AP ECO: MONOPOLIES

I. The Nature of Monopoly
   A. Basic Definitions
      1. A monopoly is a model of a firm that is the only firm in its industry
      2. A firm that sets or picks price depending on its output decision is a price setter
      3. A price setter is often said to possess monopoly power
   B. Sources of Monopoly: barriers to entry are characteristics of a particular market that block new firms from entering it
      1. Economies of Scale
         a) Economies of scale give an advantage to those that enter a market first because they have lower average costs than newer, smaller firms.
         b) A firm that confronts economies of scale over the entire range of outputs demanded in the industry is a natural monopoly.
      2. Location
      3. Sunk Costs
         a) An expenditure that has already been made and that cannot be recovered is called a sunk cost.
         b) High initial outlays for new entrants that will be lost upon exit makes exit costly and discourages new entrants
      4. Restricted ownership of raw materials and inputs
      5. Government restrictions
         a) Government granted exclusive franchises, licenses and certification requirements, and patent protection limit entry into a market and help create monopoly power.
         b) Network effects arise where products become more useful the larger the number of users of the product,
         c) Patents are especially important sources of monopoly power when network effects are present.

II. The Fragility of Monopoly Power
   A. Monopoly is always under assault from those who could gain by taking some of the monopoly's customers.
   B. Technological change is a powerful force to weaken entrenched monopolies' market power and overcome barriers to entry.

III. The Monopoly Model
   A. Monopoly and Market Demand
      1. Because a monopoly has the market to itself, it faces the downward- sloping market demand.
      2. The degree of monopoly power is often assessed in terms of the price elasticity of demand facing a firm.
      3. Since there are no competitors for the monopoly, the monopolists' demand is likely to be rather price inelastic.
   B. Total Revenue and Price Elasticity

1. A monopolist will always choose a price in the elastic region of its demand curve.
2. Demand is price elastic in the upper half of its demand curve and price inelastic in the lower half.
3. If demand is price elastic, lowering the price will result in greater total revenue. If demand is price inelastic, lowering the price will result in less total revenue.

C. Demand and Marginal Revenue
1. Because a monopolists' demand curve is downward sloping, marginal revenue cannot equal average revenue or demand.
2. Marginal revenue is less than price for the monopoly firm.
3. When the demand curve is linear, the marginal revenue curve is always linear and bisects any horizontal line from the vertical axis to the demand curve.
4. Where marginal revenue is positive, demand is price elastic. Where marginal revenue is negative, demand is price inelastic. Where marginal revenue is zero, demand is unit price elastic.

D. Monopoly Equilibrium: Applying the Marginal Decision Rule
1. Steps for Determining Monopoly Equilibrium
   a) Determine the demand, marginal revenue, and marginal cost curves.
   b) Select the output level at which the marginal revenue and marginal cost curves intersect.
   c) Determine from the demand curve the price at which that output can be sold.
2. Once equilibrium output and price are determined, profit can be found by adding the firm's average total cost curve to the graph showing demand, marginal revenue, and marginal cost.

IV. Assessing Monopoly and the Monopoly Model

A. Efficiency, Equity, and Concentration of Power
1. Monopoly and efficiency
   a) Because monopoly price exceeds marginal cost, the monopoly equilibrium is inefficient.
   b) The efficiency of competition and the inefficiency of monopoly can be illustrated graphically.
   c) The net gain in moving from monopoly to competition is called the deadweight loss from monopoly.
2. Monopoly and equity
   a) The higher price charged by a monopolist reduces consumer surplus created at the competitive price.
   b) Part of the consumer surplus loss is contained in the deadweight loss. The rest is transferred to the monopolist.
3. Monopoly and the concentration of power
   a) Monopolists may be largely immune from market pressures to lower prices, meet consumer preferences, and innovate.
   b) Monopolists may have incentive and resources to protect their monopoly position.

B. Public Policy towards Monopoly

1. Objections to monopoly
   a) Monopoly is inefficient.
   b) Monopoly prices and persistent economic profits are inequitable.
   c) Monopoly is an unacceptable concentration of power.
2. Public policy positions
   a) Regulatory efforts to prevent monopoly fall under the purview of the nation’s antitrust laws.
   b) Elimination of all monopolies ignores economies of scale in natural monopolies, for example.
   c) Policy generally seeks a balance between preventing unwarranted monopoly and regulating natural monopoly.