MONOPOLY

Monopoly refers to a market situation where there is one producer (firm/seller) but with many buyers of a commodity without close substitutes.

Examples of monopoly includes;

- UNEB
- UMEME
- National Water and Sewerage Corporation
- National Council of Sports

NB: A monopolist refers to a single producer (firm) of a commodity without close substitutes.

Monopsony refers to a market situation where there is one buyer of a commodity but with many sellers.

FEATURES / CHARACTERISTICS OF MONOPOLY.

1. There is only one producer / firm but with many buyers.
2. Entry of new firms into the industry is blocked.
3. The goal of the firm is profit maximisation. Profits are maximised at a point where MC = MR.
4. There is no persuasive advertising. This is due to absence of close substitutes.
5. The demand curve under monopoly is inelastic. This is due to absence of close substitues.
6. There is production at excess capacity and resources are underutilised.
7. Monopoly firms practice price discrimination. A similar commodity is sold to different customers at different prices.
8. A firm under monopoly is a price maker. A monopolist determines the price of his product.
9. There is production of a single commodity without close substitutes.

FORMS OF MONOPOLY.

1. **Pure/ Perfect / Absolute monopoly** is a market situation where there is a single seller / producer of a commodity without substitutes at all.
2. **Simple / Imperfect monopoly** is where there is a single seller / producer of a commodity without close substitutes.
3. **Bi-lateral monopoly** is a market situation where there is one buyer and one seller of a single commodity.
4. **Spatial monopoly** refers to monopoly which arises due to long distance between producers of a commodity such that each producer monopolises the market in his locality.
5. **Statutory monopoly** refers to monopoly set up by an act of parliament where a firm produces a commodity without rival firms.
6. **Collusive monopoly** is where few firms producing similar products come into agreement to determine price for their commodities.
7. **Natural monopoly** refers to monopoly which arises due to ownership of strategic natural resources thus making it hard for other firms to join production of a given commodity.

FACTORS THAT GIVE RISE TO MONOPOLY (CAUSES / ORIGINS / SOURCES / BASIS OF MONOPOLY)

1. Awarding of patent rights to innovators. These rights legally prohibit other firms or individuals from dealing in the same product making the producer a monopolist e.g copy rights given to authors.
2. Long distance between producers. This makes each producer a monopolist in his locality hence spatial monopoly.
3. Existence of a small market. This does not allow other firms to develop and produce the commodity due to low demand and low profits. This makes the existing firm a monopolist.
4. Government policy which leads to statutory monopoly. Under this, a firm is set up by an act of parliament to be controlled by the state as the only supplier of a given commodity.
5. Protectionism in international trade e.g use of total ban. This makes the firm the only supplier of a given commodity, which leads to sheltered monopoly.
6. Ownership of strategic source of raw materials. This makes a firm the only producer and supplier of a given commodity since other firms do not have raw materials hence natural monopoly.
7. High initial capital requirement. This makes a firm with huge capital resource to set up business and become the only supplier of a given commodity.
8. Limit pricing policy. This is where the existing firm sets a very low price to discourage entry of new firms into the industry so that it becomes the only supplier of a given commodity.
9. Merging of small firms. Small firms producing similar products come together and form one large firm, which becomes the only supplier of a given commodity.
10. Long period of training / apprenticeship. This leads to professional monopolists such as chartered accountants and specialist doctors in the short run.
11. Cartel arrangements and common marketing policies. Firms producing similar products come into agreement to determine output and price hence collusive monopoly.
12. Possession of special natural talents. Individuals become monopolists in certain fields due to special natural abilities e.g great footballers and comedians.

DEMAND CURVE OF A FIRM UNDER MONOPOLY

A monopoly firm has an inelastic demand curve due to absence of close substitutes.

The MR curve lies below the AR curve. This is because if a monopolist wants to sell an additional unit of output, it has to reduce the price.

Illustration

2OO4 P.1 (a) How are profits maximised in a monopoly market situation? (8mks)

(b) Explain the merits and demerits of monopoly in an economy. (12mks)

QN. (a) With the help of a diagram, explain how a monopolist firm maximises profits.

(b) Explain the implications of the existence of absolute monopoly in a developing country.

PROFIT MAXIMISATION IN MONOPOLY.

