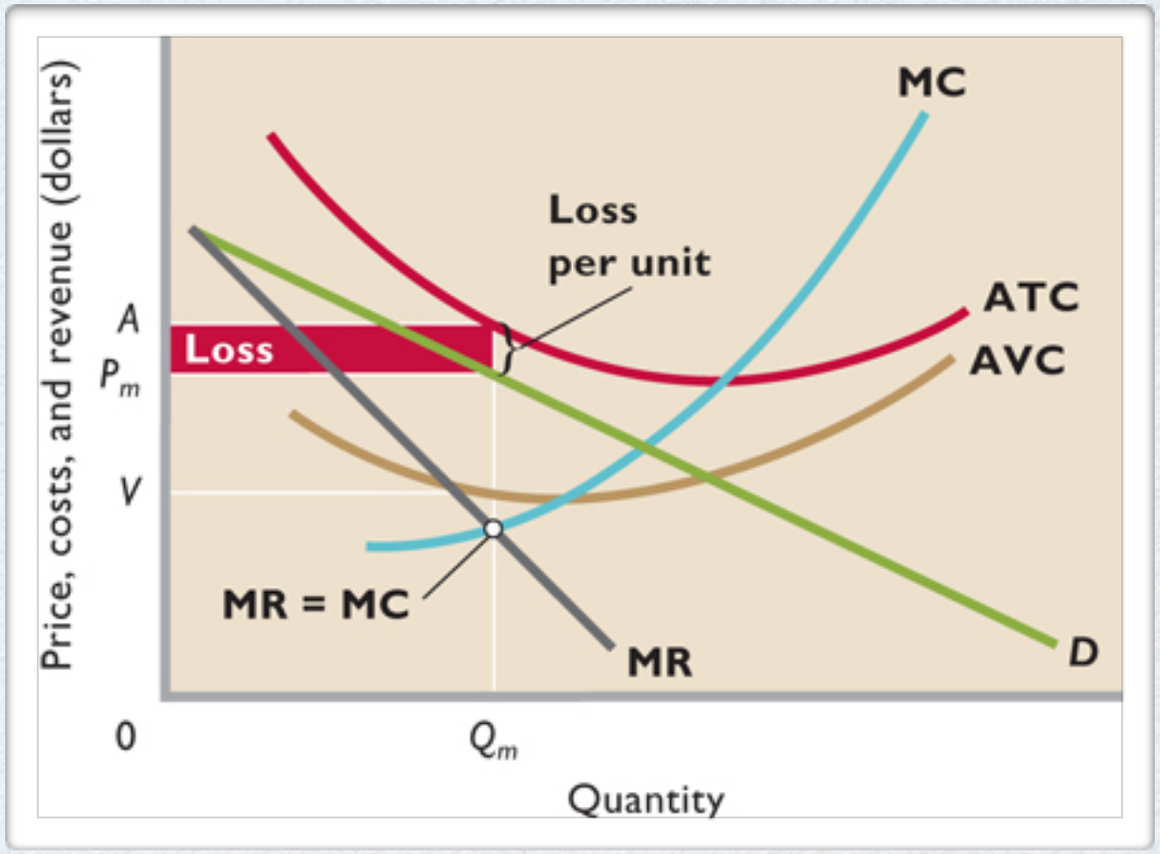


The monopolist will always want to sell in the elastic part of the demand curve where MR is positive. Do not want TR to decline as additional units are sold.

