Monopoly-competition

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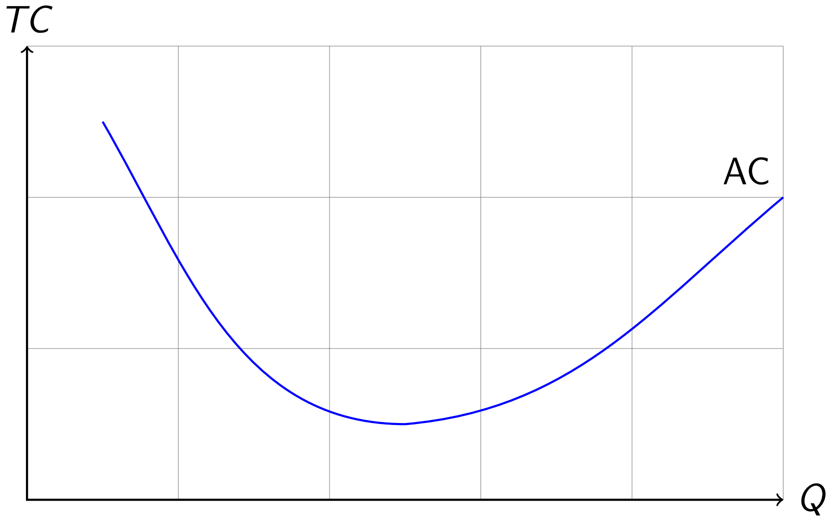
Average Costs

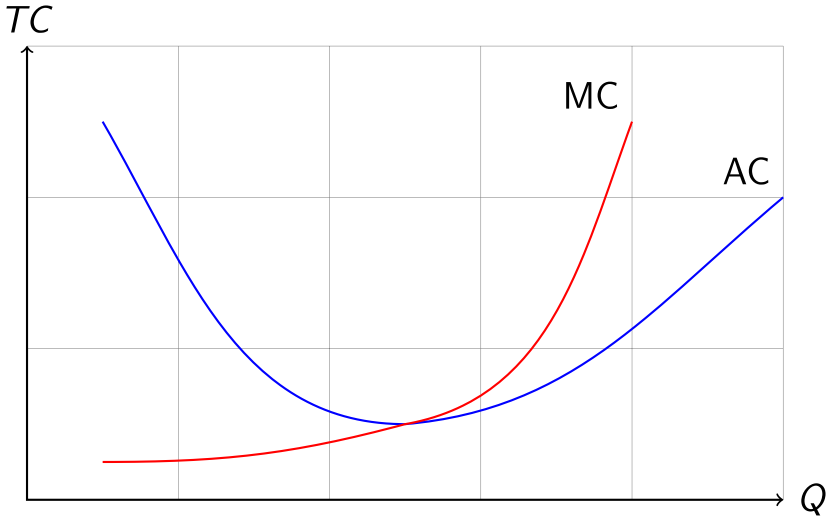


Shape of average cost

The average cost curve is U shaped because

- Average costs initially fall with specialisation
- Average costs initially fall because fixed costs are spread
- Average costs eventually rise because of *diminishing returns* in the short-run
- Average costs eventually rise because of *diseconomies of scale* in the long-run

Marginal costs



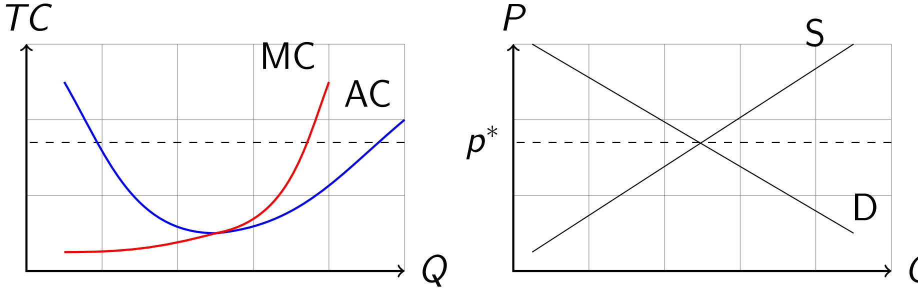
Shape and position of the marginal cost

The average cost curve is U shaped because

- The marginal cost is the cost of one more unit of output
- The marginal cost is below the average cost while average cost is falling
- The marginal cost is above the average cost while the average cost is rising
- The marginal cost cuts the average cost at the lowest point on the average cost

