



# Monopoly Price and Output

A2 Microeconomics

Monopoly price and output

The constraints on a monopolist

Monopoly and economic efficiency

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## Key Issues

- The meaning of [monopoly power](#)
- Monopoly price and output equilibrium
- How monopoly may affect economic welfare and economic efficiency
  - Allocative and productive efficiency
  - Dynamic efficiency
  - X inefficiency / external diseconomies of scale
- How monopoly power may benefit consumers
  - [Economies of Scale](#)
  - Natural monopoly arguments
- The arguments for and against reducing monopoly power through [competition policy](#)

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## Market concentration

- The concentration ratio is a way of measuring monopoly power
- A five firm ratio adds together the market share of the leading five firms in the market
- The higher the concentration ratio the stronger is the hold on the market held by the leading businesses



## Example: UK Grocery Market

Tesco	30.8
Asda (Walmart)	16.8
Sainsburys	16.2
Waitrose	4.2
Morrison / Safeway	11.4
Marks and Spencer	3.5
Kwik Save	2.6
Iceland	1.9
Co-Op / Somerfield	5.9

*Market share in 2010*



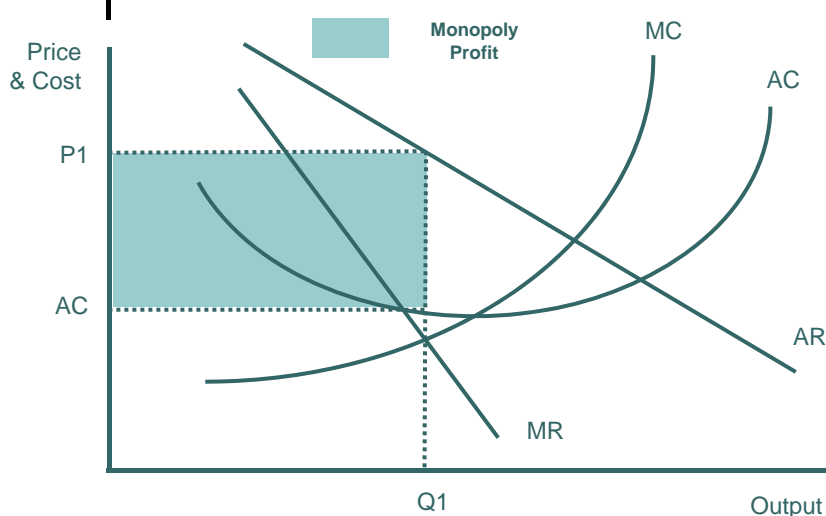
## Monopoly demand

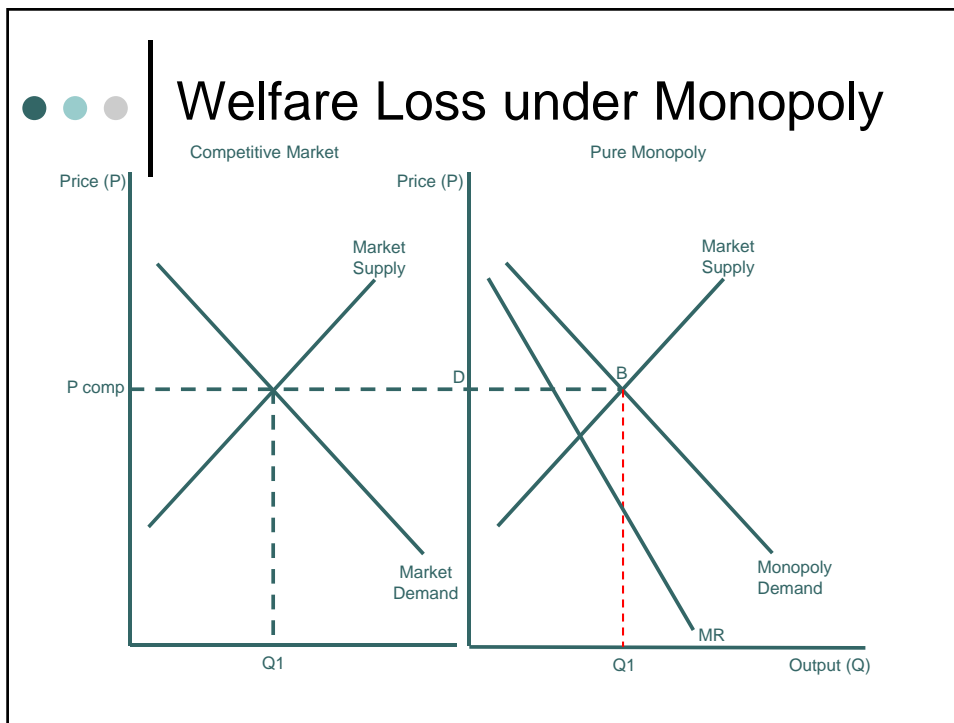
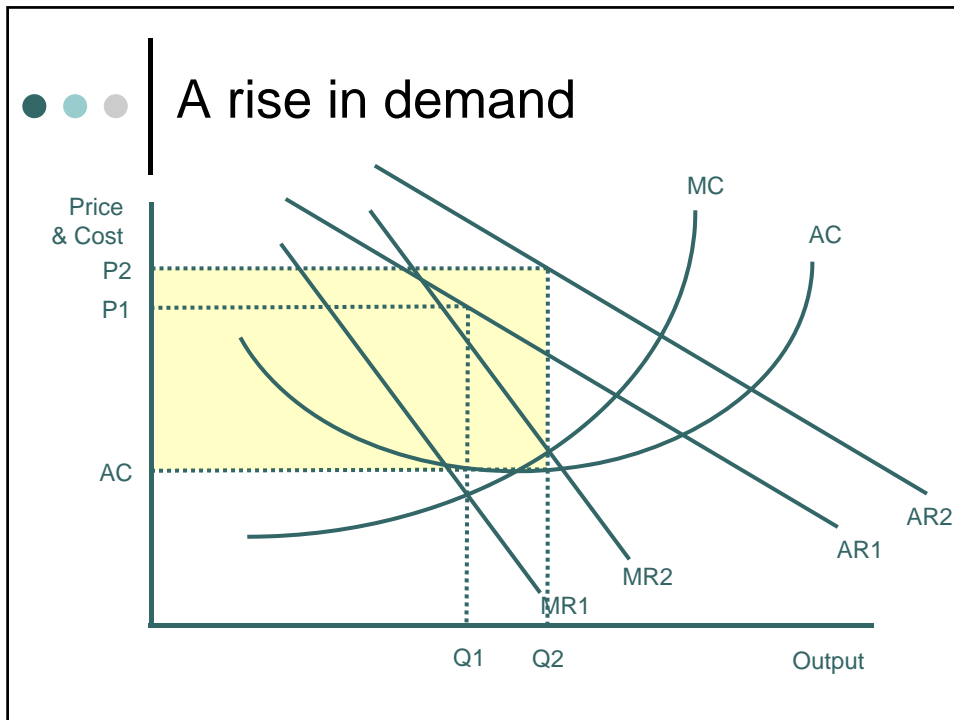
- A pure monopolist can take market demand as its own demand curve
- The firm is a **price maker** but a monopoly cannot charge a price that the consumers in the market will not bear
- The **elasticity of the demand curve** acts as a constraint on the pricing-power of the monopolist
- Assuming that the firm aims to maximise profits (where  $MR=MC$ )

