RATU NAVULA COLLEGE
YEAR 12 ECONOMICS 2021

WEEKLY HOME STUDY LESSON NOTES – Week 3 (# 40 – 44)

Strand: (2) Microeconomics **Lesson 40**
Sub Strand: (2.4) Market Structures
L/Outcome: - Discuss why monopolies regulate
- Explain why government regulates Monopolies.

Regulation of monopoly

- The government may wish to regulate monopolies to protect the interests of consumers.
- For example, monopolies have the market power to set prices higher than in competitive markets.
- The government can regulate monopolies through:
  - ✓ Price capping – limiting price increases
  - ✓ Regulation of mergers
  - ✓ Breaking up monopolies
  - ✓ Investigations into cartels and unfair practises
  - ✓ Nationalisation – government ownership.

Why the Government regulates monopolies

1. **Prevent excess prices**. Without government regulation, monopolies could put prices above the competitive equilibrium. This would lead to allocative inefficiency and a decline in consumer welfare.
2. **Quality of service**. If a firm has a monopoly over the provision of a particular service, it may have little incentive to offer a good quality service. Government regulation can ensure the firm meets minimum standards of service.
3. **Monopsony power**. A firm with monopoly selling power may also be in a position to exploit monopsony buying power. For example, supermarkets may use their dominant market position to squeeze profit margins of farmers.
4. **Promote competition**. In some industries, it is possible to encourage competition, and therefore there will be less need for government regulation.
5. **Natural Monopolies**. Some industries are natural monopolies – due to high economies of scale, the most efficient number of firms is one. Therefore, we cannot encourage competition, and it is essential to regulate the firm to prevent the abuse of monopoly power.

Strand: (2) Microeconomics **Lesson 41**
Sub Strand: (2.4) Market Structures
L/Outcome: - Define Monopolistic Competition
- Discuss the characteristics of Monopolistic Competition

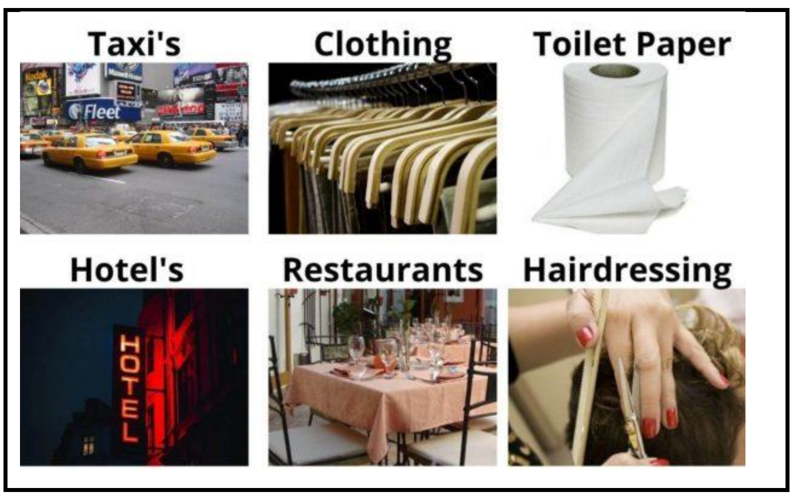
2. MONOPOLISTIC COMPETITION

Definition

- is a market structure that lies between two extremes of prefect competition and monopoly.
- It is referred to as monopolistic competition because, through its behaviour in advertising, product differentiation and pricing aims to increase sales, it able to enjoy market power like monopolies.
- Examples are: Solicitors, restaurants, hairdresser, takeaways food stores, coffee shops and dry cleaners and TV programmes