- Profits are maximised at a point where MC = MR.

- Equilibrium output Q1 is determined at a point where MC = MR.
- Price P1 is charged where the output line meets the AR curve.
- AR is greater than AC at equilibrium output.
- Abnormal profits are earned shown by the shaded area P1ABC.

MERITS OF MONOPOLY.

1. Abnormal profits are enjoyed both in the short run and in the long run. This is due to limited competition in the market.
2. Monopoly encourages research and innovations. This is due to abnormal profits earned by the firm.
3. Monopoly increases employment opportunities. This is especially with state monopolies which usually operate on a large scale and employ many people.
4. Monopoly firms are a source of government revenue through taxation. The abnormal profits earned are taxed to raise revenue for the government.
5. Monopoly promotes growth of infant industries. This is due to protection from foreign competition through total ban on substitutes from other countries.
6. Economies of scale are enjoyed. This is due to large scale production in order to serve a wider market.
7. Price discrimination is possible and this benefits low income earners. Low income earners are charged a lower price.
8. Monopoly avoids wastage of resources. This is due to limited duplication of goods and services.
9. Monopoly reduces costs of operation. This is due to limited expenditure on sales promotion activities e.g advertising.
10. State monopolies provide cheaper services to the people. This is because they receive government subsidies and therefore charge lower prices for goods and services.

DEMERITS OF MONOPOLY.

1. Low quality products are produced. This is due to absence of competition in production.
2. Monopoly causes income inequality. This is due to excessive profits earned by owners of monopoly firms unlike other producers.
3. Consumers are exploited by being charged high prices. This is due to the desire for high profits by the monopolists.
4. Monopoly limits choice of goods for consumers. This is because only one commodity is produced without close substitutes.
5. Monopoly leads to underutilisation of resources. This is because firms under monopoly produce at excess capacity.
6. Shortages occur especially in times of breakdown. This is due to existence of one firm producing the commodity without rival firms.
7. Monopoly causes unemployment and underemployment. This is due to production at excess capacity which limits job creation and resource utilisation.
8. Workers are exploited through underpayment. This is because there is only one firm producing a given commodity where labour can get employed.
9. Monopoly firms exert pressure on government. They influence government decisions and policies such as taxation because they are the controllers of production.

QN. Why is it necessary for the government to control monopoly? (Form reasons from demerits)

- To improve the quality of output.
- To reduce income inequality.
- To reduce consumer exploitation.
- To widen consumer choices of commodities.
- To increase utilisation of resources.
- To avoid shortages especially in times of breakdown of the firm.
- To reduce unemployment.
- To reduce exploitation of workers.
- To minimise pressure exerted on government by monopoly firms.

QN (a) Describe the basis of monopoly. (10mks) (causes / origins/ sources of monopoly)

(b) How is monopoly controlled? (10mks)

QN. What measures should be taken to reduce monopoly tendencies in an economy?

WAYS / MEASURES THAT CAN BE TAKEN TO REDUCE /CONTROL MONOPOLY.

- Price control should be adopted. Government can set a maximum price above which a monopolist should not sell his products. This can reduce consumer exploitation through high prices.

- Heavy taxes should be imposed on monopoly firms. High taxes should reduce abnormal profits made by monopoly firms and therefore discourage them.
- Private monopoly firms should be nationalized. Government can take over ownership of private monopoly firms and tis can reduce exploitation of consumers through provision of cheaper.
- Trade restrictions in international should be removed. This should enable foreign firms (industries) to compete with domestic monopoly firms by providing substitutes.
- The period of patent rights should be restricted to a specific period. This means that a firm does not become a monopolist for a long period of time.
- State monopoly firms should be privatised. This should promote competition and efficiency in production, and will increase output and reduce monopoly power.
- Merging of firms should be discouraged. This should give a chance to individual firms to operate independently and therefore compete with each other. This will increase supply of the commodity.
- New rival firms should be subsidized. This should enable new firms develop and compete with the existing monopoly firms due to reduced costs of production and this reduces monopoly power.
- Government owned firms should be set up to compete with private monopoly firms. This should increase output levels and competition in the market which reduces monopoly power.
- Anti-monopoly laws (legislations) should be enacted and used. Such laws forbid the creation of monopoly firms.

