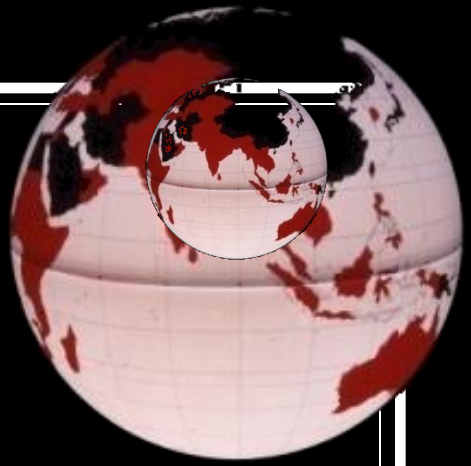
Monopolies Part III



Competition is always a good thing. It forces us to do our best. A monopoly renders people complacent and satisfied with mediocrity.

Nancy Pearcey

Price Discrimination

A monopolist may be able to extract greater profits by practicing price discrimination.

Consider how *Global Air* can increase profit with price discrimination.

Chart: A Single Price of Air Travel

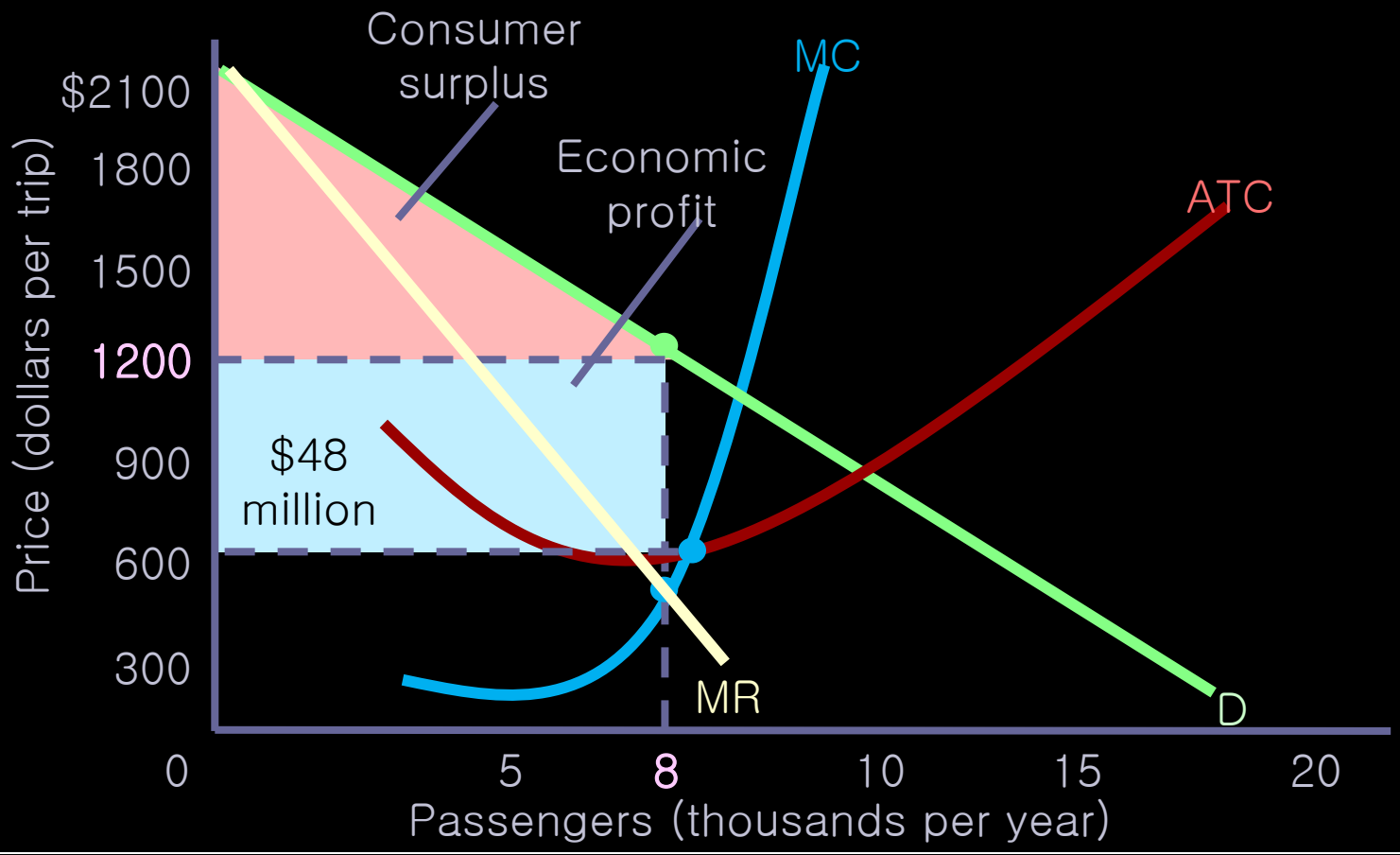
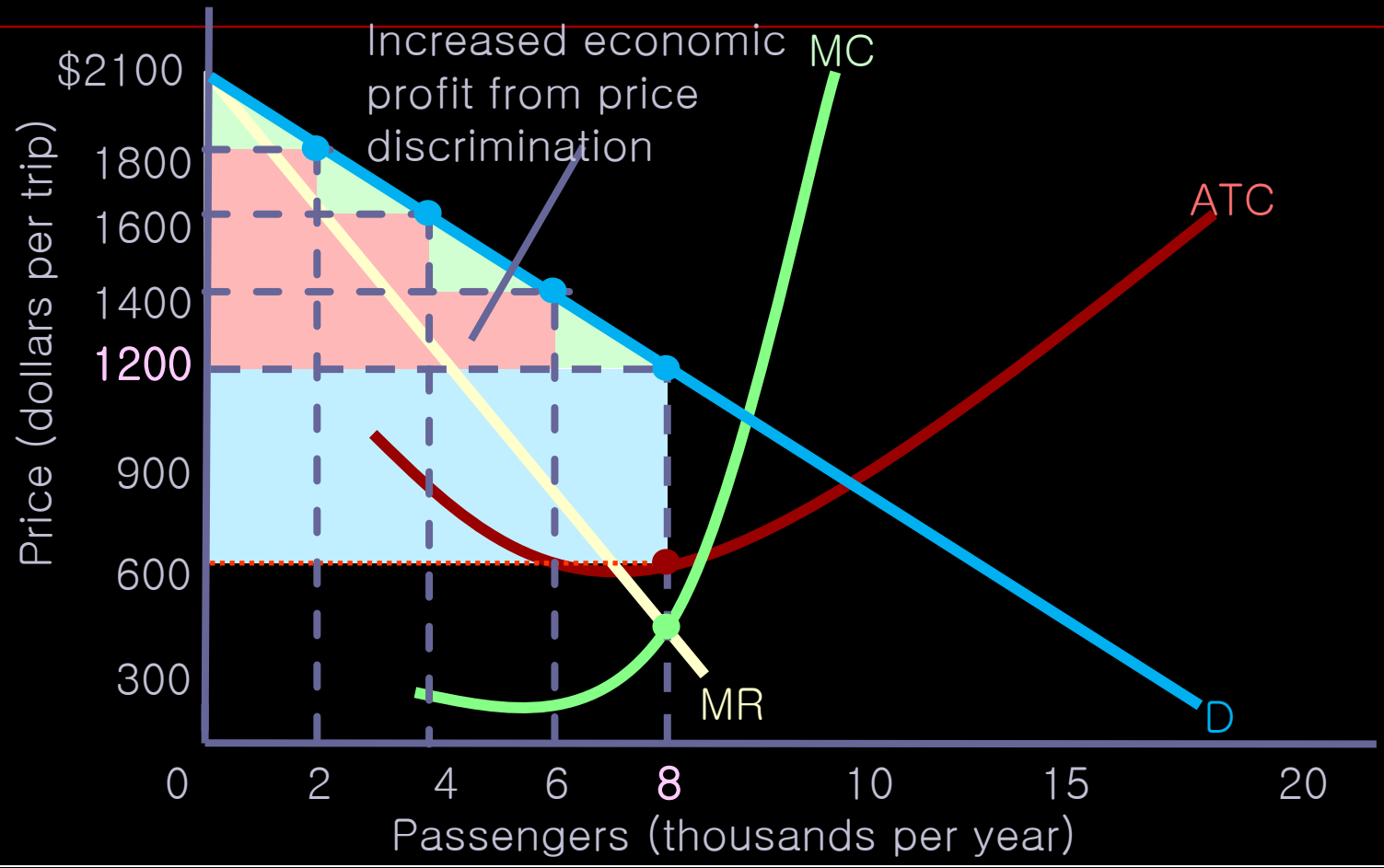


