



MONOPOLY II:

Welfare & Price-Discrimination

la
patio
FINE DINE . BAR

LADIES NIGHT



TUESDAYS

6PM-10PM

Recap

ASSUMPTIONS:

- 1. One Seller/Firm of a good or service.
- 2. Price Makers (they set the price).
- 3. Possess Market Power due to price-making ability.
- 4. High Barriers to Entry (key feature of monopoly).

Monopoly & Market Power

- Monopolies charge a price that exceeds marginal cost.
 - $P > MC$
- The higher price reduces the quantity that is purchased.
- The output is lower than the social optimum.
 - Less quantity being supplied than in competitive equilibrium.
- Are monopolies a good way to organize markets?

Perception of A Monopoly



Perception of A Monopoly

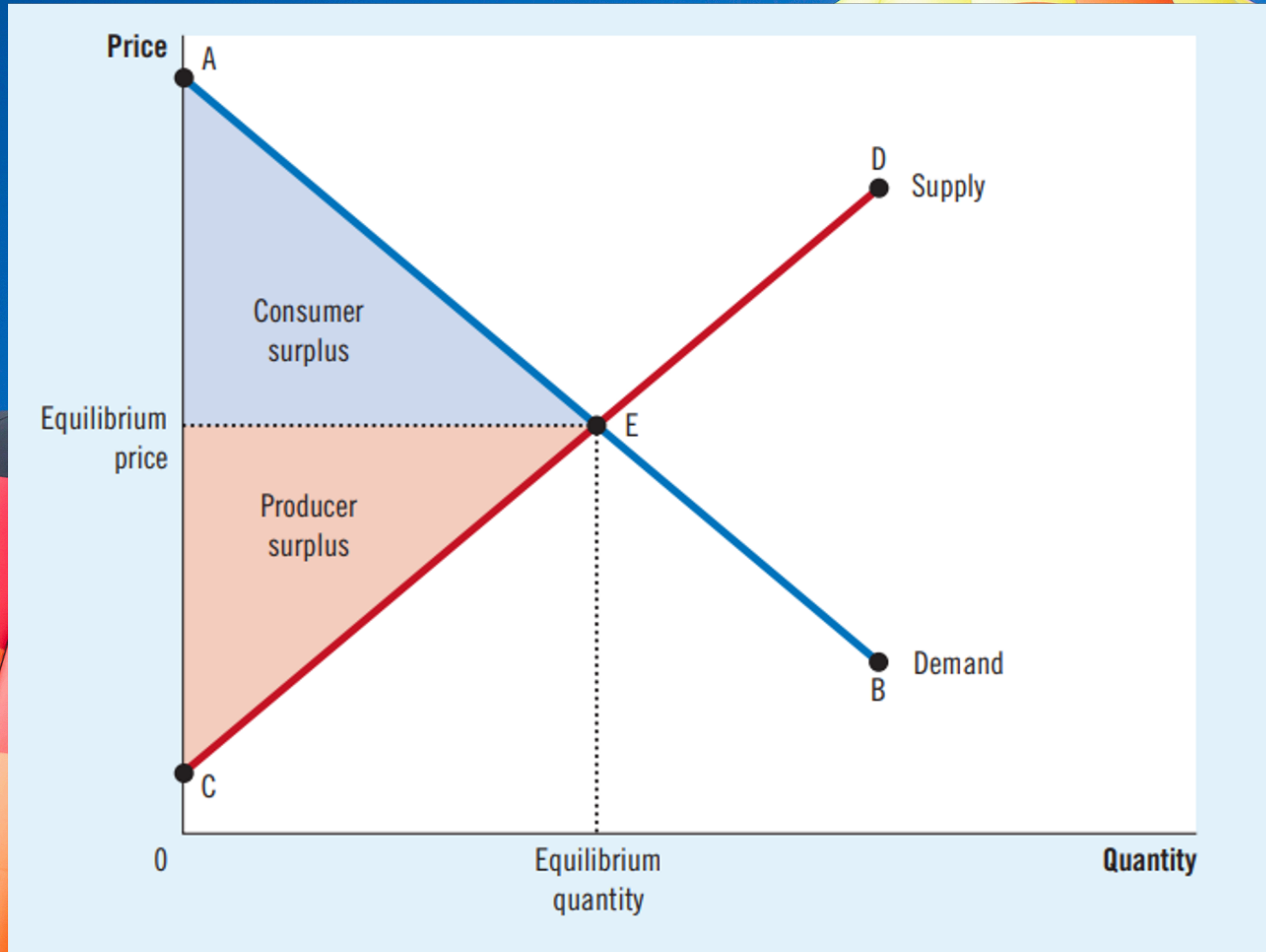
Monopoly from what point of view?



