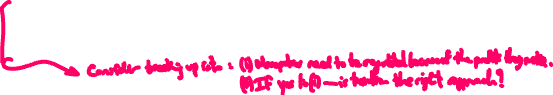
“Since monopolies make super-normal profits, would it be a good idea to tax them”. Discuss.



# Thesis

* Monopolies making super-normal profits is an example of market failure and inefficiency. Taxing them would raise revenue which could be used for redistribution or other government aims, but would not improve efficiency or (directly) outcomes for consumers. More effective: a per-unit subsidy, or a price ceiling (with poss lump sum subsidy).



# Introduction

* Defining terms
  + Monopolist = a firm that is the only seller in its market
  + Profit = revenues – costs, accounting for opportunity costs (i.e. forgone alternatives)
  + Super-normal profits = economic profit > 0

# Antecedent

* Monopolies do make super-normal profits
* Draw P/Q diagram with MR, D, MC, AC and mark on y\*, p\*, and profit
* Explain why MR is below D (mathematically & intuitively), and that this leads to an equilibrium where P =/= MC
* Contrast to perfect competition case
  + Super-normal profits would attract new entrants in LR
  + The aggregate supply curve would become shallower (more elastic) and shift right



* + Price at equilibrium is now lower
  + This repeats until there are no super-normal profits (i.e. P = AC(y\_i) for each firm at their level of output y\_i)
  + With normal profits, no incentive for entry or exit and LR equilibrium is reached
* But in monopolies, no entry into the market, so super-normal profits can persist into LR

# What’s bad with monopolies?

* They’re Pareto inefficient (define = an allocation of resources such that there exists another allocation where no agent is worse off and some agents are better off)



* + E.g. an alternative allocation where holding everything else constant, one extra unit x is sold s.t. MC(x) < p\* < WTP(x)
  + Illustrate DWL from these untraded units on chart earlier
* [also likely don’t produce at minimum of their AC curve]



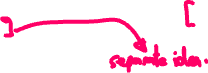
# Consequent



* Taxes wouldn’t help with efficiency; monopolist in fact can pass these on above the rate t to the consumer. But revenue can be raised without affecting output through profit tax.



* + Illustrate with diagram for constant elasticity demand curve and profit-max equation



# What might be better?



* Price ceiling with P = MC (but hard to work out the MC and might entail firm operating at a loss in which case it’d close down, so a lump sum subsidy might be required); give diagram
* Per-unit subsidy so that MR shifts upwards and intersects MC at the same quantity that D does (again hard to work out how much to subsidise as need to know demand curve and what q\* at competitive equilibrium would be, also might not want to subsidise monopolist); give diagram
* Price ceiling at P = AC for y~ where AC meets D curve: no subsidy required but some inefficiency; diagram.

