

# Monopoly: Perfect Competition Vs Monopoly, Social Cost of Monopoly, Price Discrimination, Antitrust-Law, Natural Monopoly

## Perfect Competition Vs Monopoly

### • Monopoly versus Competition

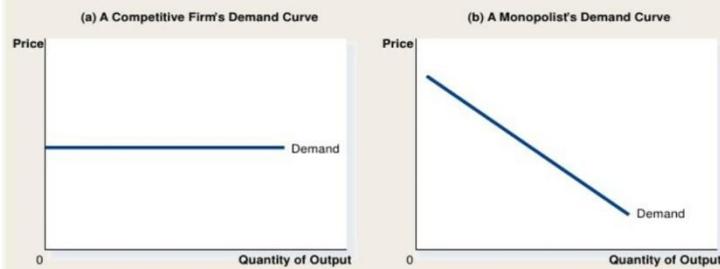
#### – Monopoly

- Is the sole producer
- Faces a downward-sloping demand curve
- Is a price maker
- Reduces price to increase sales

#### – Competitive Firm

- Is one of many producers
- Faces a horizontal demand curve
- Is a price taker
- Sells as much or as little at same price

Figure 2 Demand Curves for Competitive and Monopoly Firms

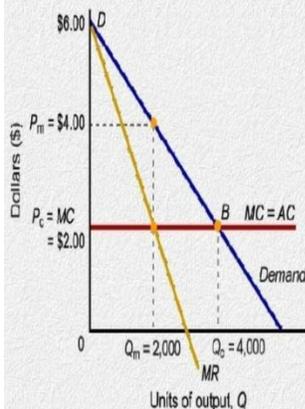


Since a monopoly is the sole producer in its market, it faces the market demand curve.

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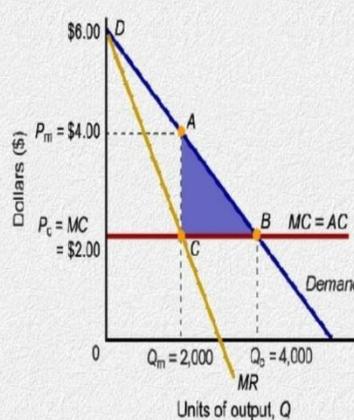
## Social Cost of Monopoly

### The Social Costs of Monopoly



- Monopoly leads to an inefficient mix of output.
- Price is above marginal cost, which means that the firm is underproducing from society's point of view.

### The Social Costs of Monopoly



- The triangle ABC measures the net social gain of moving from 2,000 units to 4,000 units (or welfare loss from monopoly).

## Price Discrimination

### PRICE DISCRIMINATION

- *Price discrimination* is the business practice of selling the same good at different prices to different customers, even though the costs for producing for the two customers are the same.

### The Analytics of Price Discrimination

- Price discrimination is not possible when a good is sold in a competitive market since there are many firms all selling at the market price. In order to price discriminate, the firm must have some *market power*.
- Perfect Price Discrimination
  - Perfect price discrimination refers to the situation when the monopolist knows exactly the willingness to pay of each customer and can charge each customer a different price.

### The Analytics of Price Discrimination

- Two important effects of price discrimination:
  - It can increase the monopolist's profits.
  - It can reduce deadweight loss.

### Examples of Price Discrimination

- Movie tickets
- Airline prices
- Discount coupons
- Financial aid
- Quantity discounts

## Types Of Price Discrimination

Personal

Geographical

On The Basis Of Use

Personal

Refers to price discrimination when different prices are charged from different individuals. The different prices are charged according to the level of income of consumers as well as their willingness to purchase a product. For example, a doctor charges different fees from poor and rich patients.

Geographical

Refers to price discrimination when the monopolist charges different prices at different places for the same product. This type of discrimination is also called dumping.

On the Basis of Use

Occurs when different prices are charged according to the use of a product. For instance, an electricity supply board charges lower rates for domestic consumption of electricity and higher rates for commercial consumption.

## Degrees of Price Discrimination

### First-degree Price Discrimination

Refers to a price discrimination in which a monopolist charges the maximum price that each buyer is willing to pay. This is also known as perfect price discrimination as it involves maximum exploitation of consumers. In this, consumers fail to enjoy any consumer surplus. First degree is practiced by lawyers and doctors

### Second-degree Price Discrimination

Refers to a price discrimination in which buyers are divided into different groups and different prices are charged from these groups depending upon what they are willing to pay. Railways and airlines practice this type of price discrimination.

### Third-degree Price Discrimination

Refers to a price discrimination in which the monopolist divides the entire market into submarkets and different prices are charged in each submarket. Therefore, third-degree price discrimination is also termed as market segmentation

## Necessary Conditions for Price Discrimination

Existence of Monopoly

Separate Market

No Contact between Buyers

Different Elasticity of Demand

## Price Discrimination By Graph (B)

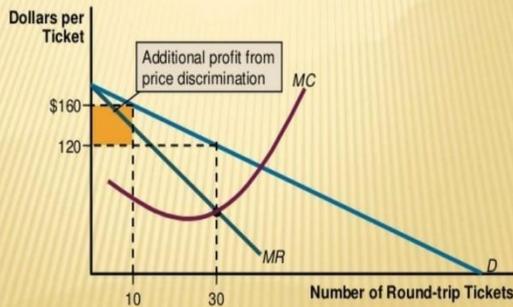


Figure 10 Welfare with and without Price Discrimination

### (b) Monopolist with Perfect Price Discrimination



## Antitrust-Law

### Increasing Competition with Antitrust Laws

- Antitrust laws are a collection of statutes aimed at curbing monopoly power.
- Antitrust laws give government various ways to promote competition.
  - They allow government to prevent mergers.
  - They allow government to break up companies.
  - They prevent companies from performing activities that make markets less competitive.

### Increasing Competition with Antitrust Laws

- Two Important Antitrust Laws in U.S.
  - Sherman Antitrust Act (1890)
    - Reduced the market power of the large and powerful “trusts” of that time period.
  - Clayton Antitrust Act (1914)
    - Strengthened the government’s powers and authorized private lawsuits.

## Natural Monopoly

### Natural Monopolies

- ▶ An industry is a *natural monopoly* when one firm can supply a good or service to an entire market at a lower cost than could two or more firms.
- ▶ In other words, natural monopoly is an industry in which economies of scale are so important so that only one firm can survive.

Example: delivery of electricity, phone service, tap water, etc.

# Types of Natural Monopoly

- ▶ Unregulated natural monopoly
- ▶ Regulated natural monopoly

## Unregulated Natural Monopoly

- ▶ An unregulated natural monopoly would attempt to maximize profits by producing the quantity of output where marginal revenue equals marginal cost. ( $MC=MR$ )

## Regulating Natural Monopoly

- ▶ If a natural monopoly is regulated to produce the optimal quantity of output, the firm will suffer an economic loss.
- ▶ To keep the monopoly firm to survive would require a government subsidy to the firm to eliminate the economic loss.

## Natural Monopolies

