What Causes Monopolies?

• Natural Monopolies

What causes Monopolies?

• Natural Monopolies
• Government

Natural Monopolies

• The cost function is \( C = 100 + 2q \)
• The cheapest way to serve the market is with one firm
• In fact, only one firm will survive
Natural Monopolies

• The cost function is
  \( C = 100 + 2q \)
• The cheapest way to serve the market is with one firm
• In fact, only one firm will survive
• It will be a monopoly

The American Model

• Establish a legal monopoly; regulate it
• Examples include
  – Local phone service
  – Electric utility
  – Gas Company

The European Model

• Establish a legal monopoly; regulate it
• Examples include
  – Local phone service
  – Electric utility
  – Gas Company
• Government ownership and control
What Causes Monopolies?

Natural Monopolies

- Which system works best?
- Problems with either approach.
  - Regulated monopolies are always trying to cheat on the regulation
  - State-owned businesses have a reputation for inefficiency
- Some private ownership seems best.

Contestible Monopolies

- Suppose the cheapest way to provide airplane service from Cleveland to Chicago is to fly one 747 a day in each direction.
  - This is a natural monopoly
  - It is contestible; anyone who wants to control the traffic can simply start flying the 747. If you lose the contest, simply take the 747 off the route. Nothing is lost.
Contestible Monopolies

• Suppose the cheapest way to provide airplane service from Cleveland to Chicago is to fly one 747 a day in each direction.
• Suppose someone wants to compete for electric power distribution in a city.

Can the Government Create Monopolies?

• Patents and Copyrights
  – Gives inventors and authors an incentive to produce

• Patents and Copyrights
  – Gives inventors and authors an incentive to produce
  – Clearly important to United States
What Causes Monopolies?

Can the Government Create Monopolies?
- Patents and Copyrights
- Trademarks
  - A way of giving firms an incentive to produce high quality products
  - Why Bayer lost its aspirin trademark
  - Why Intel called the chip the Pentium and not the 586

Can the Government Create Monopolies?
- Certificates of Necessity and Convenience
  - Airline, Railroad and Trucking Service
What Causes Monopolies?

Can the Government Create Monopolies?

• Certificates of Necessity and Convenience
  – Airline, Railroad and Trucking Service
  – Long Distance Telephone Service

• Other Government Regulations
  – Glass Steagall Act
  – Zoning

• Other Government Regulations
  – Glass Steagall Act
  – Zoning
Can the Government Create Monopolies?

- Certificates of Necessity and Convenience
- Other Government Regulations
  - Glass Steagall Act
  - Zoning
  - Quotas

Can the Government Create Monopolies?

- Why are there so many lawyers and lobbyists in Washington?
- Remember, that some monopolies the government creates serve a useful purpose.
- But it does create monopolies

Can the Government Destroy Monopolies

- Sherman Act makes monopolies illegal
- The courts apply the “rule of reason”
What Causes Monopolies?

Can the Government Destroy Monopolies

- Sherman Act makes monopolies illegal
- The courts apply the “rule of reason”
- Monopolies created through competition or innovation are allowed

Monopolies with no economies of scale

- Suppose that
  - There are no economies of scale
  - The government does not protect the monopoly

Monopolies with no economies of scale

- Suppose that
  - There are no economies of scale
  - The government does not protect the monopoly
  - Can it survive?
    - No

Monopolies with no economies of scale

- Suppose that
  - There are no economies of scale
  - The government does not protect the monopoly
  - Can it survive?
    - No

Can the Government Destroy Monopolies

- Sherman Act makes monopolies illegal
- The courts apply the “rule of reason”
- Monopolies created through competition or innovation are allowed
  - Widgets are selling for $10
  - I discover a way to produce widgets for $5 and establish a monopoly
  - It is beneficial to allow me to have that monopoly

End

©2004 Charles W. Upton