PRICE DISCRIMINATION (Parallel pricing / Discriminating monopoly)

Price discrimination is where a monopolist sells a similar commodity to different consumers at different prices without basing differences on the costs of production.

FORMS OF PRICE DISCRIMINATION.

- Price discrimination according to the income of consumers e.g doctors charge highly the rich than the poor patients.
- Price discrimination based on age e.g barbers charge less money for children haircuts than the adults.
- Price discrimination based on the time of service e.g entertainment centres charge highly for weekend shows than shows done during week days.
- Price discrimination based on sex e.g ladies are charged less money than gentlemen on some forms of entertainment.
- Price discrimination based on the nature of the product e.g hard cover books are charged highly than soft cover books of the same edition.

CONDITIONS NECESSARY FOR THE SUCCESS OF PRICE DISCRIMINATION.

1. The seller should be a monopolist. This means that the commodity should not have close substitutes so that there is full control of whatever is supplied on the market.
2. Consumers should be ignorant about the existence of cheaper goods in other markets.
3. There should be absence of government interference in the market i.e there should be no form of price control.
4. Elasticity of demand should be different in different markets. A high price is charged where demand is inelastic and a low price is charged where demand is elastic.
5. There should be geographical separation of markets so that no reselling can take place.
6. Goods should be sold on special order so that the buyer does not know the price charged on others.
7. Transport costs between markets should be high. This makes it difficult for buyers to transfer goods from one market to another.
8. Price discrimination is possible where personal (direct) services are provided. Such services cannot be transferred from one person to another e.g medical services.
9. The cost of separating markets by the producer should be low. This allows easy transfer of goods from one market to another by the monopolist.
10. Marginal revenue in different markets should be the same. This enables the producer to make profits in all markets.

QN. (a) What is meant by term price discrimination? (4mks)

(b) Explain the conditions necessary for the success of price discrimination in an economy. (16mks)

QN. Under what circumstances may price discrimination succeed?

Approach.

-When……

-In case…….

-If………….

QN. Under what circumstances may price discrimination fail to succeed?

QN. (i) What is meant by price discrimination?

(ii) Give any three factors that limit effectiveness of price discrimination in a market economy.

MERITS OF PRICE DISCRIMINATION.

1. Price discrimination enables low income earners to get essential goods cheaply e.g poor patients.
2. Reduces income inequality. This is because the rich are charged high prices while the poor are charged low prices.

3. Increases prospects of employment opportunities. This is due to increased production for a large market.
4. Captures a wider market abroad e.g price discrimination that takes the form of dumping.
5. Increases total revenue of the producer. This is because more units of the commodity are sold in different markets.
6. Increases consumption of goods that would be more expensive e.g in case of electricity, charges reduce as more units are used.
7. Expands the scale of production. This increases output and benefits consumers.

DEMERITS OF PRICE DISCRIMINATION.

1. Low quality products may be provided especially where the price charged is low.
2. Discourages growth of domestic industries especially if it is in form of dumping.
3. Leads to wastage of resources. There is underutilisation of resources by a monopolist in order to produce less output and charge a higher price.

QN. (a) Distinguish between perfect competition and monopoly.

(b) What are the differences between perfect competition and monopoly market situations? (Compare their features to get similarities and differences)

MONOPOLISTIC COMPETITION.

Monopolistic competition is a market structure where there are many buyers and sellers of differentiated products (close substitutes).

Examples of monopolistic competition in Uganda include:

- Tooth paste industry.
- Bread industry.
- Soap industry.
- Transport industry.

FEATURES / X-TICS OF MONOPOLISTIC COMPETITION.

1. There are many buyers and sellers in the market.
2. There is free entry and exit of firms in the industry.
3. The major goal of the firm is profit maximisation. This is achieved where MC = MR.
4. The demand curve under monopolistic competition is elastic (fairly elastic). This is due to existence of close substitutes.
5. There is persuasive advertising. This is necessary to attract customers and increase sales.
6. There is existence of excess capacity i.e resources are underutilised.
7. There is existence of brand loyalty by consumers. Consumers prefer particular brands which they feel are better and superior compared to other brands.
8. Firms are price makers to a certain extent. This is because of having monopoly power over their brands.