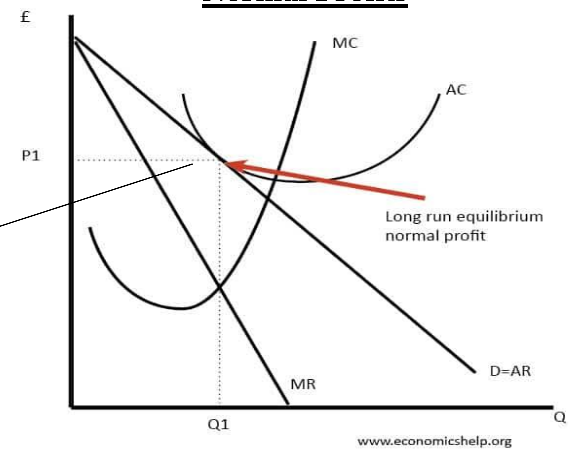
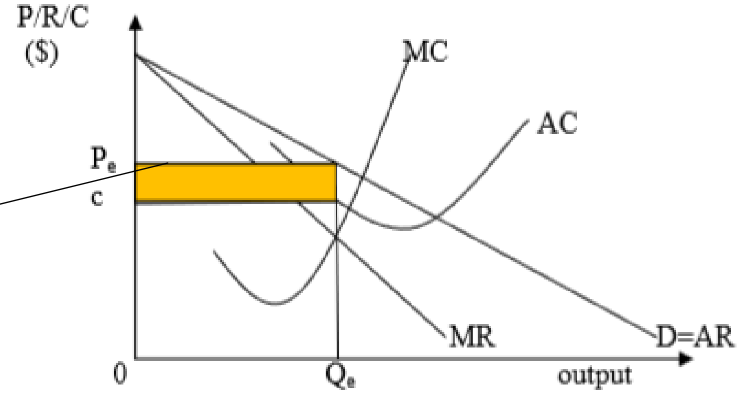
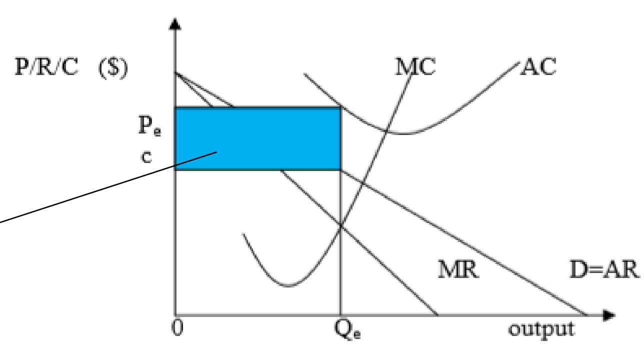
Characteristics of Monopolistic Competition

1. There are **many producers and many consumers** in the market, and no business has total control over the market price.
2. There are **freedom to entry and exit**.
3. Producers have a degree of control over price.
4. Factor prices and technology are given.
5. Each firm spends substantial amount on advertisement. The publicity and advertisement costs are known as selling costs.
6. **Product differentiation** (Forms of product differentiation are packaging and quality improvement)
7. Buyers and sellers do not have perfect information (**Imperfect Information**)
8. They are **price makers** to some extent due to successful competition
9. Firms have **price inelastic demand**; they are price makers because the good is highly differentiated



Strand: (2) Microeconomics **Lesson 42**
Sub Strand: (2.4) Market Structures
L/Outcome: - Identify the types of profits in Monopolistic Competition

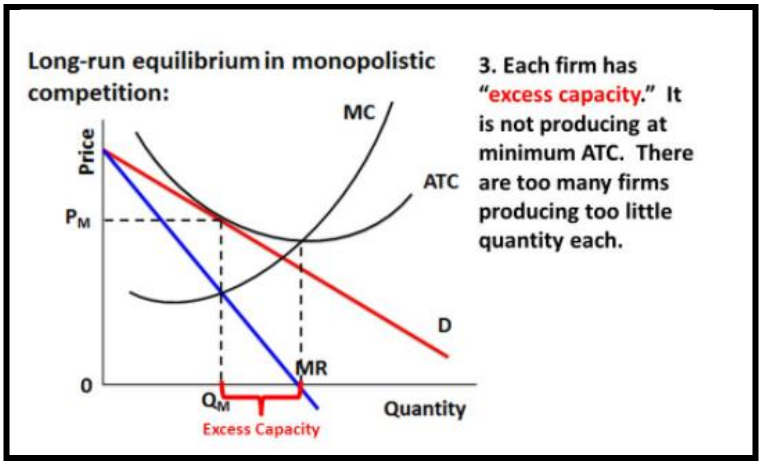
Types of Profits for Monopolistic Competition

