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
What Causes Monopolies

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
- Government ownership and control
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.

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.
  – An extensive set of power lines must be built
  – If the competition is lost, the value of the power lines is lost.

Can the Government Create Monopolies?

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

Can the Government Create Monopolies?

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

- Patents and Copyrights
- Trademarks
  - A way of giving firms an incentive to produce high quality products

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
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”
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

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  – No

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End

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