9. There is limited interdependence between the firms.
10. There is production differentiation. Firms produce differentiated products which are close substitutes.

PRODUCT DIFFERENTIATION

Product differentiation refers to the practice by producers in an imperfect market of creating artificial differences between goods with the same use.

Features / Forms of product differentiation.

- Different branding.
- Use of different colours.
- Use of different shapes.
- Different packaging.
- Different sizes.
- Different designs.
- Through persuasive advertising.

DEMAND CURVE UNDER MONOPOLISTIC COMPETITION.

The demand curve of a firm under monopolistic competition is fairly elastic. This is due to existence of many firms producing close substitutes.

Illustration

SHORT RUN PROFIT MAXIMISATION IN MONOPOLISTIC COMPETITION.

- Profits are maximised at a point where MC = MR.

- Equilibrium output Q_1 is determined where MC = MR.

- Price P_1 is determined at a point where the output line meets the AR/ demand curve.
- AR is greater than AC at equilibrium output.
- Abnormal profits are made, shown by the shaded area P_1ABC.

LONGRUN PROFIT MAXIMISATION IN MONOPOLISTIC COMPETITION.

- Profits in the longrun are maximised where MC = MR.

- Output Q1 is determined where MC = MR.
- Price P1 is charged where the output line meets the AR/ demand curve and AR is tangential to the AC curve.
- Normal profits are made since AR = AC. This is because new firms enter the industry and compete away the abnormal profits that existed in the short run.

MERITS OF MONOPOLISTIC COMPETITION

(Positive implications / impact/ effects)

- Better quality goods and services are produced. This is due to competition among firms.
- A wide variety of products is provided to consumers. This is due to existence of many firms producing differentiated products.
- Abnormal profits are made in the short run and these help the firm to expand. This is especially when profits are re-invested in the firm.
- Increases output in the long run hence economic growth. This is due to production by many firms.
- Increases employment opportunities in the short run. This is due to a large number of firms engaged in production, which employ many people.
- Encourages research and innovations in the short run. This is due to abnormal profits made, which are used to carryout research.
- Economies of scale are enjoyed as a result of large scale production.
- Provides government revenue through taxation. Firms are taxed to raise revenue for the government.
- Low prices are charged and this benefits consumers. This is due to a high degree of competition among firms producing close substitutes.

DEMERITS OF MONOPOLISTIC COMPETITION.

(Costs/ Negative implications/ impact / effects)

- Causes underutilisation of resources. This is due to production at excess capacity.
- Consumer choices are distorted. This is due to persuasive advertising carried out by firms.
- Normal profits are made in the long run and this limits expansion of firms.
- Increases costs of operation. This is due high expenditure on sales promotion e.g persuasive advertising.
- Causes unemployment in the long run. This is because some firms exit due stiff competition and occurrence of normal profits.
- There are limited inventions and innovations in the long run. This is due to normal profits, which limit research.
- Consumers are exploited in form of high prices charged in order to maximise profits.
- Low government revenue is generated from taxes in the long run. This is due to normal profits earned by firms.

2013 P.1 (a) How does a firm in a monopolistic competitive market determine output, price and profits in the long run? (6mks)

(b) Explain the merits and demerits of monopolistic competition. (14mks)

QN. (a) Describe the features of monopolistic competition.

(b) How does a firm under monopolistic competition maximise profits in the:

(i) short run

(ii) long run?

QN. (a) What are the differences between monopoly and monopolistic competition?

(b) How is output, price and profit determined under monopolistic competition in the short run and long run?

OLIGOPOLY.

Oligopoly is a market where there are many buyers and few firms dealing in either homogeneous products or differentiated products.

FORMS OF OLIGOPOLY.

1. **Pure / Perfect oligopoly** refers to a market structure where there are few firms dealing in homogeneous products.

2. **Imperfect oligopoly** refers to a market structure where there are few firms dealing in differentiated products.

   Examples of imperfect oligopoly in Uganda include:
   - Petrol dealers.
   - Beer breweries.
   - Press (Newspaper) industry.
   - Soft drinks industry.
   - Telecommunication industry.

NB: **Duopoly** is a market situation where there are two firms but with many buyers of either homogeneous products or differentiated products.

FEATURES / CHARACTERISTICS OF OLIGOPOLY.