Normal Profits	**Normal Profits**
• Demand curve is at AR = P =D • Profit maximising output is at MR = MC • Pe is at MR = MC = AR • Pc is at MR = MC = AR = AC • Normal profit is at TR = TC • Pe = Pc • In the long run Normal Profit is made.	
Supernormal Profit	**Supernormal Profit**
• Demand curve is at AR = P =D • Profit maximising output is at MR = MC • Pe is at MR = MC = AR • Pc is at MR = MC = AC • Supernormal profit is at TR > TC • Pe > Pc	
Subnormal Profit	**Subnormal Profit**
• Demand curve is at AR = P =D • Profit maximising output is at MR = MC • Pe is at MR = MC = AR • Pc is at MR = MC = AC • Subnormal profit is at TC > TR • Pc > Pe	

Strand: (2) Microeconomics **Lesson 43**
Sub Strand: (2.4) Market Structures
L/Outcome: - Define excess capacity theorem
- Explain how a monopolistic competition performs

Excess Capacity Theorem

- Monopolistic competition is not able to achieve economic efficiency since they do not produce at optimum plant size.
- Minimum AC is considered to be the firm's optimum capacity.
- This theorem states that each firm has the capacity to increase production to produce at optimum plant size, i.e. produce maximum at minimum average cost.



Performance of Monopolistic Competition

- No single firm is large enough to achieve economies of scale.
- Productive and economic efficiency is not achieved because MC does not equal minimum AC.
- Consumers pay high price since monopolistic competitive firms restrict output and charge higher prices
- Monopolistic Competitive firm is economically inefficient because they do not produce at optimum plant size. Thus, there is misallocation of resources because too many firms producing too little (lies below than optimum plant size)
- Firms innovate and undertake research and development.
- Monopolistic competitive firms involve in real product differentiation

Non-price competition refers to the efforts on the part of a monopolistic competitive firm to increase its sales and profits through product variation and selling expenses instead of a cut in the price of its product.

Product differentiation means attracting customers by making the product look different or appear different and superior to the competition's product through advertising, different packaging, different brand names, longer warrantee periods and discount offers.

Strand: (2) Microeconomics **Lesson 44**
Sub Strand: (2.4) Market Structures
L/Outcome: - Define Monopsony and state its characteristics.

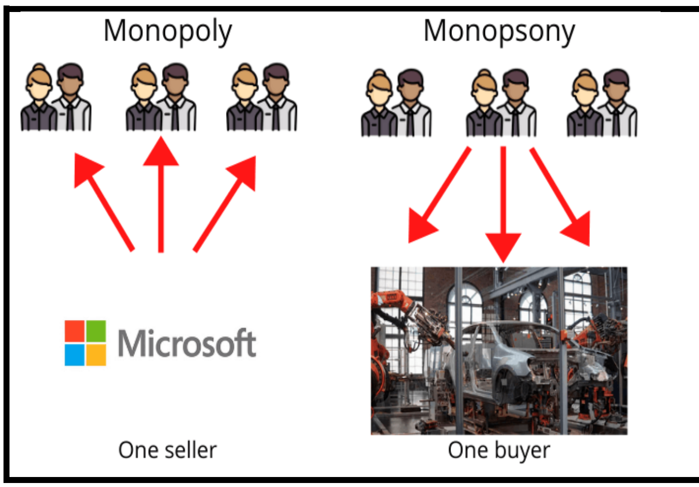
3. MONOPSONY

Definition

- Monopsony is a market in which a single buyer completely controls the demand for a good.