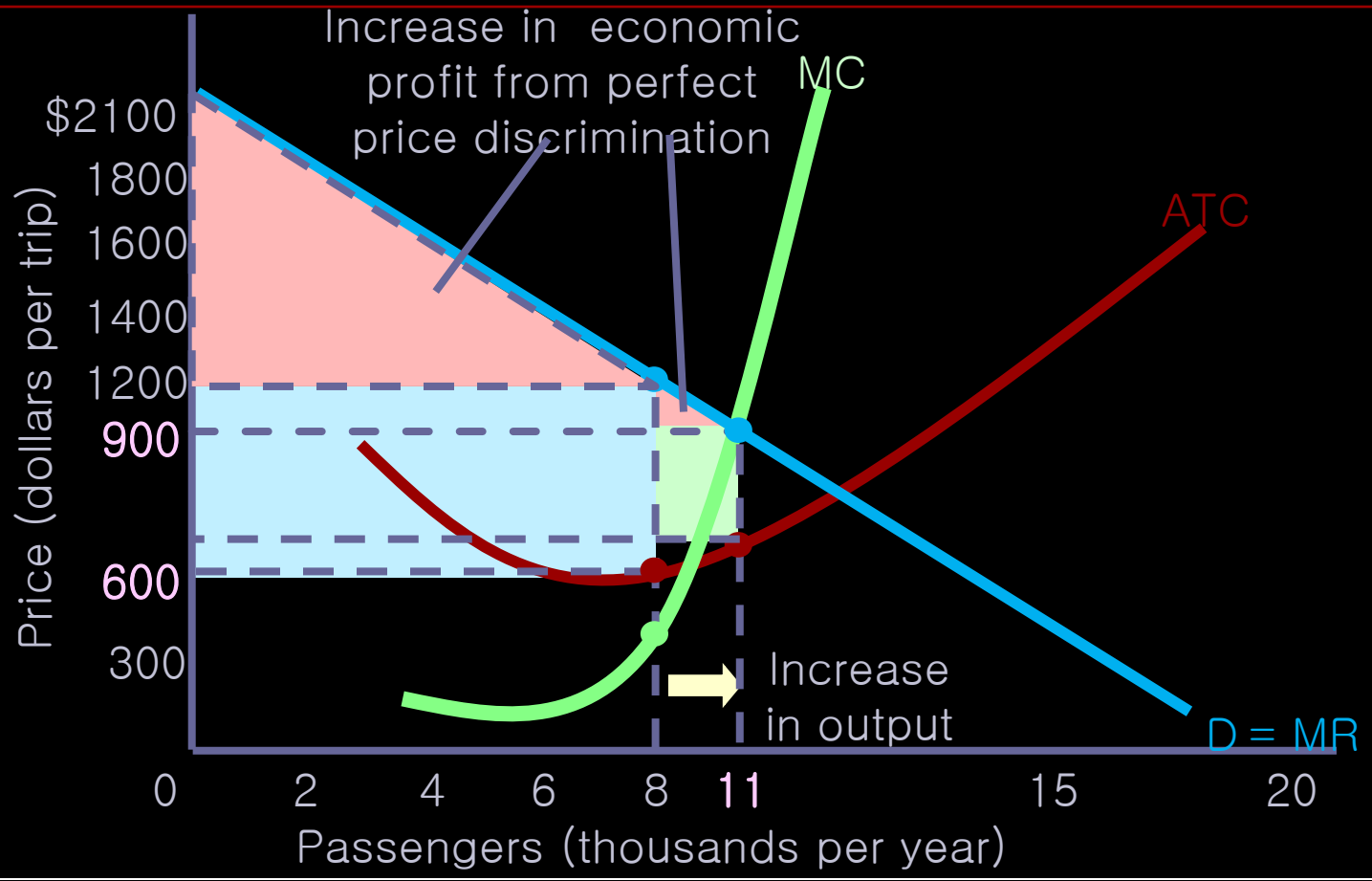
Chart: New Fare Structure



Perfect Price Discrimination

Global Air extracts the entire consumer surplus.

Chart: Perfect Price Discrimination



Entry Barriers

The preservation of monopoly power depends on keeping potential competitors out of the market.

Entry Barriers

- Patents offer a producer 20 years of exclusive rights to produce a particular product.
- Monopoly franchises – Governments create and maintain monopolies by giving a single firm the exclusive right to supply a particular good or service.

Entry Barriers

- Control of key inputs – A company may lock out competition by securing exclusive access to key inputs.
- Lawsuits may be used to prevent new companies from successfully entering an industry.

Entry Barriers

- Acquisition – When all else fails, purchase a potential competitor.
- Economies of scale – A monopoly may persist because of cost advantages over smaller firms.

Pros and Cons of Market Power

It is conceivable that monopolies could benefit society.