Perfect Competition

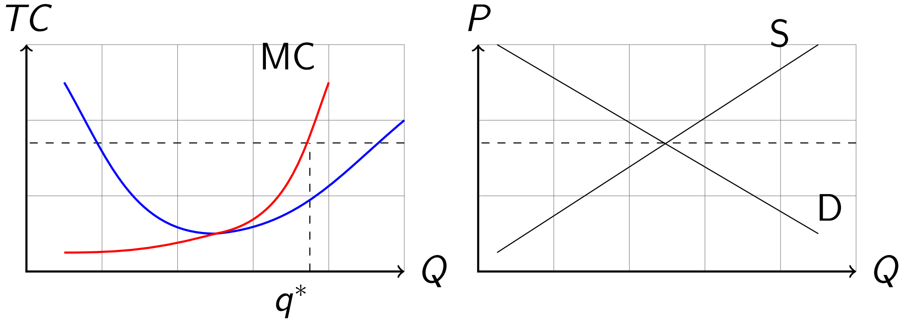
In a perfectly competitive market, the marginal cost curve is the firm supply curve



Equilibrium price $= p^* = AR = MR$

Profit maximisation

Profit maximised at MR = MC



Profit-maximising output moves along the MC curve

Profits and supply

Costs include *normal profits*

$$\pi = TR - TC$$

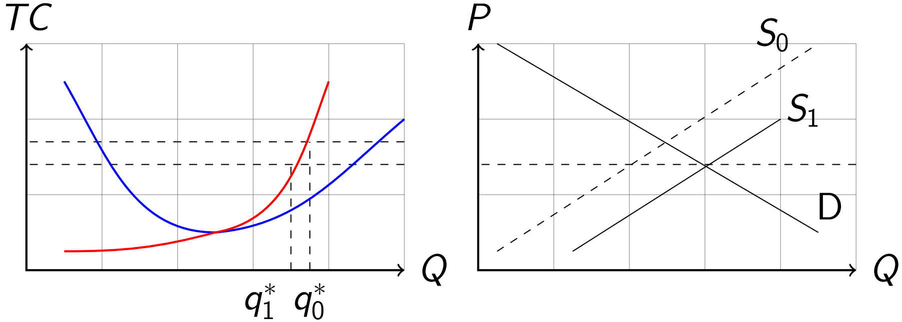
Profit per unit sold (average profit)

$$\frac{\pi}{Q} = AR - AC$$

Where there are *super-normal profits* new firms will enter the industry.

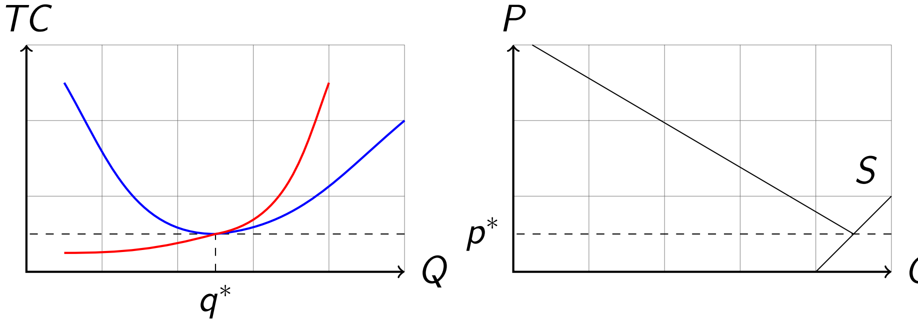
Supply increase

Profit maximised at MR $=$ MC



Profit-maximising output moves along the MC curve

Long-run Equilibrium



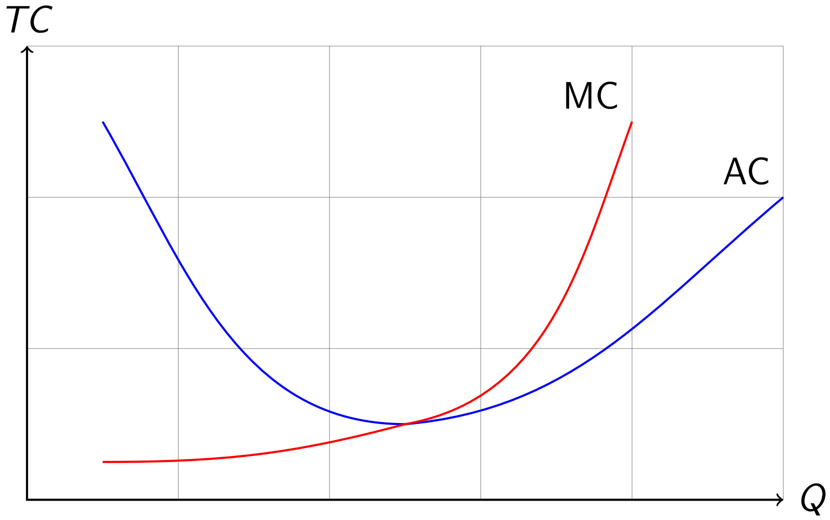
Long-run equilibrium when price is equal to the minimum on the average cost curve.

