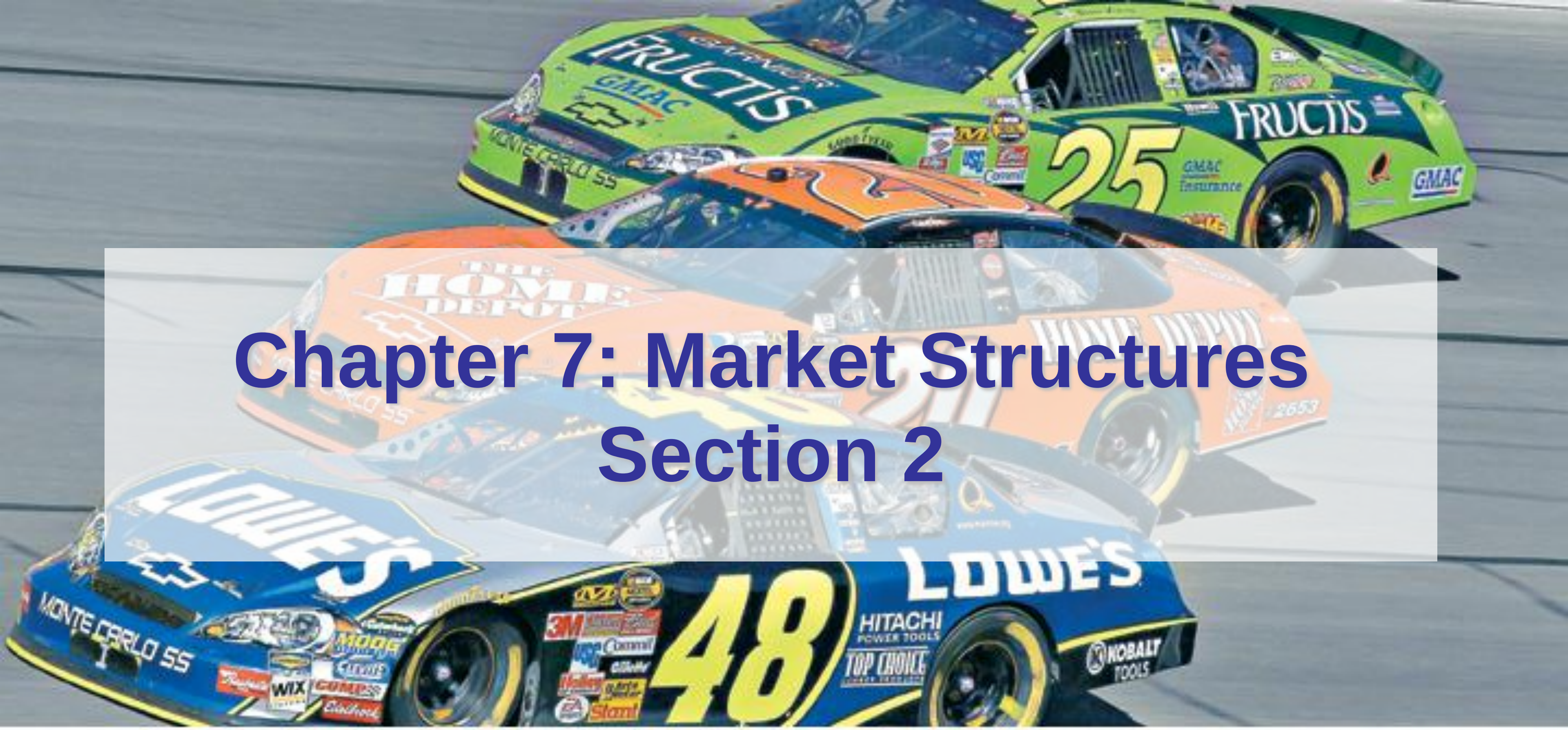

Chapter 7: Market Structures
Section 2

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ECONOMICS

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Objectives

1. **Describe** characteristics and give examples of a monopoly.
2. **Describe** how monopolies, including government monopolies, are formed.
3. **Explain** how a firm with a monopoly makes output decisions.
4. **Explain** why monopolists sometimes practice price discrimination.