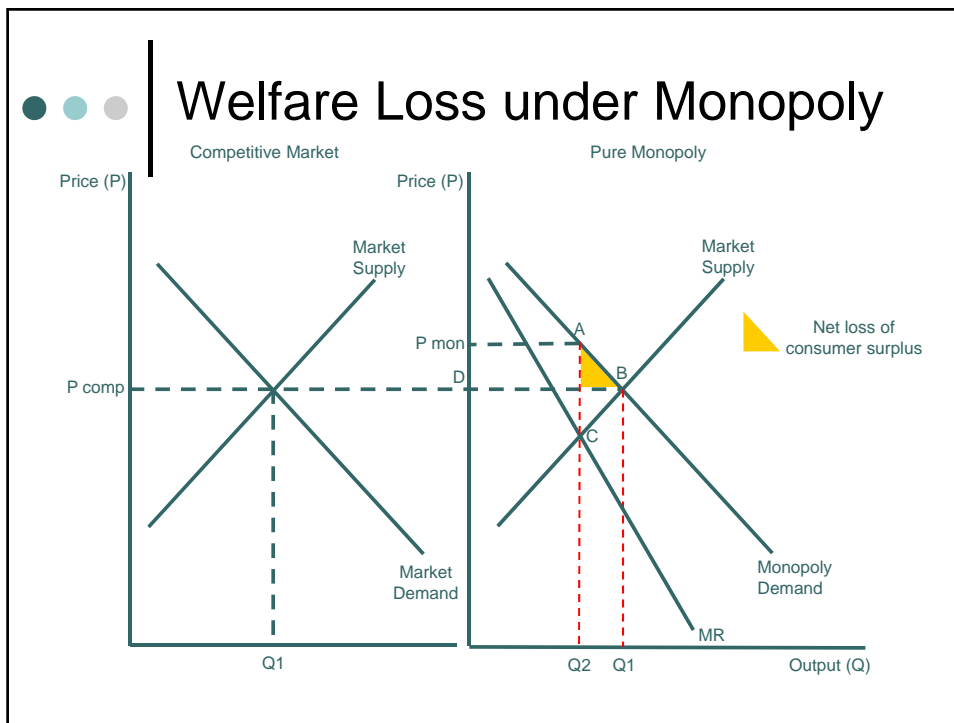
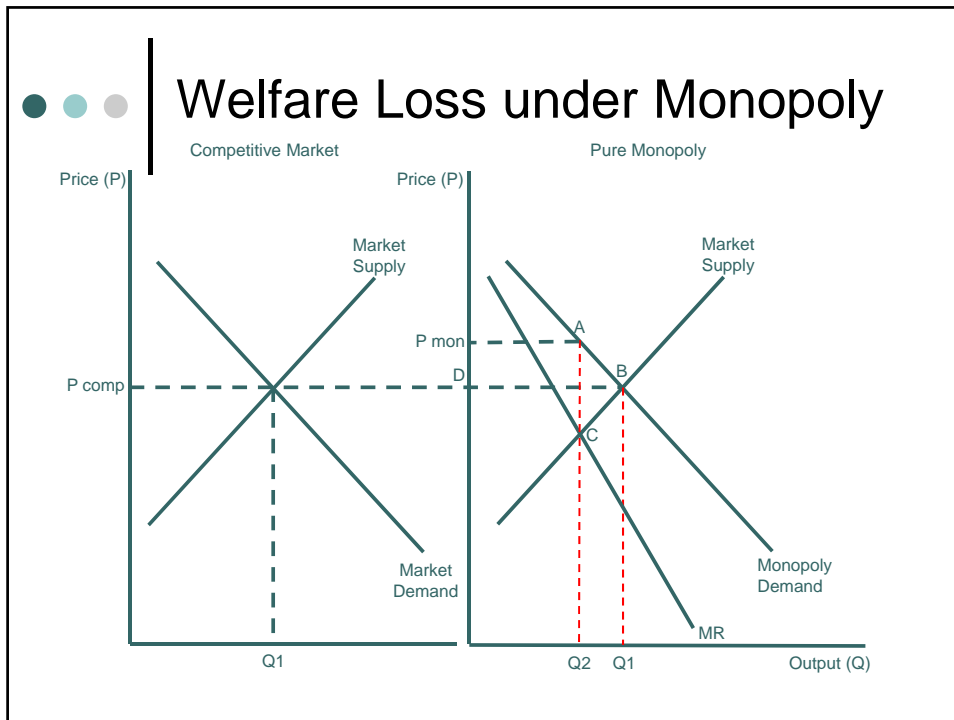
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