1. There are few firms and many buyers in the market. Each firm takes a considerable part of the total market.
2. There is restricted entry of new firms into the industry. This is partly due to high costs of production.
3. The major goal of the firm is profit maximisation. Profits are maximised at a point where MC = MR.
4. There is close interdependence between firms. Each firm in the industry is aware that the actions and reactions of the other rival firms affect it.
5. Firms produce either homogeneous products or differentiated products.
6. Firms are of different sizes. Some firms are small while others are large depending on the amount of capital that has been invested in the firm.
7. There is no unique pattern of pricing. Prices may be determined through collusion, price leadership or independent pricing.
8. The demand curve under oligopoly is kinked. This is due to price rigidity.
9. There is a high degree of uncertainty in the market. One firm cannot predict exactly how other firms will react to its price changes.
10. Firms practice non-price competition e.g provision of after sale services and use of promotional offers.
11. There is price rigidity. Firms are unwilling to change their prices in the long run.

NB: **Price rigidity** is where prices in the market remain stable for a period of time despite changes in the costs of production and demand.

DEMAND CURVE UNDER OLIGOPOLY.

A firm under oligopoly has a kinked demand curve.

It is elastic at high price levels and inelastic at low price levels.

If one firm increases its price above P_1, its competitors will not follow hoping to attract more customers by maintaining a lower price.

If one firm reduces its price below P_1, its competitors will also reduce their prices fearing that they lose customers to the firm with low prices. Therefore, a firm faces two different demand curves; one which is elastic above the kink and another one which is inelastic below the kink.

METHODS OF PRICING IN OLIGOPOLY.

1. **Independent pricing** is where each firm sets its own price.

Independent pricing leads to price war or cut throat competition.

NB: **Price war** is where firms undercut each other in terms of prices in order to increase sales.

2. **Collusive pricing / perfect collusion** is where all firms in an industry jointly set a common price for the commodity.
   Perfect collusion is done through a cartel arrangement.

NB: **A cartel** refers to the organisation of firms in an industry formed to reduce competition amongst themselves in order to increase sales and profits.

3. **Price leadership / imperfect collusion** is where the dominant or low cost firm sets the price and other firms in the industry follow it.
4. **Price administration / legislation** is where the prices for the products of firms are fixed by the government.

PROFIT MAXIMISATION UNDER OLIGOPOLY.

- Profits are maximised at a point where MC = MR.

- Output Q_1 is determined at a point where MC = MR.
- Price P_1 is determined at a point where the output line meets the AR curve.
- AR is greater than AC at equilibrium output.
- Abnormal profits are earned, shown by the shaded area P_1ABC.
- MC and AC curves pass through the disjointed part of MR.

MERITS OF OLIGOPOLY.

1. Oligopoly leads to production of better quality products. This is due to stiff competition among firms.
2. Consumers gain from non-price competition e.g gifts and after sale services.
3. Oligopoly eases consumer budgeting due to price rigidity. Price rigidity in the industry makes prices to be stable.
4. Oligopoly widens consumer choices of goods and services. This is due to production of a variety of products especially under imperfect oligopoly.
5. Oligopoly leads to provision of efficient services to consumers. This is due to competition among firms.
6. Low prices are enjoyed by consumers. This is due to competition among firms in the short run leading to price undercutting.
7. Oligopoly provides employment opportunities to many people. This reduces unemployment problem and improves people's standards of living.
8. Oligopoly increases innovations due to competition and the need to maximise profits. Firms employ new methods of production in order to compete with rival firms.
9. Oligopoly contributes to economic growth. This is due to increased output by competing firms.
10. Oligopoly leads to the development of infrastructure. Some firms construct social facilities and modern premises as a means of competing with rival firms.
11. Oligopoly firms contribute revenue to the government through taxation. Abnormal profits made are taxed to raise government revenue.
12. Oligopoly firms earn abnormal profits both in the short run and in the long run. These profits are used to expand production especially when they are ploughed back.
13. Leads to increased resource utilisation. The supernormal profits earned enable firms to exploit the would- be idle resources.

DEMERITS OF OLIGOPOLY.