Research and Development

- Because of their greater profits, monopolists have a greater advantage in pursuing research and development.
- However, they don't have a clear incentive to do so.

Entrepreneurial Incentives

- Market power can be an incentive for entrepreneurial activity.
- An innovator can make substantial profits in a competitive market before the competition catches up.

Economies of Scale

- If economies of scale exist, the monopolist may attain much greater efficiency than a large number of competitive firms.
- There is no guarantee that such economies of scale will exist in a given industry.

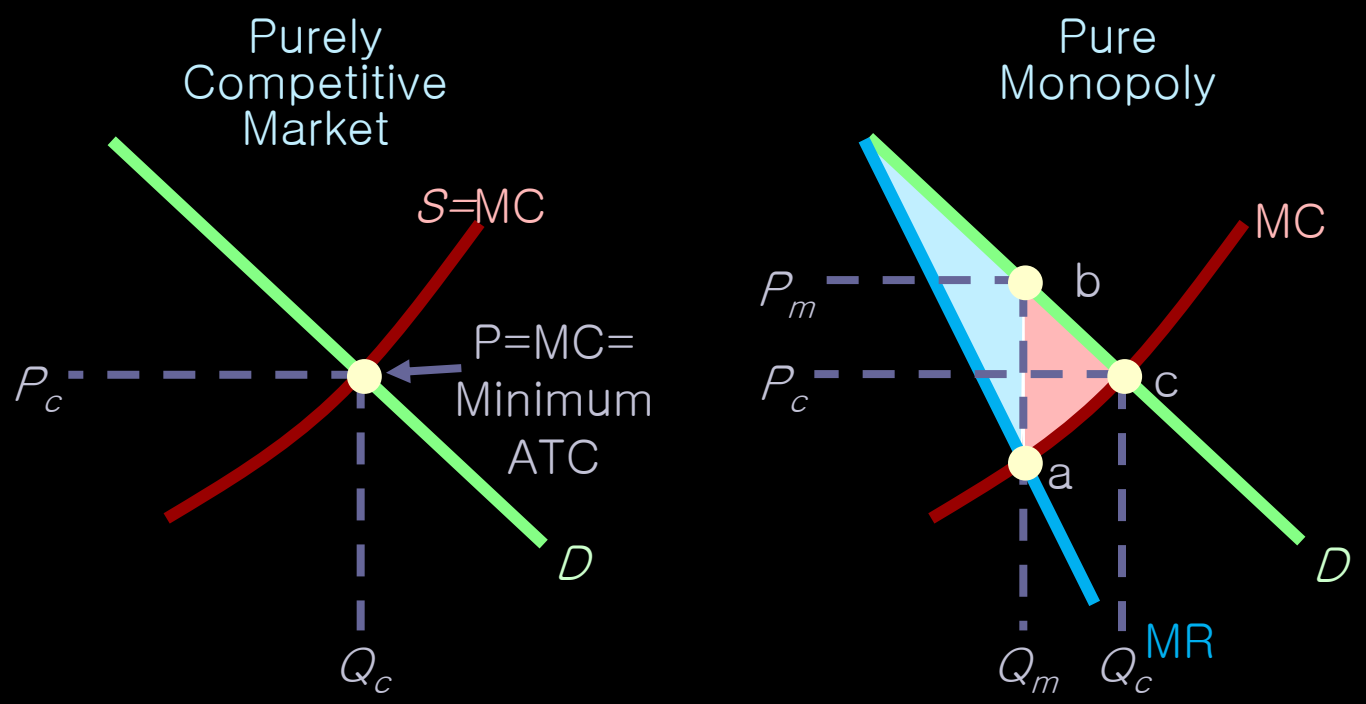
Efficiency and Distribution

- Compare competition with a single-price monopolist in terms of
  - distribution of the gains from trade.
  - efficiency.

