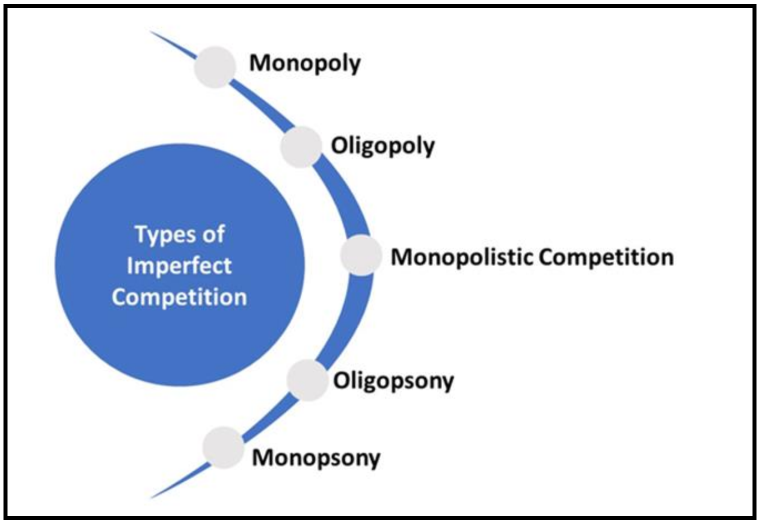
RATU NAVULA COLLEGE
YEAR 12 ECONOMICS 2021

WEEKLY HOME STUDY LESSON NOTES – Week 2
(# 35 – 39)

Strand: (2) Microeconomics **Lesson 35**
Sub Strand: (2.4) Market Structures **(Monopoly)**
L/Outcome: - Identify the types of Imperfect Competitions
- Define Monopoly market structure and explain the characteristics of Monopolies

IMPERFECT COMPETITION



1. MONOPOLY

Definition

- Is a market structure characterized by a single seller, selling a unique product in the market.
- In a monopoly market, the seller faces no competition, as he/she is the sole seller of goods with no close substitute.
- Examples of monopolies are PWD, Post & Telecom, FSC, FINTEL and EFL.

Characteristics of Monopoly

1. **Single seller** of goods and services. (one seller produces all of the output for a good or service. The entire market is served by a single firm.)
2. **Price makers** (the monopoly decides the price of the good or product being sold. The price is set by determining the quantity in order to demand the price desired by the firm (maximizes revenue).
3. Monopolies are faced by **downward sloping demand cure**
4. Monopolies **maximize profit** by charging higher prices and restricting output since they are profit oriented (have profit motive).
5. They have **strong barriers to entry**.
6. **Price discrimination** (in a monopoly the firm can change the price and quantity of the good or service. In an elastic market the firm will sell a high quantity of the good if the price is less. If the price is high, the firm will sell a reduced quantity in an elastic market.

Strand: (2) Microeconomics **Lesson 36**
Sub Strand: (2.4) Market Structures **(Monopoly)**
L/Outcome: - Explain how monopolies are created.
- Explain the performance of monopolies.

How Monopolies are created?

Monopolies emerge because of barriers preventing entry of other firms in the industry. Such barriers are:

- Legal Barriers – are the law and order that has to be observed before monopoly can emerged.

  These include:

  - **Government Regulation** – laws passed to commences the monopoly e.g. government license.
  - **Government Franchise** – is an exclusive right given to affirm to supply good or service e.g. Telecom has been given exclusive right to deal with all post & telecom services.
  - **Patent Right** – is an exclusive right given to the inventor or producer to produce the particular good or services?

- ✓ Regional barriers – If products are produced cross national boundaries this leads to very high transport and tariff costs.
- ✓ Technological barriers – very high capital investments required to start up monopolies or to achieve the economies of scale.
- ✓ Unique Supply Of resources - e.g. Gold are only found Vatukoula and Hydro system in Monosavu.

Sources of Monopoly Power

In a monopoly, specific sources generate the individual control of the market. Sources of power include:

- Economies of scale
- Capital requirements
- Technological superiority
- No substitute goods
- Control of natural resources
- Network externalities
- Legal barriers

Performance of Monopolies

- Due to the fact that monopoly firm is the industry it has a significant market power and can earn supernormal profit in he long run.
- Since it is a single producer it has freedom to produce at a plant size which is less than optimal therefore loss of Economic Efficiency. In other words they do not produce at socially desirable level of output.
- Monopolists restrict output and charge prices to earn supernormal profit. Thus Consumers have to pay higher price which is not in their best interest, therefore monopolies fail to operate efficiently or respond to consumers demand (loss of allocative and productive efficiency, creating dead weight loss)
- There is no competitive therefore lack of urgency to improve their product. This is at the expense of the public service.