Monopoly

For monopoly, the firm and the market are the same
There are barriers to entry

- Government or regulatory
- Patents or unique product
- Access to customers or materials
- First-mover advantage
- Threats
- Agreements

Monopoly firm

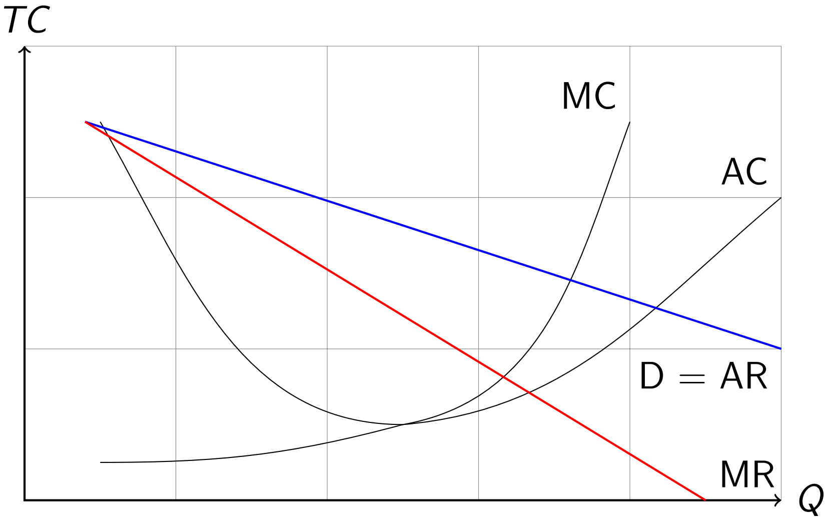


Monopoly vs perfect competition

Consider a large number of market stalls

- Each firm takes the market price
- One monopolist buys all the small market traders
- The monopolist manages market stalls to maximise profits
- $\text{MR} = \text{MC}$
- Reduce output to the point where there is *unit elasticity*

Monopoly firm

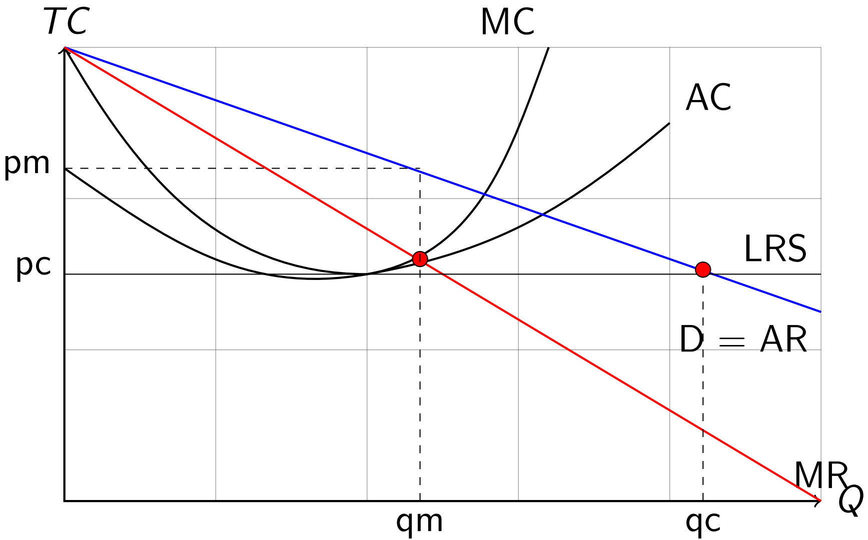


Average revenue and marginal revenue

The marginal revenue will be below the average revenue

P	Q	TR (P*Q)	AR (TR/Q)	MR ($\Delta TR/\Delta Q$)
5	1	5	5	5
4	2	8	4	3
3	3	9	3	1
2	4	8	2	-1

Competition vs monopoly 2



Competition vs monopoly 3

When costs do not change, monopoly will charge a higher price and will therefore provide less product.