Efficiency

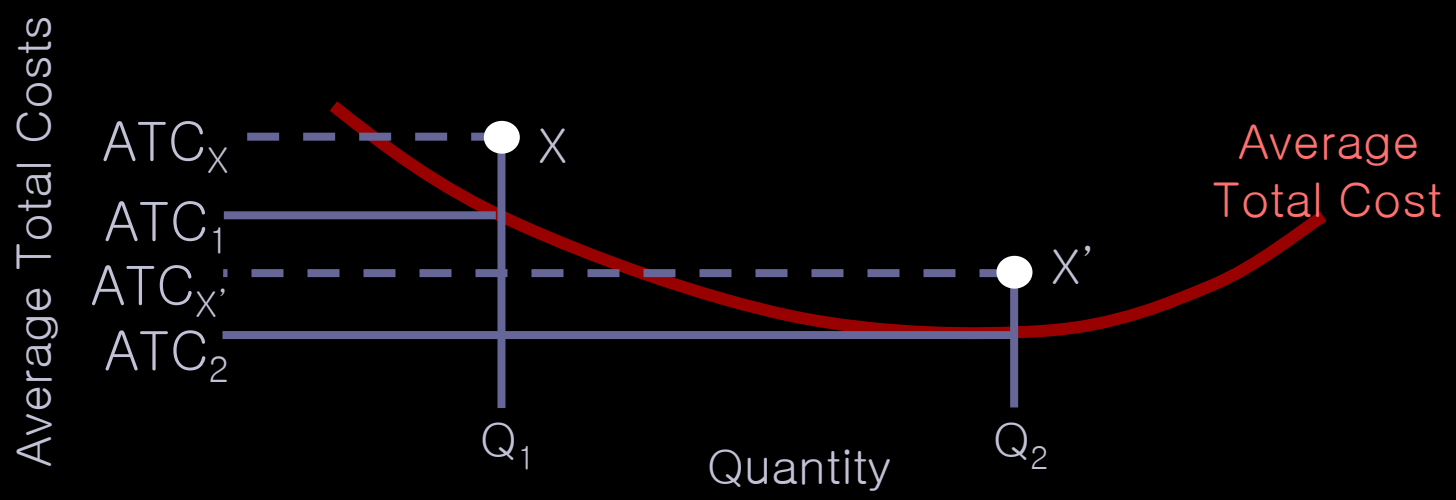
- Perfect discrimination
  - It's efficient.
  - It extracts all consumer surplus for the monopolist
- Distributional Issue: Is it fair?

Charts: Economic Effects of a Monopoly



Pure competition is efficient. The monopoly price is greater than MC and is therefore inefficient.

Chart: Economic Effects of a Monopoly



x-inefficiency
rent-seeking expenditures
rent-seeking behavior
technological advance
assesment and policy options

Natural Monopolies

- A natural monopoly is an industry in which one firm can achieve economies of scale over the entire range of market supply.
- Economies of scale act as a "natural" barrier to entry.

Contestable Markets

A contestable market is an imperfectly competitive market subject to potential entry if prices or profits increase.

Contestable Markets

- Contestable markets are characterized by moderate barriers to entry.
- When potential profits reach a certain level competitors are enticed to enter the market.

Structure vs. Behavior

- The structure of monopoly is, in itself, not a problem.
- If potential rivals force a monopolist to behave like a competitive firm, then a monopoly imposes no cost on consumers or on society at large.

Antitrust Laws

- The legal foundations for antitrust intervention are contained in three landmark antitrust laws.
- The Sherman Act (1890) prohibits "conspiracies in restraint of trade."

Antitrust Laws

Clayton Act (1914) is principally aimed at preventing the development of monopolies by prohibiting price discrimination, exclusive dealing agreements, certain types of mergers and interlocking boards of directors among competing firms.

Antitrust Laws

The Federal Trade Commission Act (1914) created the FTC to study industry structures and behavior so as to identify anti-competitive practices.

The AT&T Case

- The federal government dismantled AT&T in 1984.
- Prior to the break-up, AT&T supplied 96% of all long-distance service and over 80% of local telephone service.

Microsoft: Bully or Genius?

- Concerning Microsoft, critics argued that Microsoft
  - charged too much for its systems software.
  - suppressed substitute technologies.
  - bullied potential competitors.

The Microsoft Case

- Microsoft was accused of
  - thwarting competitors in operating systems by erecting entry barriers.
  - using its monopoly position in operating systems to gain an unfair advantage in the applications market.
  - buying out its competitors.

Microsoft's Defense

- In its defense, Microsoft asserted that
  - it dominates the computer industry because it produces the best products at attractive prices.
  - the computer industry is highly contestable even if not perfectly competitive.

The Verdict

- A federal court concluded that Microsoft abused its monopoly position in operating systems.
- The court found that by limiting consumer choices and stifling competition, Microsoft had denied consumers better and cheaper information technology.

The Remedy

The trial judge suggested a *structural* remedy. Microsoft should be broken into two separate units, one to produce the operating system and one to produce other software components.

The Remedy

The US Department of Justice decided to seek a *behavioral* remedy instead.

The proposed settlement required Microsoft to share its application programming interfaces with third-party companies and appoint a panel of three people who would have full access to Microsoft's systems, records and source code for five years in order to ensure compliance.


THE END
DJAHALLAND.COM