JUSTICE BASHEER AHMED SAYEED COLLEGE FOR WOMEN
(Autonomous) Afternoon Session Chennai 18.
S.I.E.T.

MICROECONOMIC THEORY I

Unit 2

Monopoly and Monopolistic Markets

Department of Economics

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LEARNING OUTCOMES

- What is Monopoly?
- What are the conditions of monopoly
- What are the sources of monopoly
- Explain Short run equilibrium under monopoly
- What is monopolistic markets and its features
- Illustrate Long run equilibrium under monopoly
- Explain Chamberlin Equilibrium under monopolistic markets
- Explain equilibrium under Price discrimination
- Explain Price discrimination under monopoly and equilibrium
- Explain theory of excess capacity

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Monopoly markets

a. Meaning of Monopoly
b. Conditions for Monopoly
c. Sources of monopoly
d. Short run Equilibrium under monopoly
e. Long run Equilibrium under monopoly

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a. Meaning of Monopoly

- Monopoly means single seller of a product but it is really a very rare condition to have a monopoly in a market structure, especially in the private sector.
- Since a monopolized industry is a single firm industry therefore there is no distinction between a firm and an industry in a monopolistic market structure.
- Hence the demand curve of a monopoly firm is same as the market demand curve.

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b. Conditions of Monopoly

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1. **Single Producer or Seller:** There must be a single producer or seller. He may be an individual or a firm of partners or a joint stock company. This condition is essential to eliminate competition. monopoly.
2. **Absence of Close Substitutes:** The commodity dealt in should have no closely competition substitutes. If there is to be monopoly the cross elasticity of demand between the product of the monopolist and the product of any other producer must be very small.
3. **Barriers to the Entry of New Firm:** there is one firm having a sole control over the production of a commodity. The barriers which prevent the firms to enter the industry may be economic in nature or else of institutional and artificial nature. ike legal restrictions, patent rights, sole control over the scarce resources, efficiency etc

These three conditions ensure that the monopolist can set the price of his commodity i.e., he can pursue an independent price output policy.Power to influence price is the essence of Monopoly.

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c. Sources or Causes for Monopoly

1. **Patents or Copyright:**
   a. A firm may possess a patent or copyright which prevents others to produce the same product or use a particular production process.
   b. Generally, when the firms introduce new products, they get patent rights from the Government so that others cannot produce them. These patent rights are granted for a certain period of time.
   For eg. when a new medicine is invented by a medical company, it gets, patent right from the Government so that it retains monopoly power over its production.
2. **Control over the Essential Raw Material.**
   a. Control by a particular firm over an essential raw material or input used in the production of a commodity.
   Eg. OPEC (Organisation of Petroleum Exporting Countries) exercises monopoly power in the world over the supply of crude oil from the Middle East countries as it has control over the supply of crude oil of these countries.

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c. Sources or Causes for Monopoly

3. **Grant of Franchise by the Government**
   - **a.** A firm is granted the exclusive legal right to produce a given product or service in a particular area or region. For example, in a large part of Delhi Government has granted the exclusive right to TATA-owned Company NDPL to provide or distribute electricity in Delhi.
   - **b.** When a company is given a franchise to produce a particular product or provide a particular service by the Government, the Government keeps with itself the right to regulate its price and quality.
4. **Economies of Scale: Natural Monopoly**
   - a. When significant economies of scale are present over a wide range of initial output, long-run average cost of production goes on falling over a wide range of output and reaches a minimum at an output rate that is large enough for a single firm to meet the entire market demand at a price that is profitable.

d. Short run equilibrium under Monopoly

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- The equilibrium of a firm is attained at a point where the firm earns maximum profit.
- **Conditions for equilibrium is**
  - MR = MC
  - Slope of MR > slope of MC, i.e. MR should cut MC from below.
- The Average revenue (AR) curve of a monopolist is downward sloping and is the demand curve for the monopolist firm and is always positive.
- MR -downward sloping and always less than AR and can be positive, zero or negative. MR curve has twice the slope of the AR
- SMC-short run marginal cost of the firm and U- shaped because in short run some factors are fixed and some are variable.
- SAC-Short run average cost curve of the monopolistic firm and U- shaped.