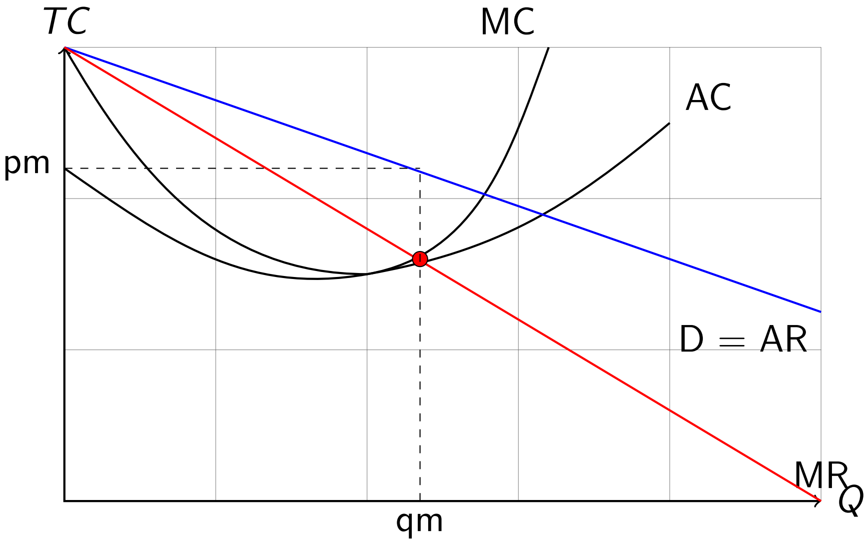
However, costs are likely to change

- Specialisation
- Economies of scale

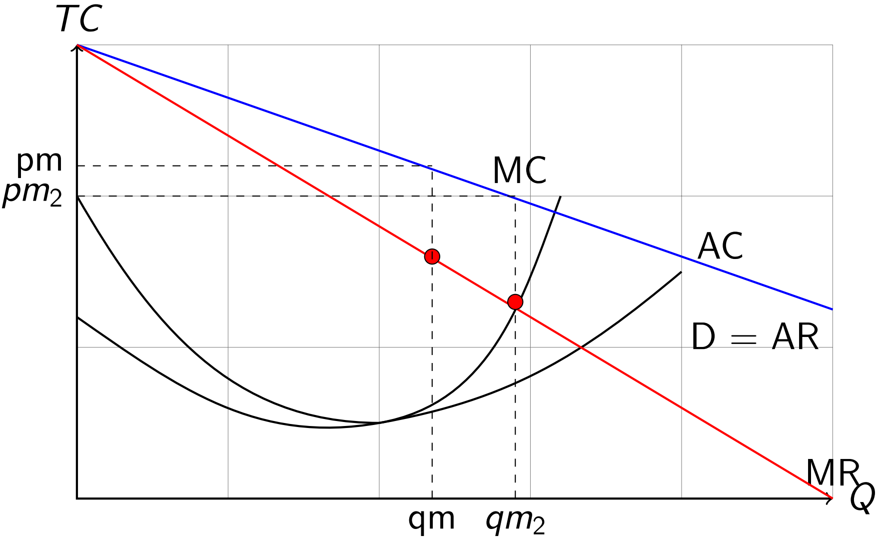
If the cost curve shifts lower after the take-over, it is possible that more can be supplied at a lower price.

Monopoly may be able to use super-normal profits for Research and Development (improve products and lower costs)