Key Terms

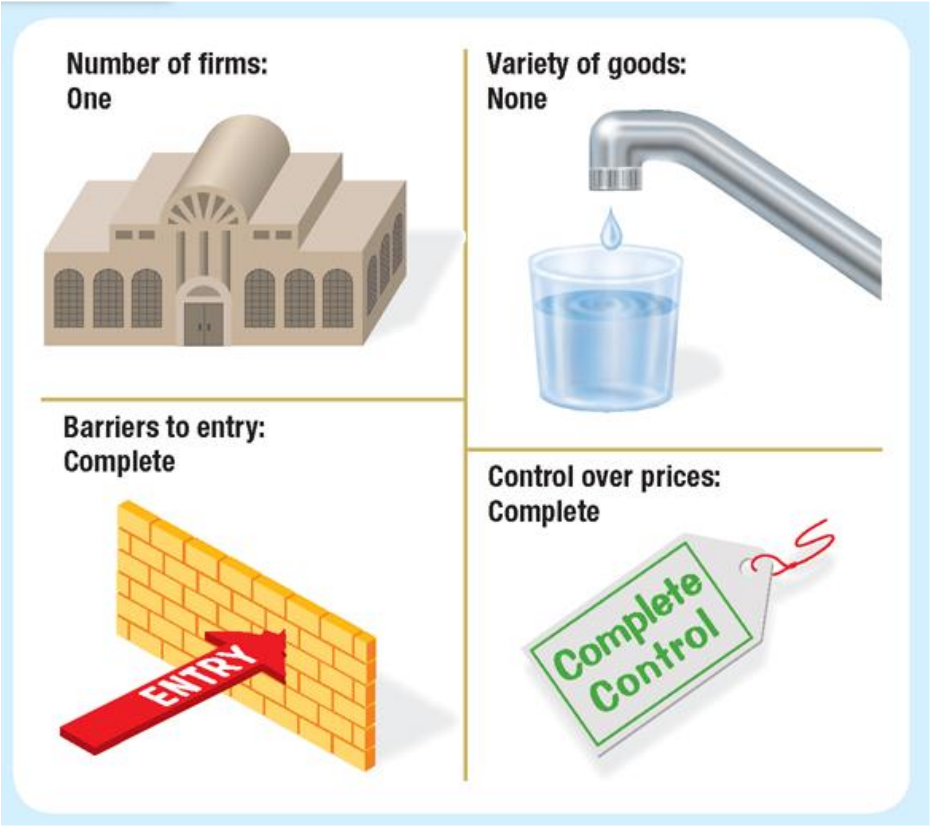
- **monopoly**: a market in which a single seller dominates
- **economies of scale**: factors that cause a producer's average cost per unit to fall as output rises
- **natural monopoly**: a market that runs most efficiently when one large firm supplies all of the output
- **government monopoly**: a monopoly created by the government

Key Terms, cont.

- **patent**: a license that gives the inventor of a new product the exclusive right to sell it for a specific period of time
- **franchise**: a contract that gives a single firm the right to sell its goods within an exclusive market
- **license**: a government-issued right to operate a business
- **price discrimination**: the division of consumers into groups based on how much they will pay for a good
- **market power**: the ability of a company to control prices and total market output

Introduction

- What are the characteristics of a monopoly?
  - A single seller
  - Many barriers to entry for new firms
  - No variety of goods
  - Complete control over price



