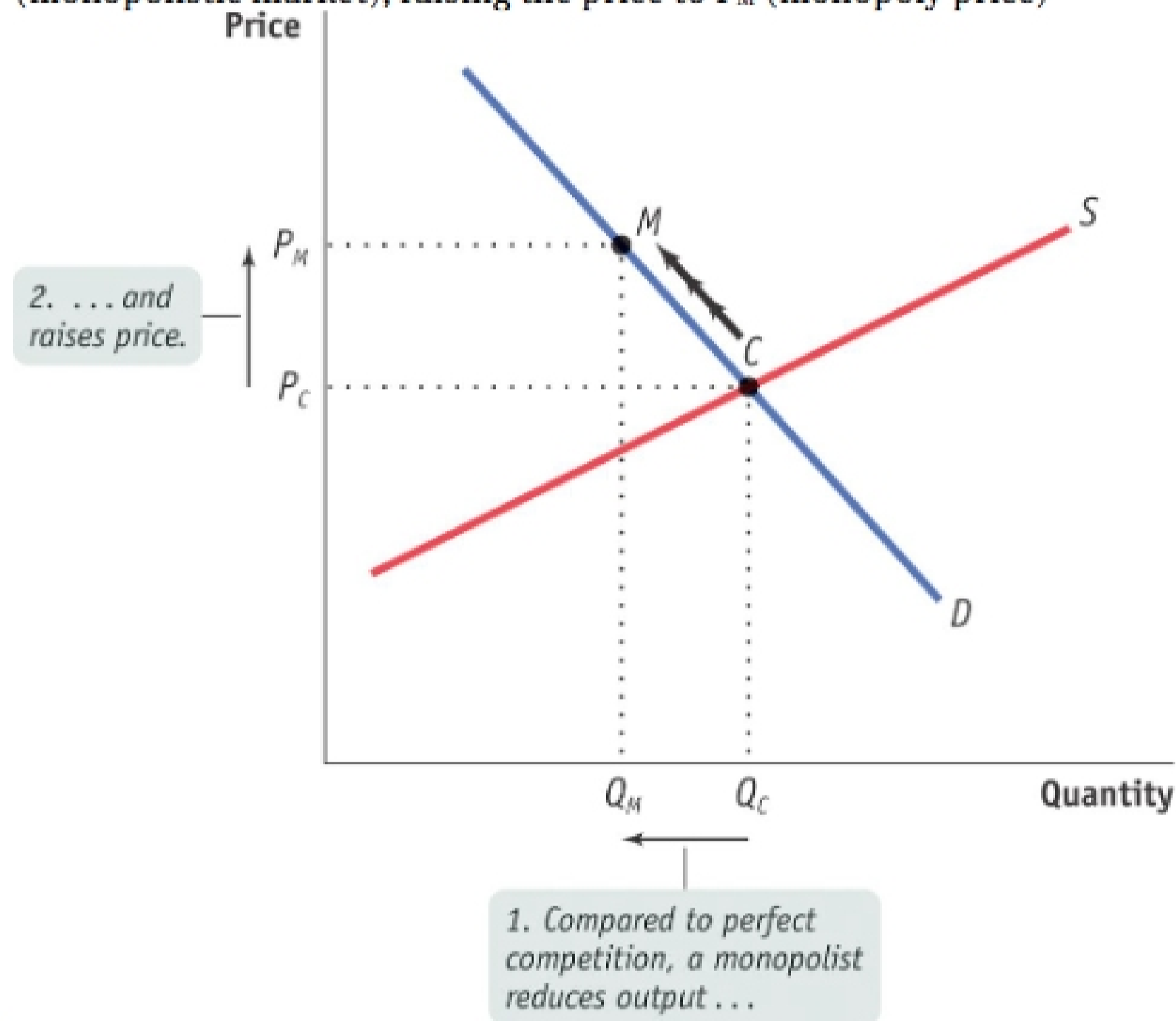


## Chapter 13

### The Meaning of Monopoly

- A producer is a monopolist if it is the sole supplier of a good that has no close substitutes
- When a firm is a monopolist, the industry is a monopoly
- What a monopolist does
  - A monopolist reduces the quantity supplied to  $Q_M$  (monopoly quantity) and moves up along the demand curve from  $C$  (competitive market) to  $M$  (monopolistic market), raising the price to  $P_M$  (monopoly price)