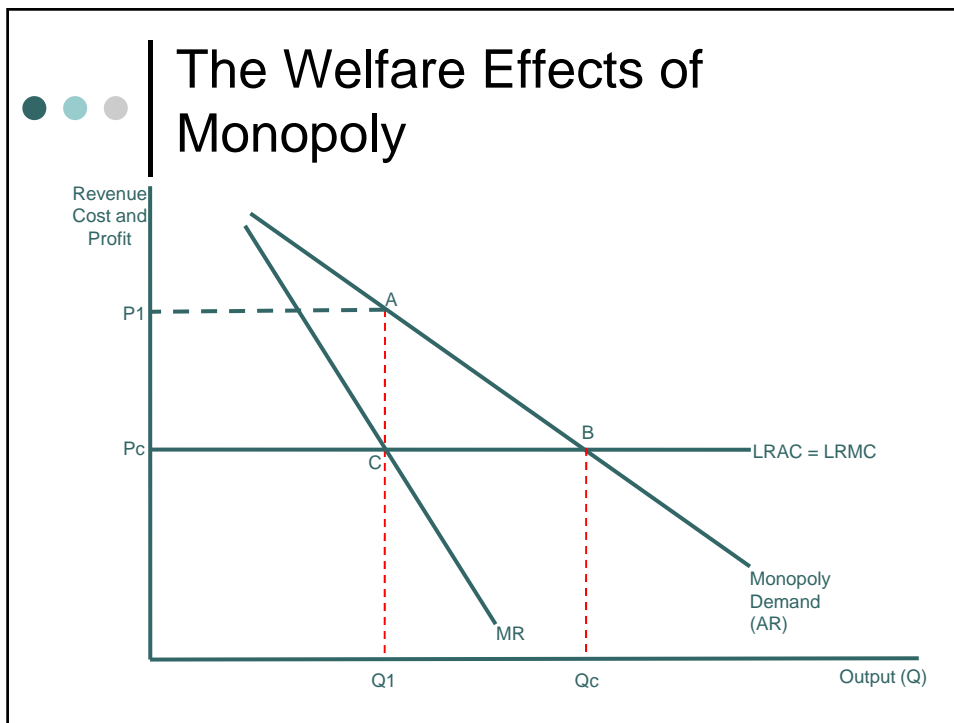
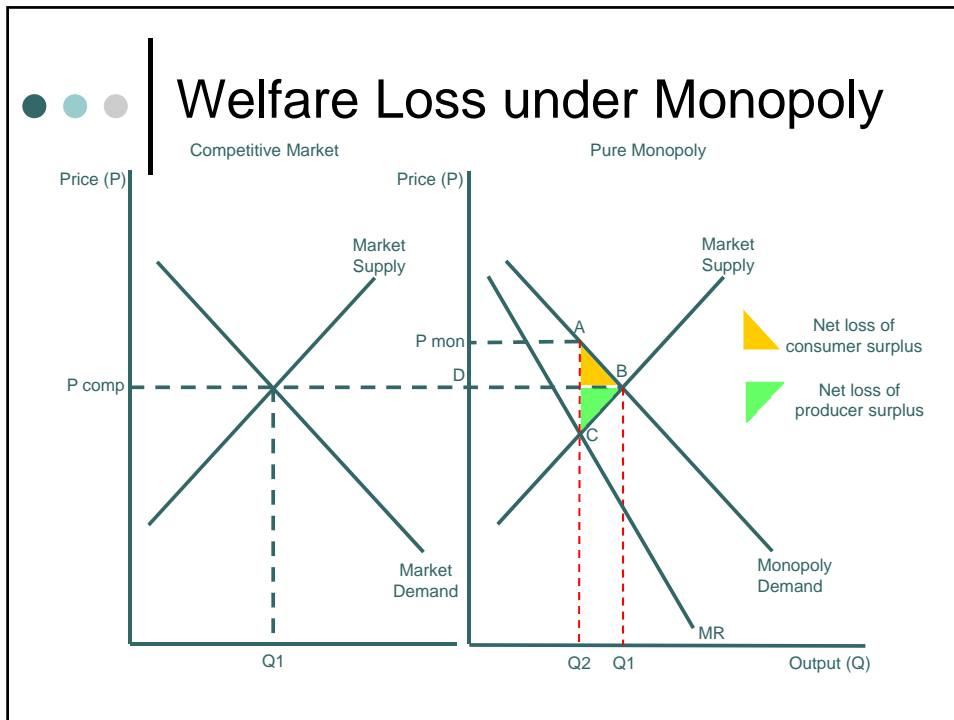