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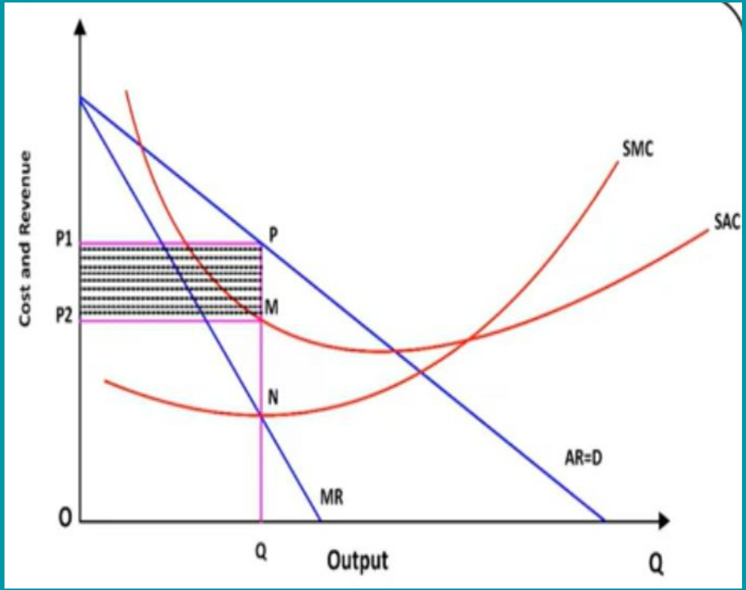
d. Short run equilibrium under Monopoly

- MR = MC at point N, the profit maximizing point or the equilibrium point of the firm is N where a monopolistic firm produces OQ quantity and sells it at OP1 price and thus maximizes its profit.
- In order to find out whether at this point the monopoly firm earns a positive profit or a normal profit or a loss, we draw SAC and the point where it cuts PQ line, i.e. at point M, shows the cost of producing OQ output i.e OP2.
- The total revenue from selling OQ output is OP1PQ and the corresponding cost of producing this output is OP2MQ. The cost of producing the output is much less than the revenue.
- The rectangle P2P1PM is the positive profit or the super normal profit which a monopolistic firm earns in the short run.



Super normal profit

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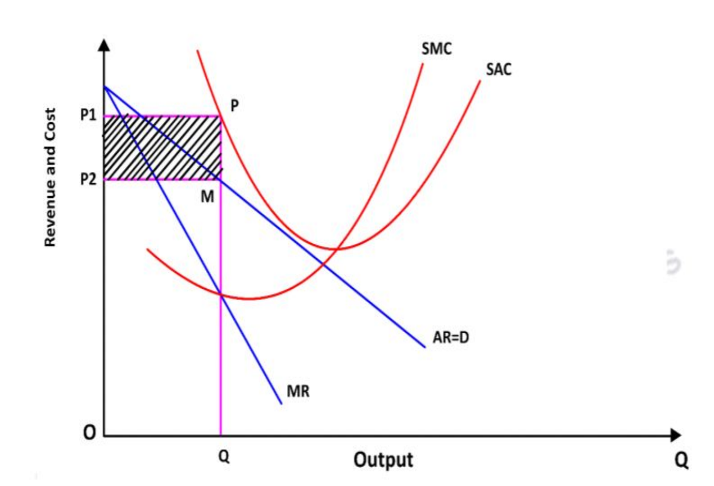
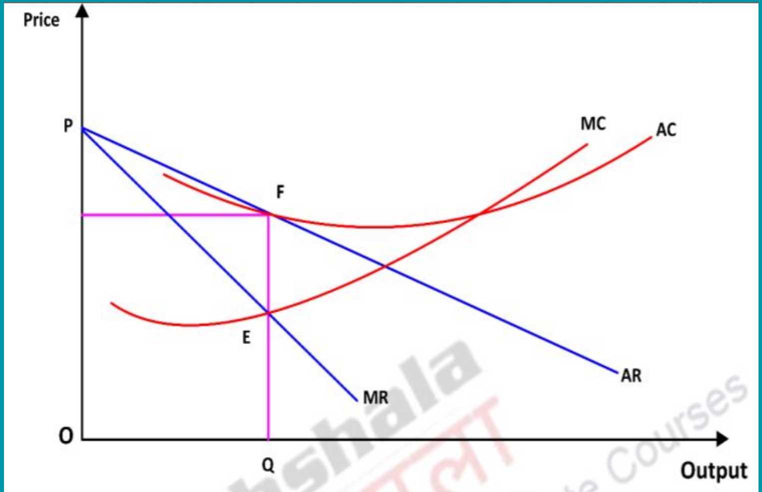
d. Short run equilibrium under Monopoly

Does a monopoly firm always make positive profit in the short run?” the answer of this is NO. Three possibilities are as follows

- If AR > AC, there is Supernormal profit for the firms,
- If AR = AC, the firm earns only normal profit and
- If AR < AC, the firm makes losses



A monopoly firm accruing loss



A monopoly firm earning normal profit

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e. Long run equilibrium under Monopoly