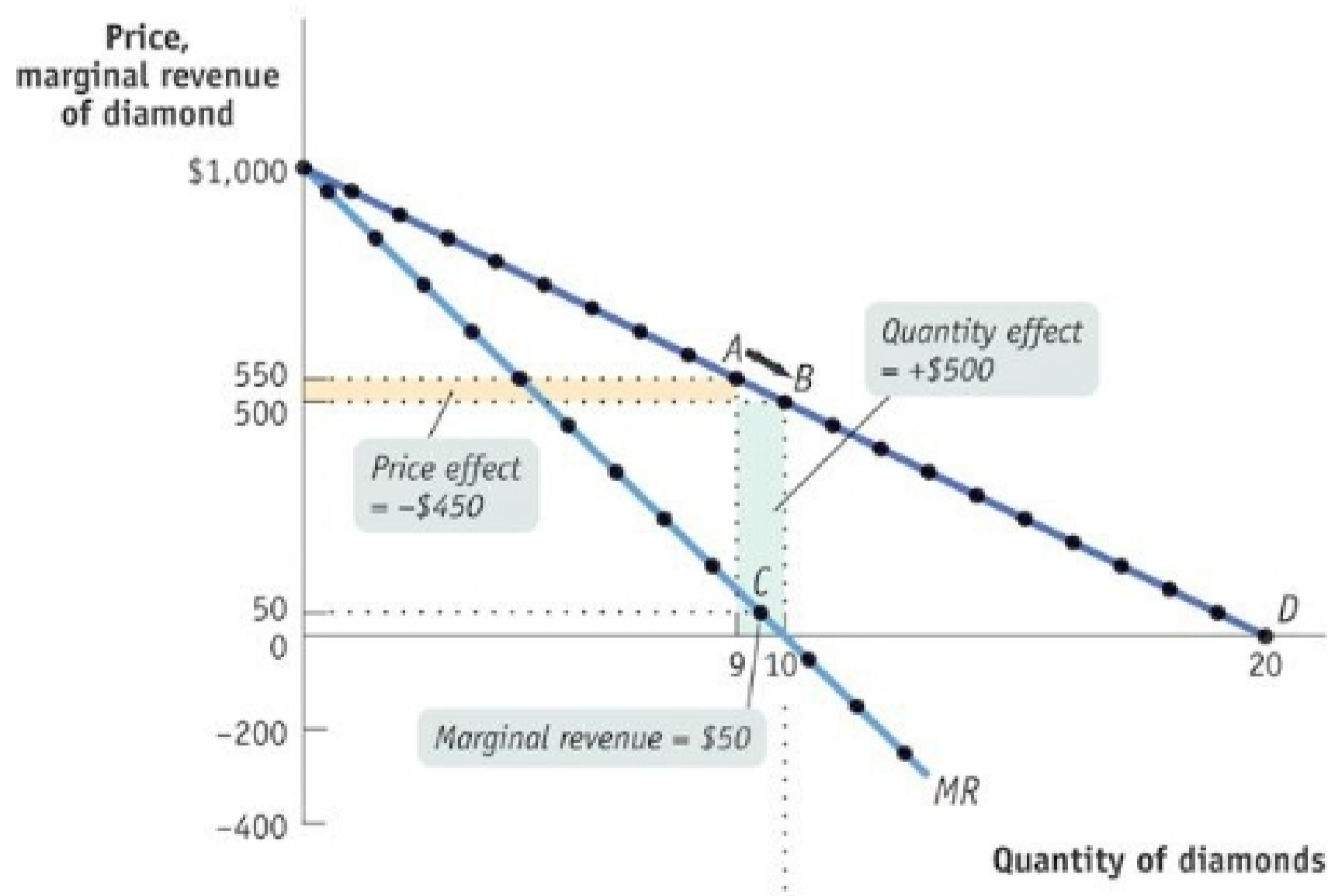
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- Why do monopolies exist?
  - How do they get away with this and protect their profit from new firms?
    - Profits will not persist in the long run unless there is a **barrier to entry**
  - **Barriers to entry** are essential for monopolies
  - Five principle types of barriers to entry:
    - Control of natural resources or inputs
      - A monopolist that controls a resource or input crucial to an industry can prevent other firms from entering its market
      - Ex. diamond industry
    - Increasing returns to scale