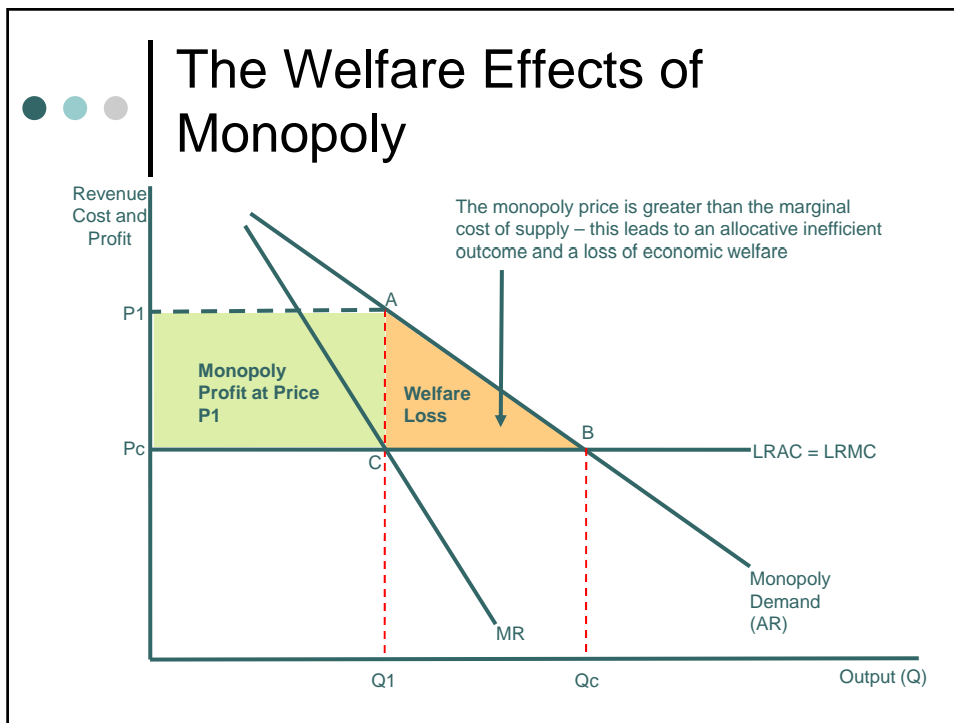
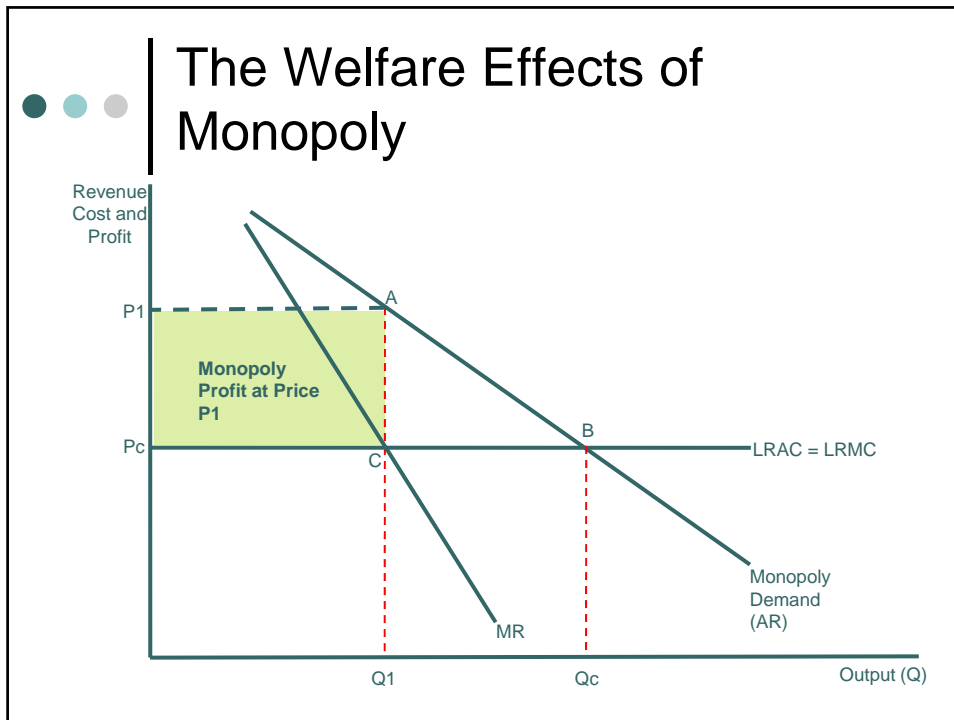
## Price and output equilibrium