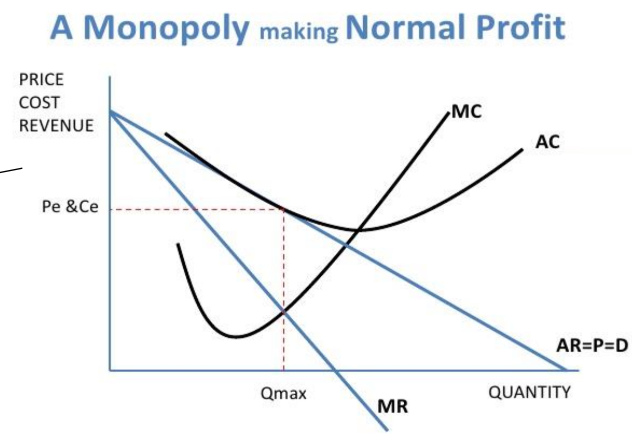
Strand: (2) Microeconomics **Lesson 37**
Sub Strand: (2.4) Market Structures **(Monopoly)**
L/Outcome: - Explain the profit maximisation under monopolies.

Profit Maximisation under Monopoly

Normal Profit

- Demand curve is at AR = P =D
- Profit maximising output is at MR = MC
- Pe is at MR = MC = AR
- Pc is at MR = MC = AR = AC
- Normal profit is at TR = TC
- Pe = Pc

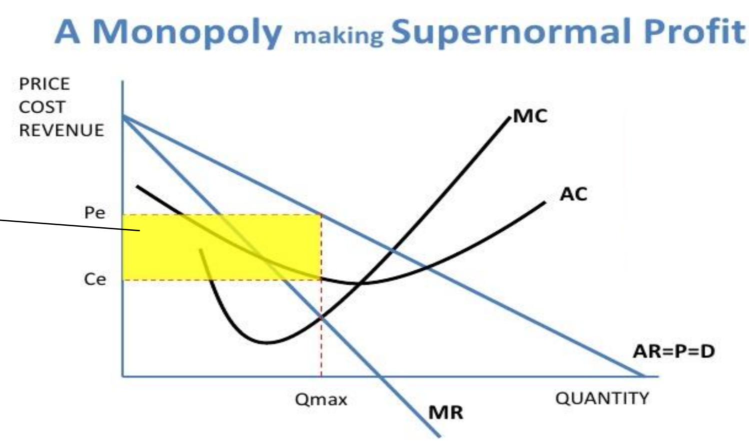
Normal Profit



Supernormal Profit

- Demand curve is at AR = P =D
- Profit maximising output is at MR = MC
- Pe is at MR = MC = AR
- Pc is at MR = MC = AC
- Supernormal profit is at TR > TC
- Pe > Pc
- Make supernormal profits in Long Run since barriers to entry restrict freedom of entry of other firms in the industry

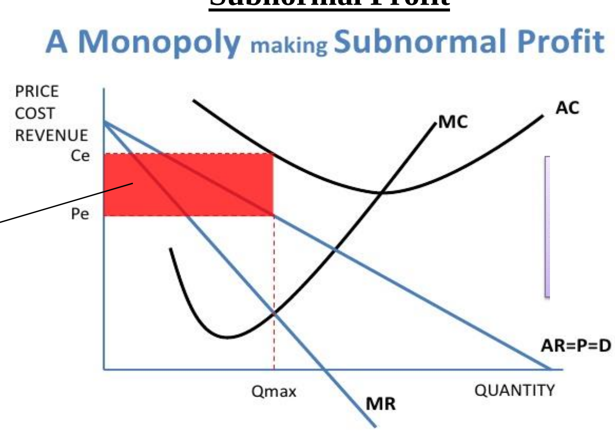
Supernormal Profit



Subnormal Profit

- Demand curve is at AR = P =D
- Profit maximising output is at MR = MC
- Pe is at MR = MC = AR
- Pc is at MR = MC = AC
- Subnormal profit is at TC > TR
- Pc > Pe

Subnormal Profit



Strand: (2) Microeconomics **Lesson 38**
Sub Strand: (2.4) Market Structures **(Monopoly)**
L/Outcome: - Explain the Disadvantages and Advantages of Monopolies
- Define the types of monopolies

Monopolies

Disadvantages	Advantages
• **Higher prices for consumers** • **Less incentive to cut costs** • **Less inventive to innovate and invest** • **Allocative inefficiency (P>MC)** • **Decline in consumer surplus** • **Productive inefficiency** • **Potential diseconomies of scale** • **May also have monopsony power (pay lower wages to workers)** • **Monopolies can gain political power to protect their vested interests.** • **Less choice for consumers**	• **Economies of scale – lower average costs from increased scale** • **High profit can be used for research and development – dynamic efficiency** • **The reward of getting patent (a monopoly power) can encourage investment** • **Firms who become monopolies may just be very efficient, successful and innovative.** • **Governments can regulate to get best of both worlds – economies of scale and fair prices.**

