

1.3: Monopoly, Monopsony, and Imperfect Competition

Monopoly: sole seller in a market.

Monopoly or market power: an ability to raise and sustain price above marginal cost.

Standard neoclassical theory of the firm hypothesizes that the objective function of the perfectly competitive firm and the monopoly are the same: profit maximization. The difference in outcomes arises due to the nature of marginal revenue.

Key concepts:

- Allocative inefficiency, misallocation of resources
- Anti-competitive practices
- Rent seeking
- Unilateral v. coordinated effects

Monopsony: sole buyer in a market

Bilateral monopoly: A market situation in which a monopolist and a monopsonist must bargain over the surplus in the market.

Monopolistic Competition: A hybrid form of market structure with product differentiation and free entry and exit.

Other early models of imperfect competition:

- Kinked demand curve
- Dominant firm
- Cournot oligopoly

Relevant exercises: Problem Set 1, exercises 1 through 3.

Equilibrium in a Monopolized Market

- Even for a monopolist, the demand curve still determines price.
- The cost function determines the amount of profit that the monopolist makes.
- Barriers to entry preserve positive ("abnormal") profits.
- Dead weight loss summarizes the inefficiency of monopolization.

For a price maker, marginal revenue (MR) is declining as a function of q ...

The "standard" case against monopoly

- Monopolies restrict output and thus cause prices to rise above competitive levels.
- Monopolies generate social welfare losses
 - \leftarrow Because $P > MC$, output in monopolized markets is said to be "allocatively inefficient."
 - \leftarrow Lack of competitive pressure implies that production may not occur at minimum ATC. Thus, production may be "productively inefficient."
- Monopolies are likely to engage in "anti-competitive" practices to sustain their advantage ("rent seeking").

Monopsony
Buyer has market power

Early Models of Imperfect Competition

- Monopolistic Competition (Chamberlain, 1930s)
 - Kinked Demand Curve (Sweezy, 1939)
 - Dominant Firm Model (Stigler, 1950)