Characteristics

1. **Single Buyer:** As the only buyer, a monopsony controls the demand-side of the market completely.
2. **No Alternatives**: A monopsony achieves single-buyer status because sellers have no alternative buyers for their goods.
3. **Barriers to Entry**: The key barriers to entry are much the same as those that exist for monopoly: (1) government license or franchise, (2) resource ownership, (3) patents and copyrights, (4) high start-up cost, and (5) decreasing average total cost.



In a **monopoly**, a single seller controls or dominates the supply of goods and services. In a **monopsony**, a single buyer controls or dominates the demand for goods and services.

Class Activity

1. A Monopsony Market Structure means there is
   A. One buyer in the market
   B. One seller in the market
   C. One buyer and one seller
   D. A maximum of two buyers

2. The market structure which has only one seller is
   A. duopoly.
   B. oligopoly.
   C. monopoly.
   D. perfect competition.

Strand: (2) Microeconomics
Sub Strand: (2.4) Market Structures
L/Outcome: - Discuss about Monopoly Market

Worksheet

MULTIPLE CHOICE QUESTIONS

1. Monopolist are able to maximize profit by

A. Supplying the entire industry
B. Imperfect knowledge
C. Restricting output and charging higher prices
D. Selling differentiated product

2. Monopolies are able to maintain their supernormal profits because

A. They are price markers
B. They are faced by downward sloping demand curve
C. They have strong barriers to entry
D. They are imperfect competitors.

3. A monopoly is firm where there is

A. Single seller
B. Single buyer
C. Few sellers
D. Many sellers

4. Monopoly is different from all other market structures since

A. Produces identical products
B. Faced by downward sloping demand curve
C. Is a price marker
D. Is a single seller.

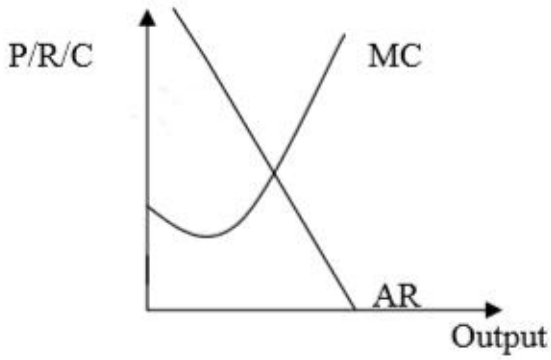
5. Price discrimination used under monopolies means

A. Competing through Non price competition
B. Using product differentiation
C. Charging different prices to different consumers.
D. Cut throat competition

Strand: (2) Microeconomics
Sub Strand: (2.4) Market Structures
L/Outcome: - Discuss about Imperfect Competition (Monopoly Market)

Worksheet

A. The diagram represents a monopolist, and the market demand curve for the output of the firm.

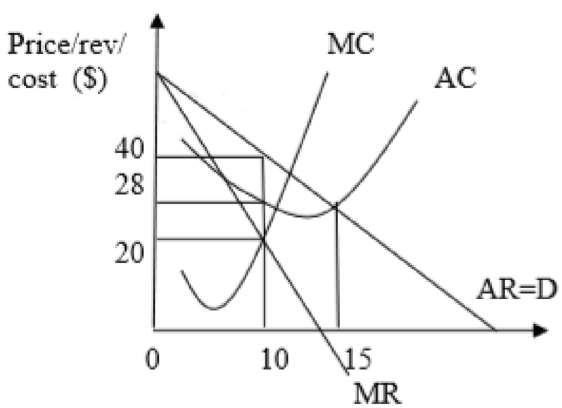


i. Determine the profit maximizing level of output for this firm and level it as Qe (1mark)

ii. Mark and level profit maximization price as Pm (1mark)

iii. Draw to illustrate supernormal profit earned by this monopoly (2mark)

Study the graph given below and answer the questions that follow



i. State the profit maximization price and output level for the firm. (1mark)

ii. Calculate the amount of profit earned by the firm (1mark)

iii. State one feature that makes this monopoly different perfect competitive firm. (1mark)