Types of Monopolies

- **Natural monopoly**: A monopoly that arises from economies of scale. The economies of scale arise from natural supply and demand conditions, and not from government actions.
- **Local monopoly**: a monopoly that exists in a limited geographic area.
- **Regulated monopoly**: a monopoly firm whose behavior is overseen by a government entity.
- **Monopoly power**: market power, the power to set prices.
- **Monopolization**: an attempt by a firm to dominate a market or become a monopoly.

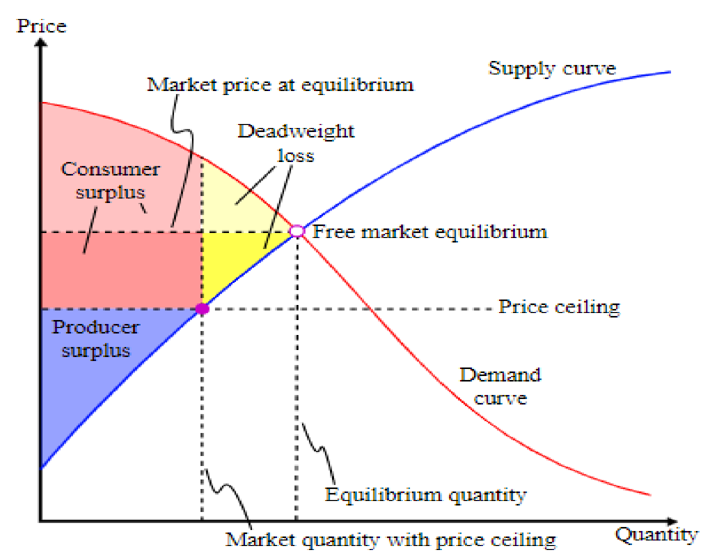
Strand: (2) Microeconomics **Lesson 39**
Sub Strand: (2.4) Market Structures
L/Outcome: - Define Deadweight loss of a Monopoly
- Identify the deadweight loss from the graph

<u>**Inefficiency in a Monopoly**</u>

- In a monopoly, the firm will set a specific price for a good that is available to all consumers.
- The quantity of the good will be less and the price will be higher.
- The monopoly pricing creates a <u>**deadweight loss**</u> because the firm forgoes transactions with the consumers. The deadweight loss is the potential gains that did not go to the producer or the consumer.
- A monopoly is less efficient in total gains from trade than a competitive market.
- <u>Allocative efficiency</u> occurs when there is optimal distribution of goods and services. (because the P = MU = MC
- Monopolies are inefficient when it comes to allocative efficiency because P > MC.
- Consumers will suffer from monopoly because it will sell a lower quantity in the market at a high price.

<u>**The deadweight loss**</u>

- <u>Deadweight loss</u> is a loss of economic efficiency that occurs when equilibrium for a good or service is not Pareto optimal.]
- Causes of deadweight loss include: imperfect markets, externalities, taxes or subsides, price ceilings and price floors
- In order to determine the deadweight loss in a market, the equation P=MC is used.



Deadweight loss: This graph shows the deadweight loss that is the result of a binding price ceiling. Policy makers will place a binding price ceiling when they believe that the benefit from the transfer of surplus outweighs the adverse impact of the deadweight loss.

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L/Outcome: - Discuss about the Imperfect Competition (Monopoly Market)

Worksheet

MULTIPLE CHOICE QUESTIONS

1. Monopolist are able to maximize profit by
   A. Supplying the entire industry
   B. Imperfect knowledge
   C. Restricting output and charging higher prices
   D. Selling differentiated product

2. Monopolies are able to maintain their supernormal profits because
   A. They are price markers
   B. They are faced by downward sloping demand curve
   C. They have strong barriers to entry
   D. They are imperfect competitors.

3. A monopoly is firm where there is
   A. Single seller
   B. Single buyer
   C. Few sellers
   D. Many sellers

4. Monopoly is different from all other market structures since
   A. Produces identical products
   B. Faced by downward sloping demand curve
   C. Is a price marker
   D. Is a single seller.

5. Price discrimination used under monopolies means
   A. Competing through Non price competition
   B. Using product differentiation
   C. Charging different prices to different consumers.
   D. Cut throat competition

6. When comparing a perfect competitor with a monopolist which of the following is true?
   A. Monopolists have greater market power because of fewer barriers to entry
   B. Monopolists tend to produce below optimal plant size
   C. A monopoly is allocative efficient firm.
   D. Both compete using price competition