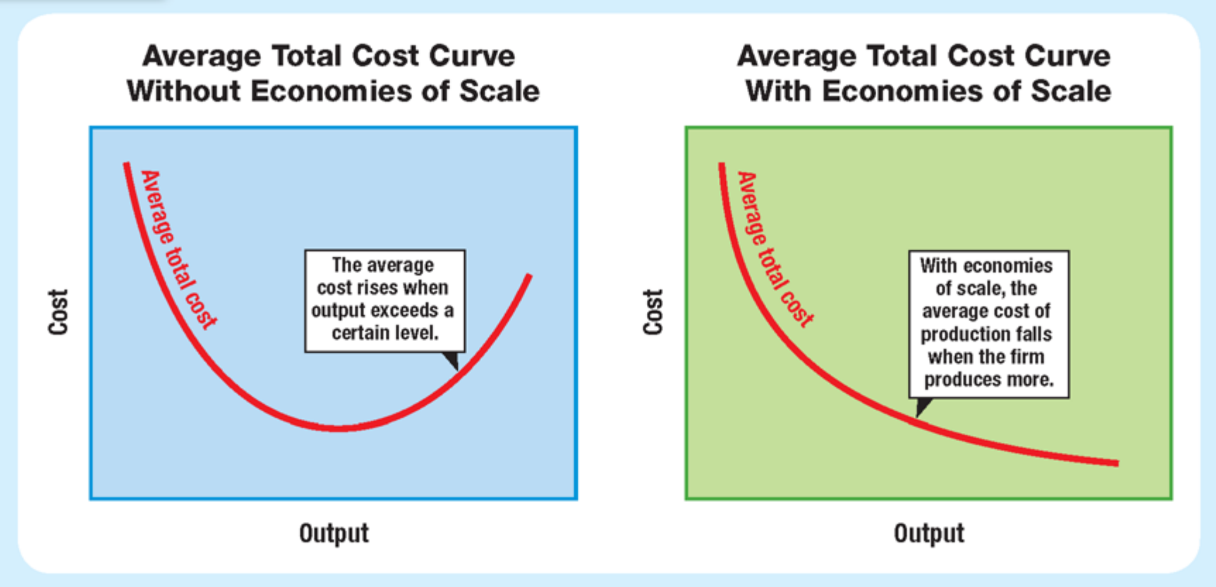
Describing Monopoly

- Checkpoint: What are three characteristics of a monopoly?
  - A single seller in a market
  - Many barriers to entry for new firms
  - Supplying a unique product with no close substitute

- Since they have the market cornered for a particular good or service, monopolies can change high prices and the quantity of goods is lower than it would be in a competitive market.

Economies of Scale

- Different market conditions can create different types of economies.
- Some monopolies enjoy what is known as economies of scale - characteristics that cause a producer's average cost to drop as production rises.
  - Why do production costs fall as output increases in an economy of scale?



Natural Monopolies

- Another type of monopoly is a natural monopoly.
- Public water is an example of a natural monopoly.
  - If water were a part of the competitive market, different companies would spend large sums of money to dig reservoirs - more land and water would be used than necessary. It would be very inefficient.

Natural Monopolies, cont.

- Technology can sometimes destroy a natural monopoly.
  - A new innovation can cut fixed costs and make small companies as efficient as one large firm.

Government Monopolies

- Checkpoint: What government actions can lead to the creation of monopolies?
  - Issuing a patent - gives a company exclusive rights to sell a new good or service for a particular period of time.
  - Granting a franchise - gives a single firm the right to sell its goods within an exclusive market
  - Issuing a license - allows firms to operate a business, especially where scarce resources are involved
  - Restricting the number of firms in a market

The Monopolist's Dilemma

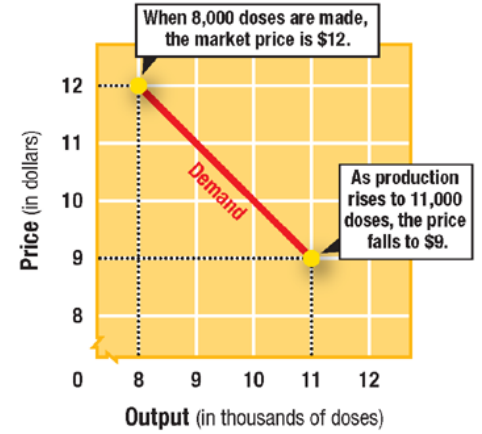
- Monopolists look at the big picture and try to maximize profits, which usually means they produce fewer goods at higher prices.

- The monopolist's dilemma can be viewed in terms of demand.
  - The law of demand states that buyers will demand more of a good at lower prices.
  - BUT the more a monopolist produces, the less they will receive in profits.