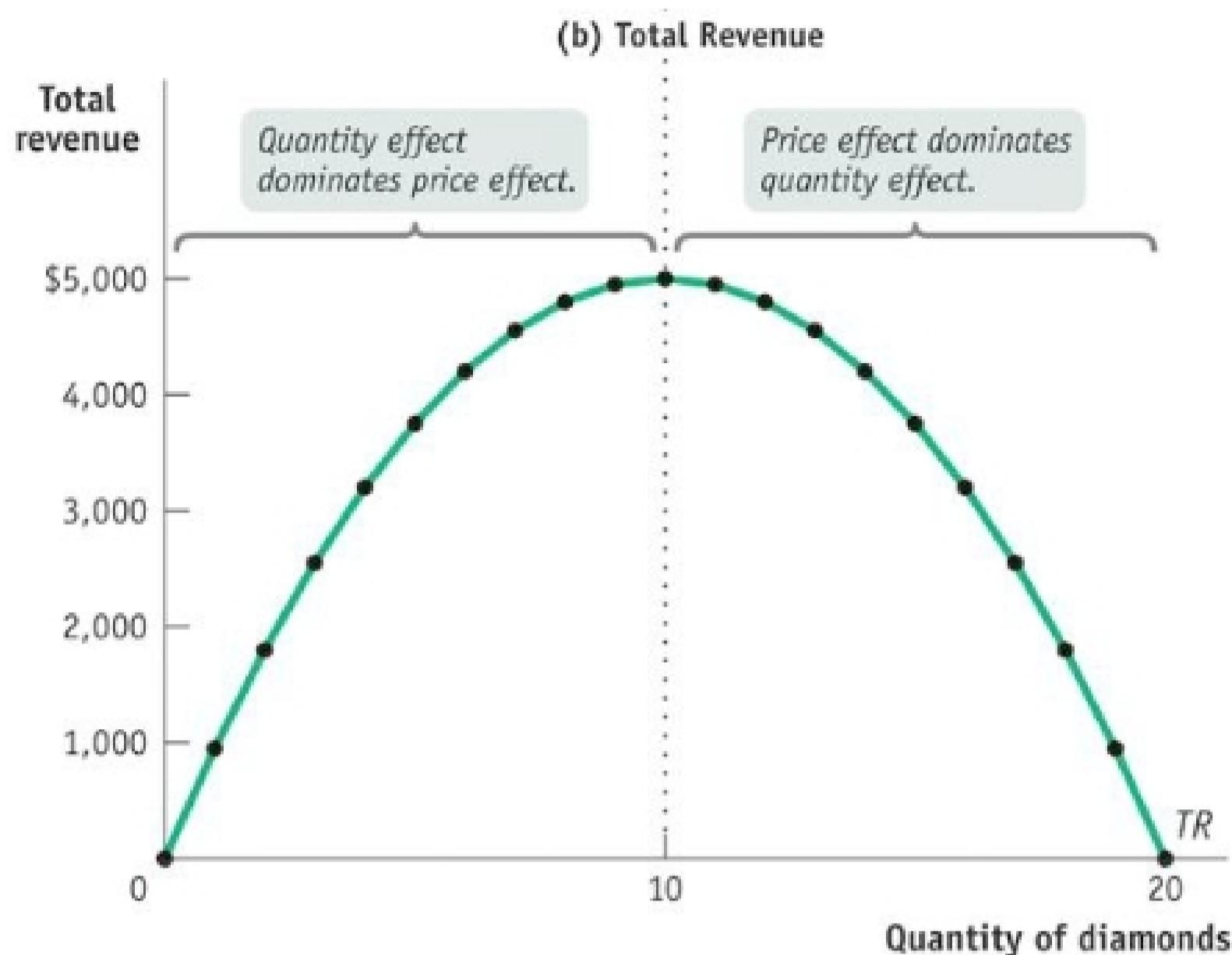
- A monopoly created and sustained by increasing returns to scale is called a **natural monopoly**
- Technological superiority
  - A firm that maintains a consistent technological advantage over potential competitors can establish itself as a monopolist
  - Ex. Apple, Windows, etc.
- Network externality
  - The value of a good or service to an individual is greater when many others use the same good or service
  - Ex. facebook (facebook wouldn't be fun if all of your friends didn't also use facebook)
- Government-made barriers, including patents and copyrights
  - A **patent** gives an inventor a temporary monopoly in the use or sale of an invention
  - A **copyright** gives the creator of a literary or artistic work sole rights to profit from that work

#### How a monopolist maximizes profit

- All firms face the same rule
  - Profit is maximized at the quantity where  $MR=MC$
- An increase in production by a monopolist has two opposing effects on revenue:
  - **Quantity effect** - one more unit is sold, increasing total revenue by the price at which the unit is sold
  - **Price effect** - to sell the last unit, the monopolist must cut the market price on all units sold; this decreases total revenue

(a) Demand and Marginal Revenue





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- Profit maximization consists of two steps:
  - Choosing a quantity (choose where  $MR=MC$ )
  - Choosing a price (once you've picked your quantity, follow the graph to the demand curve, which shows you how much consumers will pay)