Competition vs monopoly 3



Competition vs monopoly 3



Regulation

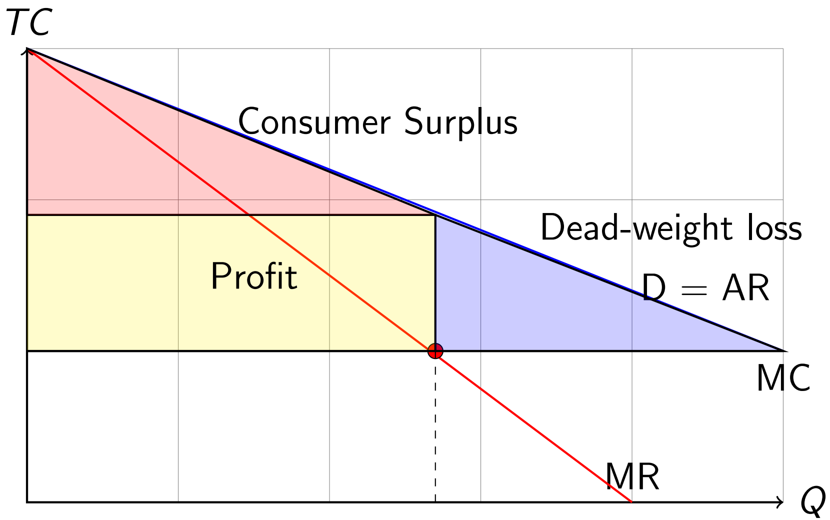
It is also possible to regulate

- Monopolies commission in UK can prevent mergers that generate too much market power
- Regulator can set prices and determine output (OFCOM, OFWAT)
- Public ownership (agency and political issues)

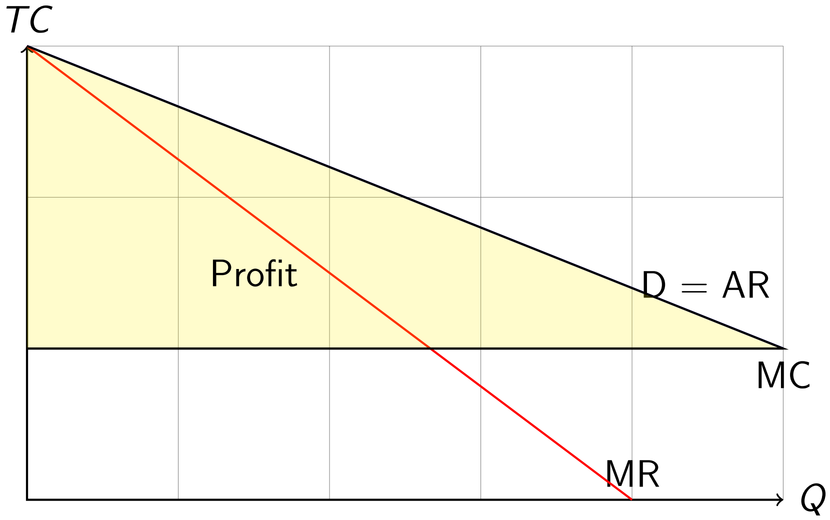
Price Discrimination

- Charge different prices to different customers
- Higher price for those with less elastic demand
- This will increase the revenue and profits of the firm
- Ethical issues
- Branding issues