## The Case Against Monopoly

- (1) The main case against monopoly is that it can earn **abnormal profits** at the expense of economic efficiency
  - (a) The monopolist can extract a price from consumers that is above the marginal cost of resources used in making the product
  - (b) I.e. consumer surplus turned into producer surplus (extra **monopoly profit**)
- (2) Consumers' needs and wants are not being satisfied - **product is under-consumed** because price is above cost

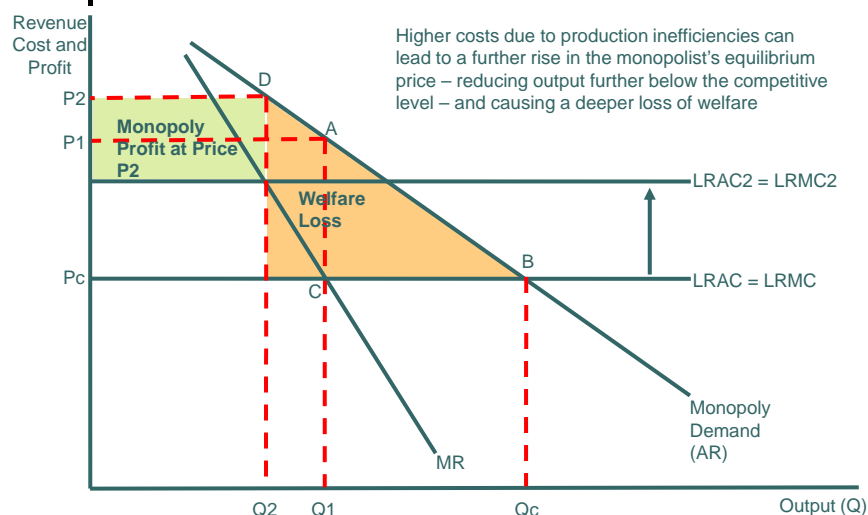


## The Case Against Monopoly

- (3) There may be little pressure for a firm with monopoly power to maximise their efficiency or minimise costs of production
  - (i) "**Managerial slack**" or "**X-inefficiencies**"
  - (ii) Limited incentives to adopt cost-reducing **innovations**
  - (iii) (John Hicks) "The best of all monopoly profits is a quiet life"
  - The result may be a higher level of costs per unit (**external diseconomies of scale**)



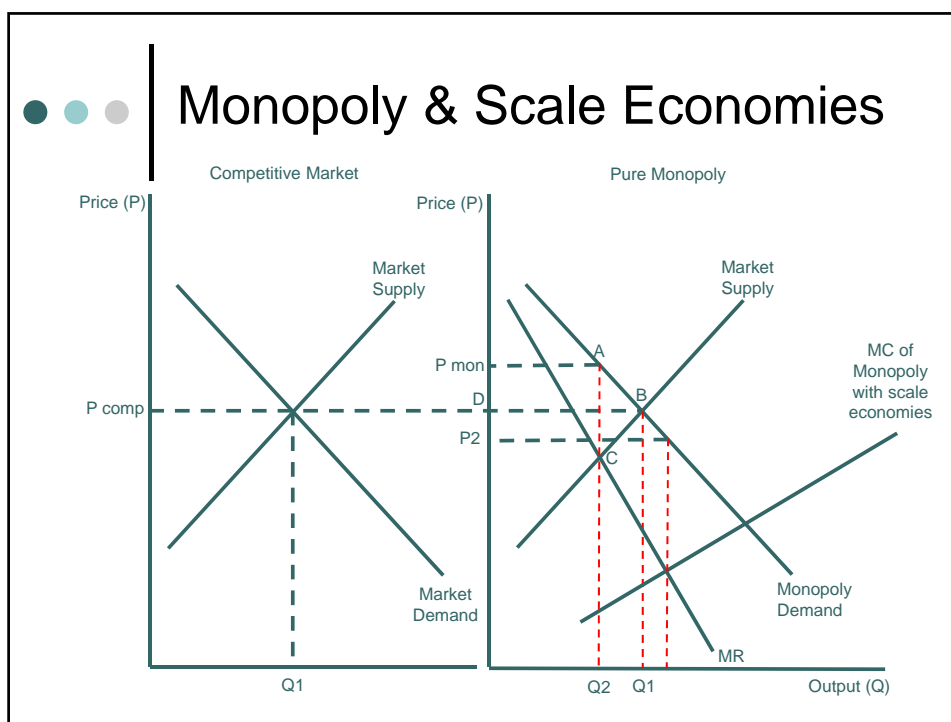
## X-inefficiency – a further loss of economic welfare



