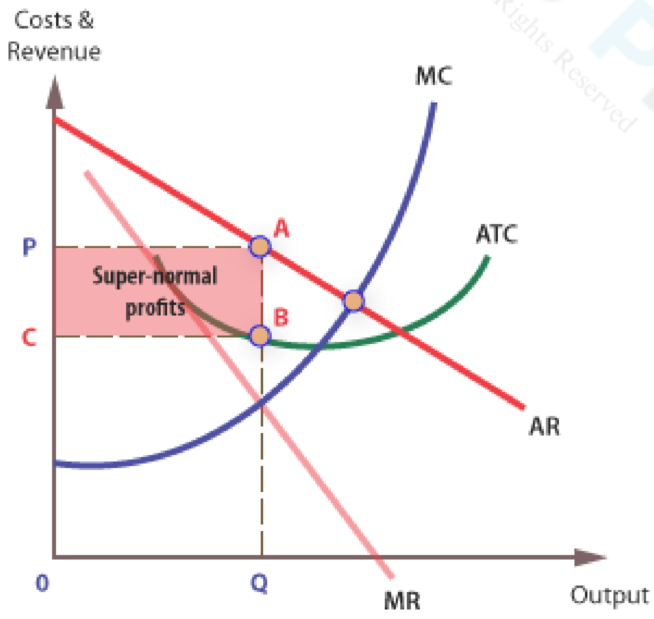
3.4.5 Monopoly

- *Characteristics of monopoly*
- *Profit maximising equilibrium*
- *Diagrammatic analysis*
- *Third degree price discrimination:*
  - *Necessary conditions*
  - *Diagrammatic analysis*
  - *Costs and benefits to consumers and producers*
- *Costs and benefits of monopoly to firms, consumers, employees and suppliers*
- *Natural monopoly like*

- Pure monopoly: one firm alone dominates the market
- Legal monopoly: one firm dominates 25% or more of the market
- Characteristics of a monopoly:
  - High barriers to entry and exit
  - Firms aim for profit maximising MR=MC
    Supernormal profits in the short run and long run
  - High barriers to entry
    - Economies of scale
    - Limit pricing: setting the price below the production costs of new entrants
    - Ring-fencing resources
    - Sunk costs such as advertising
    - Brand loyalty
    - Set-up costs
  - Price maker
  - Price discrimination
  - The firm's cost and revenue curve is the same as the industry's cost and revenue curve



- Advantages of a monopoly for consumers:
  - Innovation: a monopoly can take risks

- Research and development: they have more profits to invest and have more confidence that they will benefit
- Advantages of a monopoly for governments:
  - Higher corporation tax
  - More internationally competitive which improves the balance of payments
- Advantages of a monopoly for workers:
  - Better job security
  - Higher profits mean higher bonuses
- Advantages for other firms such as suppliers:
  - A secure outlook for suppliers
  - Firms which buy from monopolies are more likely to have consistent quality
- Disadvantages of monopolies for consumers:
  - Less choice
  - Higher prices
  - Local quality- inefficiency
- Disadvantages of monopolies for governments:
  - Monopolies can find it easy to avoid paying tax
  - Inequality tends to increase
- Disadvantages of monopolies for workers:
  - The worker has little bargaining power
  - Monopoly profits can be used to invest in new machinery which replaces workers
- Disadvantages of monopolies for other firms:
  - Firms which buy from monopolies can be exploited
  - Other firms can be deliberately forced out of the market (limiting pricing or predatory pricing) because they haven't had time to establish themselves

- Price discrimination: a firm charges different prices to different groups of consumers for the same good or service
- Conditions necessary for price discrimination:
  - Each group of consumers has different PEDs so different prices can be charged
  - The firm can stop market seepage or arbitrage- consumers reselling a product to other customers
  - The firm is a price maker
- First degree price discrimination:
  - A firm sells each unit at the maximum price each consumer is willing to pay so there is no consumer surplus
  - Assumes perfect knowledge
  - Such as a Dutch auction- high price then drops
  - MR=AR

- Second degree price discrimination:
  - A firm sells any excess capacity at a lower price than normal
  - E.g. hotels or airlines where spare rooms and seats are sold on a last minute basis or end of season sales
  - Fixed costs of production are high and marginal costs are low
  - At full capacity MC is vertical as output can't be increased
  - It benefits consumers whose surplus increases to xyz
  - The firm also benefits
  - The firm initially produced at Qa and then sells the spare capacity at P_2

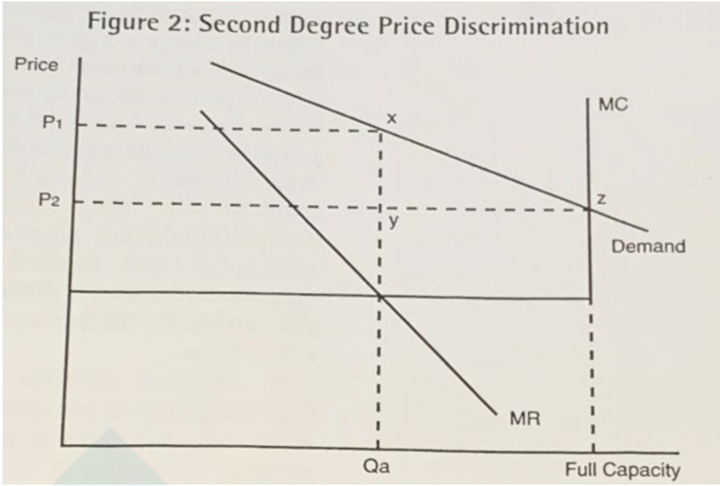
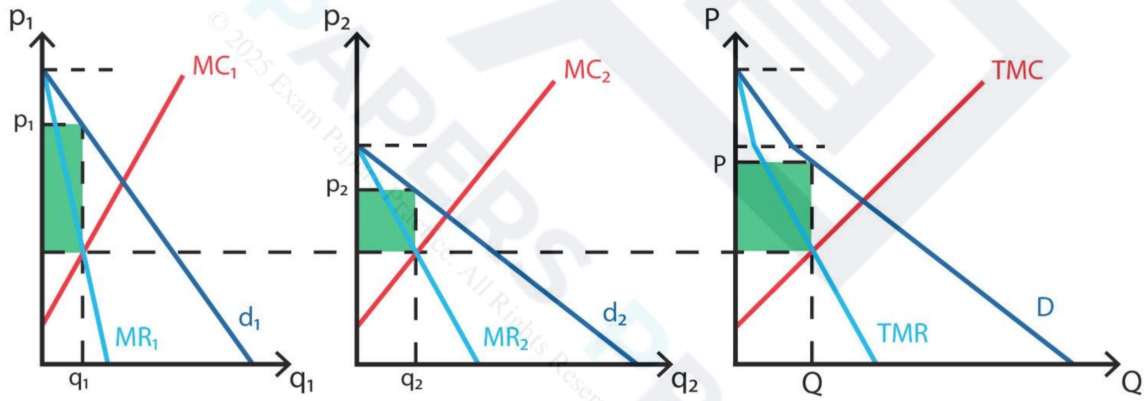


Figure 2: Second Degree Price Discrimination

- Third degree price discrimination:
  - Charging different prices for different segments
  - E.g. off peak/ peak or geography



- Characteristics of a natural monopoly:
  - High fixed costs, usually in the form of infrastructure such as Northumbria Water
  - It is considered inefficient to duplicate this infrastructure by trying to make the market more competitive