An aerial photograph of a city landscape. In the foreground, there is a large, multi-lane intersection with several cars. To the left of the intersection is a golf course with green fairways and a small pond. The background shows a city skyline with various buildings under a clear blue sky.

# Unit 3

## Market Power and Monopoly (Ch. 9)

### 10/30

ECON 323 – MICROECONOMIC THEORY – DR. STRICKLAND

# Introduction



How do firms make decisions in other market structures?

Many firms have **market power**

- Most extreme case: **monopoly**

Monopolies arise from **barriers to entry**

# Sources of Market Power



(1) Economies of scale at every output level

- Natural monopoly

e.g.  $TC = 100 + 10Q$

① ONE FIRM PRODUCES  $Q=2$

$$TC = 100 + 10(2) = 120$$

$$ATC = \frac{TC}{Q} = \frac{100}{Q} + 10 = \frac{100}{(2)} + 10 = \underline{60}$$



② TWO FIRMS PRODUCE  $Q=1$  EACH

$$TC \text{ OF EACH FIRM} = 100 + 10(1) = 110$$

$$TC \text{ OF INDUSTRY} = 110 \cdot 2 = 220$$

$$ATC \text{ OF INDUSTRY} = \frac{220}{2} = \underline{110}$$

# Sources of Market Power

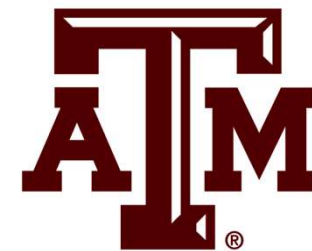


## (2) Consumer switching costs





# Sources of Market Power



## (3) Differentiation

- Product
- Spatial



# Sources of Market Power



## (4) Absolute cost advantages

أرامكو السعودية  
saudi aramco



Gavin Hellier/Alamy

# Sources of Market Power



## (5) Government **regulation**

abbvie