Output and Price Determination

- **Profit maximizing for the monopolist - MR = MC**





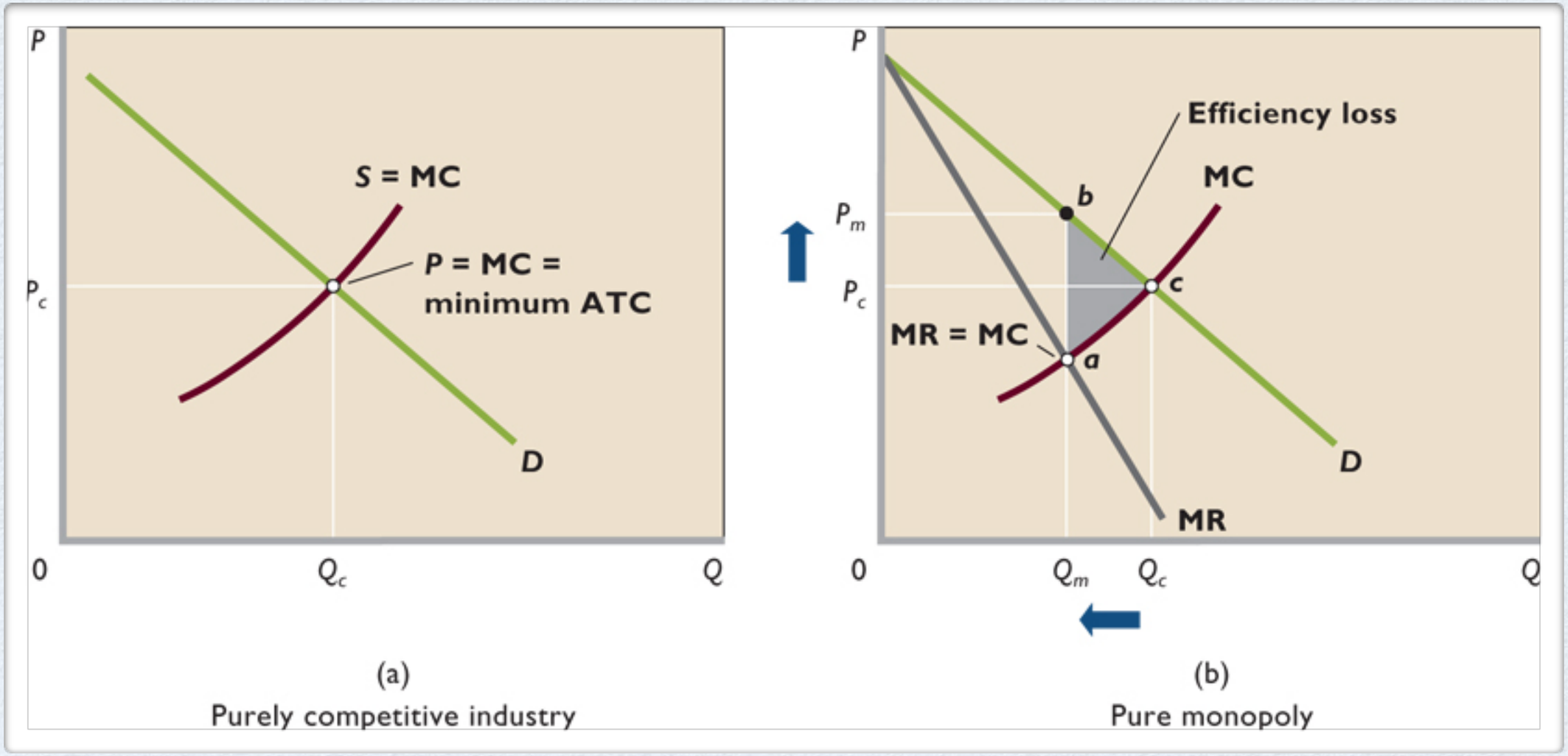
The pure monopolist does not have a supply curve. There is no unique relationship between P and Q supplied for the monopolist.

Misconceptions about monopoly pricing

1. Monopolist charges the highest price - not true! Charges the price where its TR is the highest.
2. It seeks maximum total profit not per unit profit

Economic Effects of Monopoly

- **Price, Output and Efficiency**



Productive efficiency: P = min ATC

Allocative efficiency: P = MC

Under competitive conditions P would be lower and Q would be higher. Monopoly: productive and allocative inefficiency

Regulated Monopoly

- **Socially optimal and fair return price**
  - Socially optimal price - P = MC
  - Fair return price - P = ATC
  - Monopolist price - MR =MC