Falling Marginal Revenue

- One of the key differences between monopolies and perfect competition is that in a perfectly competitive market, marginal revenue is always the same as price, and each firm receives the same price no matter how much it produces.
- Neither assumption is true in a monopoly.

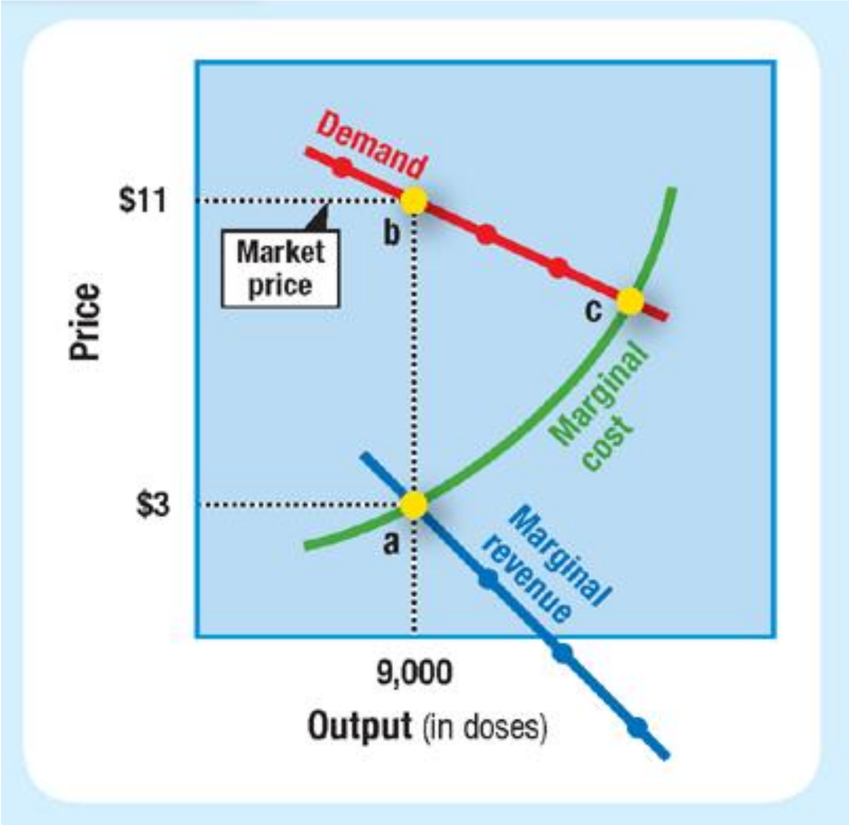
Price	Weekly Demand	Total Revenue	Change in Revenue	Marginal Revenue (per dose)
$12	8,000	$96,000	—	—
$11	9,000	$99,000	$3,000	$3
$10	10,000	$100,000	$1,000	$1
$9	11,000	$99,000	–$1,000	–$1
$8	12,000	$96,000	–$3,000	–$3



Action Graph online

Setting a Price

- The graph to the right shows how prices are set in a monopoly.
- The marginal revenue curve is in blue, the demand curve is in red, and the marginal cost in green.
  - How does point *c* show the benefits to consumers in a perfectly competitive market?



Action Graph online

Price Discrimination

- In many cases, the monopolist charges the same price to all customers.
- But in some instances, the monopolist may be able to charge different prices to different groups. This is known as price discrimination.
  - Price discrimination is based on the idea that each customer has a maximum price that he or she will pay for a good.

Targeted Discounts

- There are many targeted discounts available to particular groups, including:
  - Discounted airline fairs
  - Senior citizen and student discounts
  - Children fly or stay free promotions

Limits of Price Discrimination

- Checkpoint: What three conditions must a market meet in order for price discrimination to work?
  - Firms must have some market power
  - Customers must be divided into distinct groups
  - Buyers must not be in a position in which they can easily resell the good or service

- Most forms of price discrimination are legal, but some firms use price discrimination to drive other firms out of business, which is illegal.

Review

- Now that you have learned the characteristics of a monopoly, go back and answer the Chapter Essential Question.
  - How does competition affect your choices?