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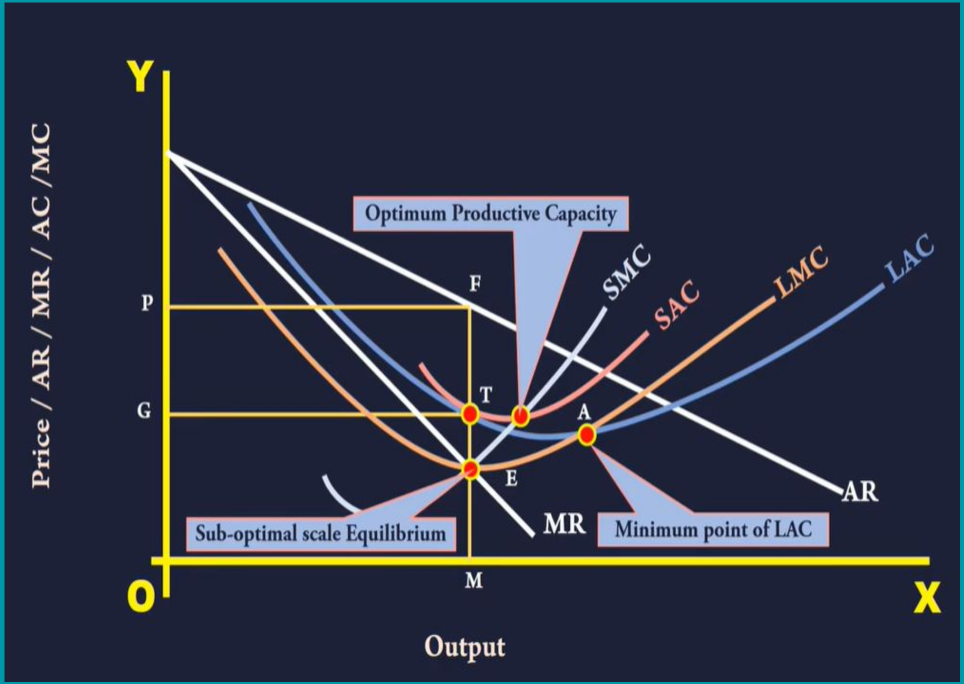
1. A monopolist continues to earn supernormal profits even in the long-run and will not stay in business if it makes losses in the long-run.
2. **Conditions of equilibrium**
   a. LMC=SMC=MR
   b. LMC AND SMC cut MR from below.
   c. SAC must be tangent to LAC.
3. However, the size of the plant and degree of its resource utilization depend upon the market demand conditions. That can be explained through three situations.
   a. Monopolist with suboptimal plant and excess capacity.
   b. Beyond Optimal Scale of the plant of a monopolist.
   c. Optimal Plant Size of a Monopolist.

e. Long run equilibrium under Monopoly

- The monopoly firm is in long run equilibrium at point E because
  - LMC =SMC=MR
  - LMC and SMC cut MR from below
  - SAC is tangent to LAC.

The point E is considered Sub-optimal scale Equilibrium because the firm is operating at the falling side of SAC as well as LAC i.e point T. The firm is not using the optimum productive capacity of the plant. It is unable to get the full benefit of the economies of scale which actually is at point A, the minimum point of LAC.



Monopolist with suboptimal plant and excess capacity.

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e. Long run equilibrium under Monopoly

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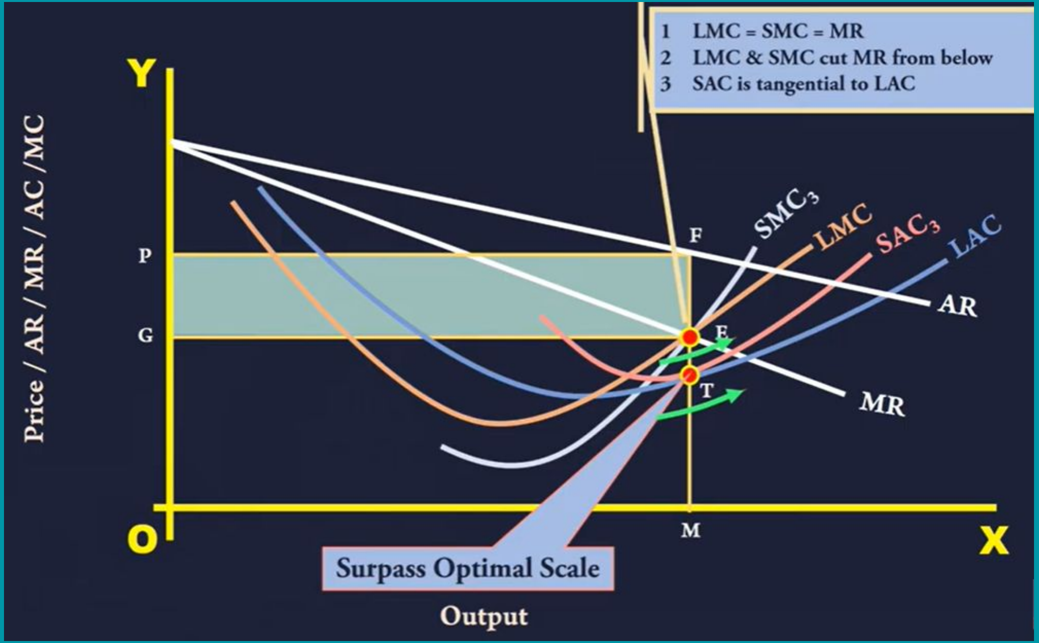
The monopoly firm is in long run equilibrium at point E with all conditions fulfilled.