## The Case for Competition (from the OFT)



- Competitive markets provide the best means of ensuring that the economy's resources are put to their best use by encouraging enterprise and efficiency, and widening choice
- Where markets work well, they provide strong incentives for good performance - encouraging firms to improve productivity, to reduce prices and to innovate; whilst rewarding consumers with lower prices, higher quality, and wider choice
- By encouraging efficiency, competition in the domestic market - whether between domestic firms alone or between those and overseas firms - also contributes to our international competitiveness





## Cross-Subsidisation

- **Cross-subsidisation** is a decision to fund a loss from one product by raising the price of another
- Examples of cross subsidisation:
  - A rail network provider might charge more to freight traffic than for passenger services
  - Universities charging higher fees for foreign students to partly fund cheaper places for domestic students
  - Mobile phone retailers selling handsets at prices below cost – knowing that they can cross-subsidise this by selling phone contracts to customers – a process known as ‘locking in’
  - Lower prices for educational usage of a piece of software and higher prices for corporate versions

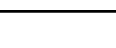
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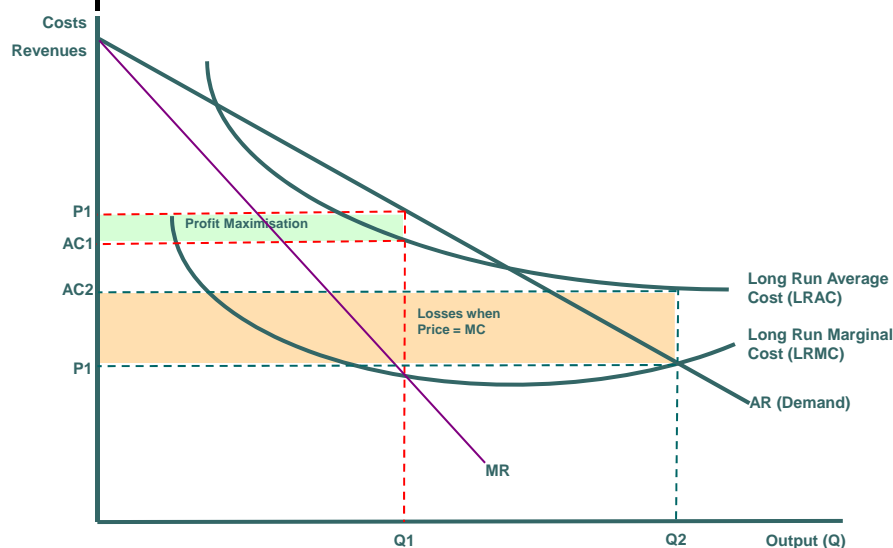
## A Natural Monopoly

- A **natural monopoly** occurs in an industry where long-run average costs fall over a wide range of output levels
- There may be room only for one supplier to fully exploit the economies of scale in the market and therefore achieve productive efficiency
- The main utilities such as gas, electricity and water are often seen as examples because of the huge fixed costs of building and maintaining nationwide networks of cables and pipes
- The natural monopoly through the exploitation of economies of scale can in theory undercut any actual or potential rivals purely on the grounds of cost

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## Natural Monopoly – Price and Output



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There are a number of interesting talks and lectures in London in the next ten days if colleagues are out and about and perhaps within striking distance of the capital. I will be attending them and if you are around, it would be good to meet up for a coffee or something stronger!

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