1. Oligopoly worsens income inequality. This is due to supernormal profits made by oligopoly firms unlike other firms that do not have them.
2. High costs of operation are incurred. This is due to high expenditure on sales promotion activities e.g advertising.
3. Consumers are exploited through being charged high prices. This is especially after collusion of firms.
4. Oligopoly distorts consumer choices of goods and services. This is due to wide spread persuasive advertising.

5. There is limited variety of goods especially under perfect oligopoly. This is due to production of homogeneous products which limits consumer choices.
6. Oligopoly limits employment opportunities. This is because there are few firms in the industry and entry of new firms is restricted.
7. Oligopoly causes underutilisation of resources. This is due to production at excess capacity.
8. Industries with large firms exert pressure on the government. This is due to collusion that makes firms behave like monopoly firms.
9. Oligopoly leads to collapse of some firms especially small firms. This is due stiff competition among firms.
10. Oligopoly leads to wastage of resources. This is due duplication of goods and services especially under imperfect oligopoly.
11. Oligopoly limits investment and entrepreneurial development. This is due to restricted entry of new firms into the industry.

1998 P.1 (a) Outline the:

(i) Features of an oligopolistic market structure. (6mks)

(ii) Advantages of an oligopolistic market to the consumers. (6mks)

(b) Explain how an oligopolistic firm maximises profits in the short run. (8mks)

2008 P.2 (a) Describe the features of an oligopolistic market. (10mks)

(b) Explain the demerits of oligopolistic markets in your country. (10mks)

2007 P.2 (a) What are the features of oligopolistic markets in your country? (10mks)

(b) Discuss the merits and demerits of oligopolistic markets in your country. (10mks)

2016 P.2 (i) Differentiate between perfect oligopoly and imperfect oligopoly. (2mks)

(ii) Give any two advantages of oligopolistic markets to the consumer. (2mks)

2013 P.2 (a) Describe the features of an oligopolistic market. (8mks)

(b) Examine the merits and demerits of oligopolistic markets. (12mks)

2011 P.2 (i) Distinguish between oligopoly and duopoly. (2mks)

(ii) State any two advantages of oligopoly market in your country. (2mks)

2001 P.2 (a) What are the features of an oligopoly market? (6mks)

(b) Describe the forms of non-price competition used by oligopoly firms in your country. (14mks)

NON-PRICE COMPETITION.

Non-price competition refers to the use of other economic methods by rival firms to compete with each other without reducing prices.

FORMS OF NON-PRICE COMPETITION.

1. **Use of attractive brand names** e.g Nice and lovely jelly. These entice and attract many customers to buy the product of the firm since it sounds unique and better than others.
2. **Provision of credit facilities to customers** e.g hire purchase. This helps the firm to attract more customers especially those who cannot afford to buy goods on cash basis.
3. **Use of persuasive advertising in various media** e.g radios and televisions. This increases consumer awareness about the product and convinces many customers to buy the product at the same price.
4. **Use of differentiated and attractive packaging of goods**. Attractive packaging materials seduce many customers to buy the product of the firm because it looks unique from others.
5. **Sponsoring sports events and programmes** e.g MTN Kampala Marathon. This helps the firm to gain national and international publicity and this increases its market share.
6. **Distribution of free samples to customers**. These free samples are given to potential customers and they show the high quality of the products. This induces the customers to buy the product.
7. **Offering gifts to customers**. These gifts are given to encourage customers to buy more of the product and keep on using it.
8. **Provision of after sale services to customers** e.g free transport. These services attract more customers to buy the products of the firm at the same price.
9. **Opening up branches and distribution points in various areas**. This helps the firm to gain a wider market because goods and services are brought nearer to the customers.
10. **Improving on the quality of products**. This helps the firm to gain a wider market and outcompete other firms because consumers always wish to have better quality products.
11. **Renovation of premises of the firm**. This provides a good visual image so that the firm's products are known and this induces the customers to buy more.
12. **Organising trade fairs and exhibitions**. This gives customers a chance to access and learn about the products of the firm which increases sales of the firm.
13. **Organising draws and promotional offers**. This is done to encourage consumption of the products of the firm in large quantities in order to increase the chances of winning prizes. This increases sales of the firm.
14. **Use of one stop shopping centres**. These are common at fuel stations and help to attract customers which increases the sales of the firm.