The point E is considered Surpass optimal scale Equilibrium because the firm is at the rising side of SAC as well as LAC i.e point T. The firm over utilising the optimum productive capacity of the plant. The firm suffers internal diseconomies of scale.



Beyond Optimal Scale of the plant of a monopolist.

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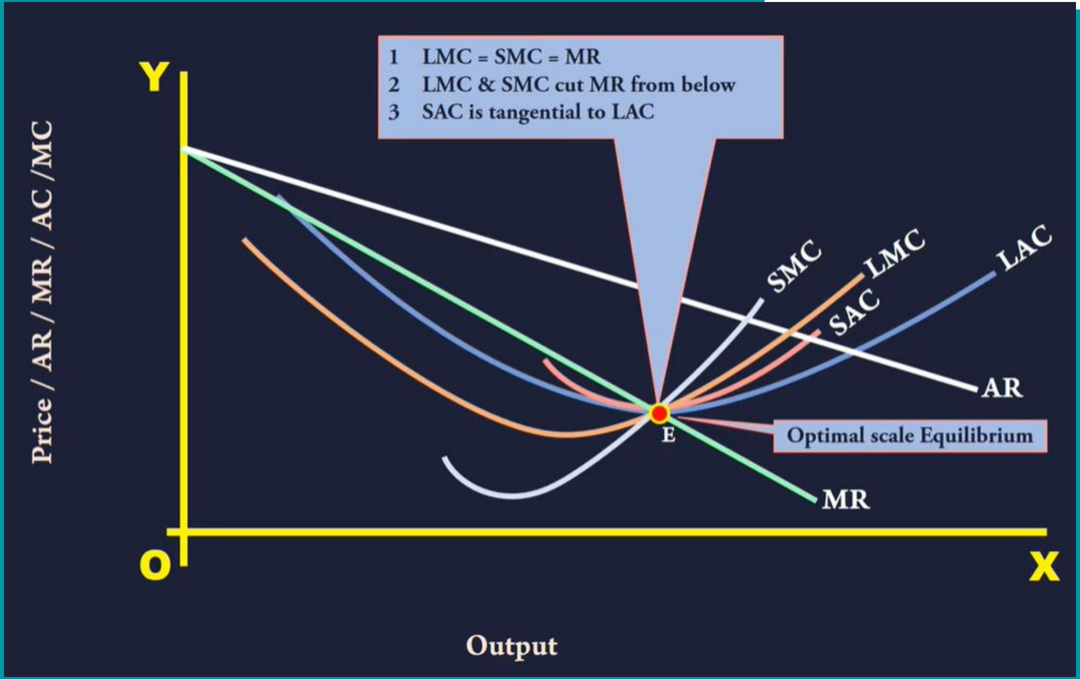
e. Long run equilibrium under Monopoly

- The monopoly firm is in long run equilibrium at point E with all conditions fulfilled.
- The point E is considered Optimal scale Equilibrium because the firm is operating at the minimum point of SAC as well as LAC. The firm is using the optimum productive capacity of the plant. It enjoys the full economies of scale.



Optimal Plant Size of a Monopolist

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Videos for reference

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Short run Equilibrium under monopoly

- https://www.youtube.com/watch?v=xXHzCuNdZ6g&list=PLbjDTCk3RrE_0LXFkHc1WHz3jarwVs8dX&index=3
- https://www.youtube.com/watch?v=sCHJHyKc6b8&list=PLbjDTCk3RrE_0LXFkHc1WHz3jarwVs8dX&index=2

Long Run Equilibrium under monopoly

- https://www.youtube.com/watch?v=z12hRNATSAs&list=PLbjDTCk3RrE_0LXFkHc1WHz3jarwVs8dX&index=5
- https://www.youtube.com/watch?v=bxmhIeuL7xk&list=PLbjDTCk3RrE_0LXFkHc1WHz3jarwVs8dX&index=6

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