Price Discrimination



Perfect Price Discrimination

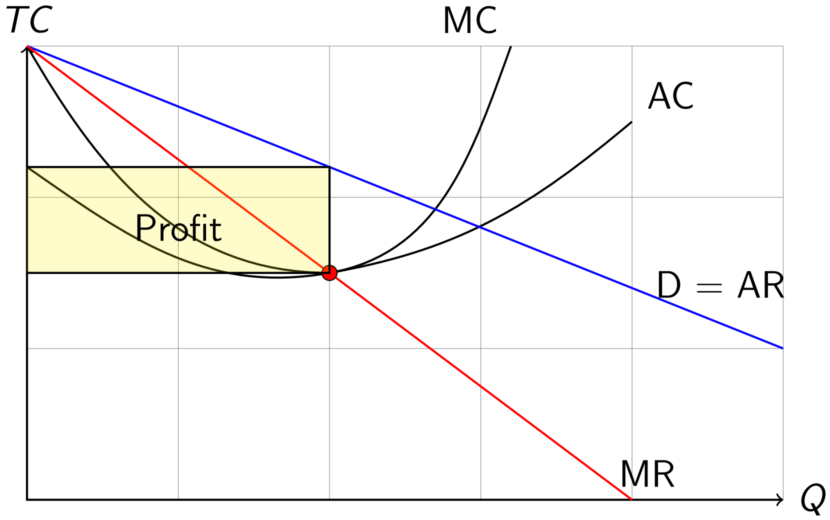


Monopolistic competition

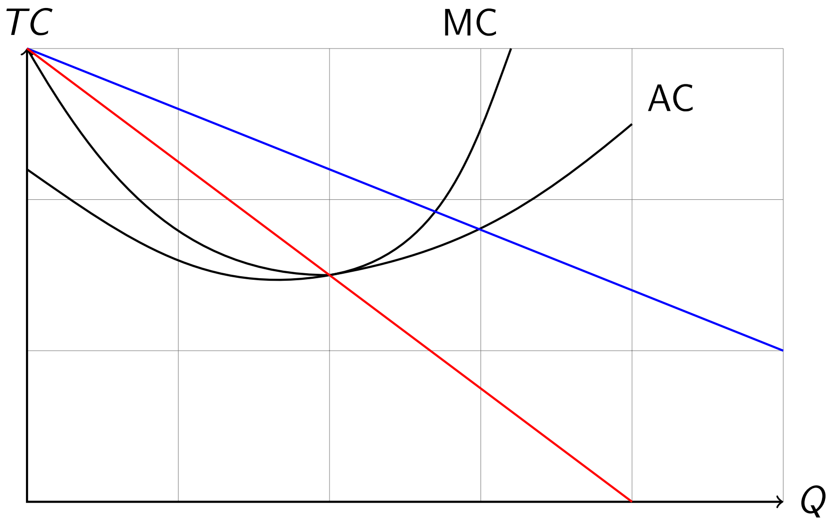
Monopolistic competition A combination of monopoly and competition

- There are no significant barriers to entry
- However, there is pricing power so firms face a downward sloping demand curve
- There is *product differentiation*
- Restaurants, game makers, Cinemas ...

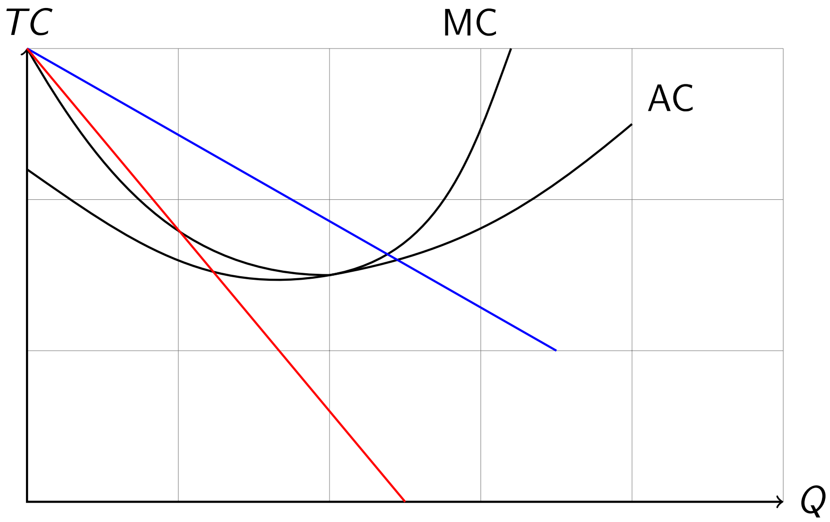
Monopolistic Competition



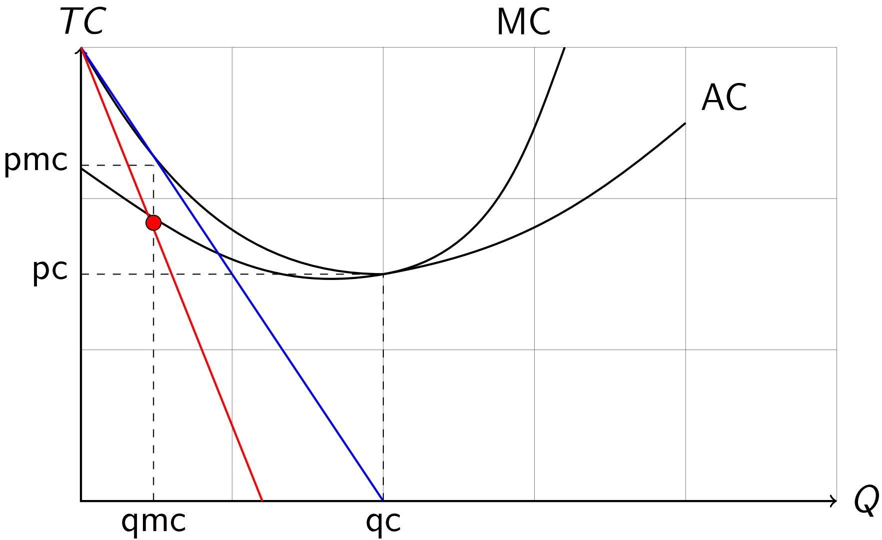
Monopolistic Competition: Long run 1



Monopolistic Competition: Long run 2



Monopolistic Competition: Long run 3



Difference Perfect competition and monopolistic competition

- There is spare capacity in monopolistic competition
- Firms operate at the efficient scale (lowest point on the average cost curve) in perfect competition
- Price is above marginal cost in monopolistic competition