THE WELFARE COST OF MONOPOLIES

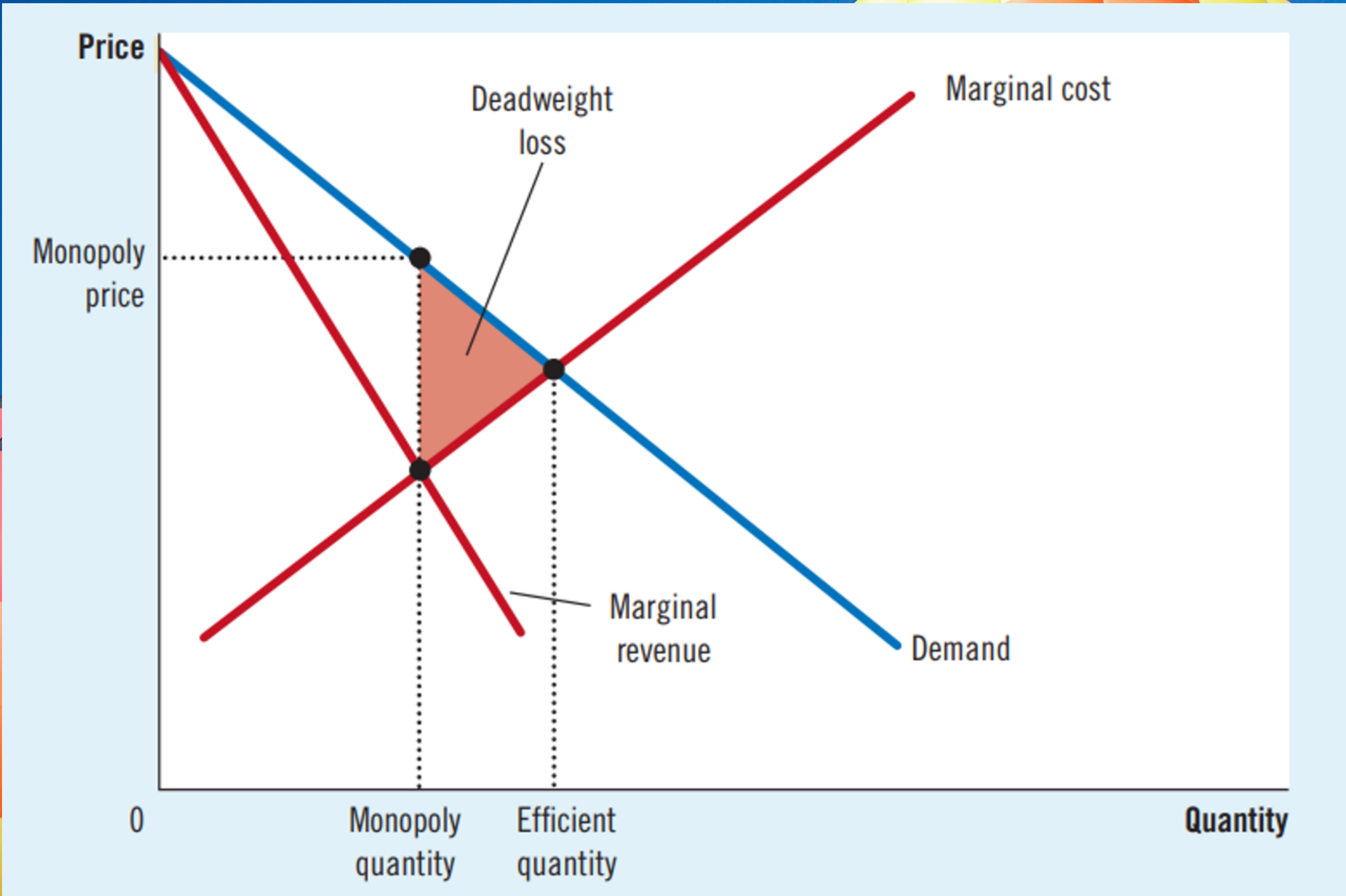
The Welfare Cost of Monopolies

- Total Surplus
 - The sum of consumer & producer surplus.
 - The total value of economic well-being of buyers & sellers in a market.
- Consumer Surplus
 - The difference between the price consumers are willing to pay for a good, minus what they actually pay for it.
- Producer Surplus
 - The difference between the price sellers actually receive for a good, minus what they were willing to receive for it.



The Welfare Cost of Monopolies

- Under monopoly, we don't reach the zero-profit condition.
 - Monopolists charge a higher price ($P > MR = MC$), which leads to less quantity purchased in the market.
- Deadweight Loss
 - The value of economic surplus forgone when the market does not reach the competitive equilibrium.
 - Because monopolists charge a $P > MC$, not all consumers who value the good at more than MC buy it.



WELFARE ANALYSIS

Monopoly market

The Welfare Cost of Monopolies

- Is monopoly profit the social cost?
 - A higher monopoly profit just shifts around the welfare distribution.
 - Higher profit/producer surplus, lower consumer surplus.
 - NOT a reduction in economic welfare and NOT a social problem.
- The social loss is the DWL.
 - This stems from the fact that there is less output.
 - Profit is not the social problem of monopolies.
 - Lower quantity is the social problem of monopolies.

Price discrimination

PRICE DISCRIMINATION:

- The practice of selling the same good at different prices to different consumers.
- A firm must possess market power in order to price discriminate.

Price Discrimination

- A legitimate, rational business strategy aimed at increasing profit.
- To price discriminate, firms must be able to separate consumers based on their willingness to pay.
- Price discrimination can increase economic welfare!

Perfect Price Discrimination

- Charge each consumer a different price equal to their exact willingness to pay.

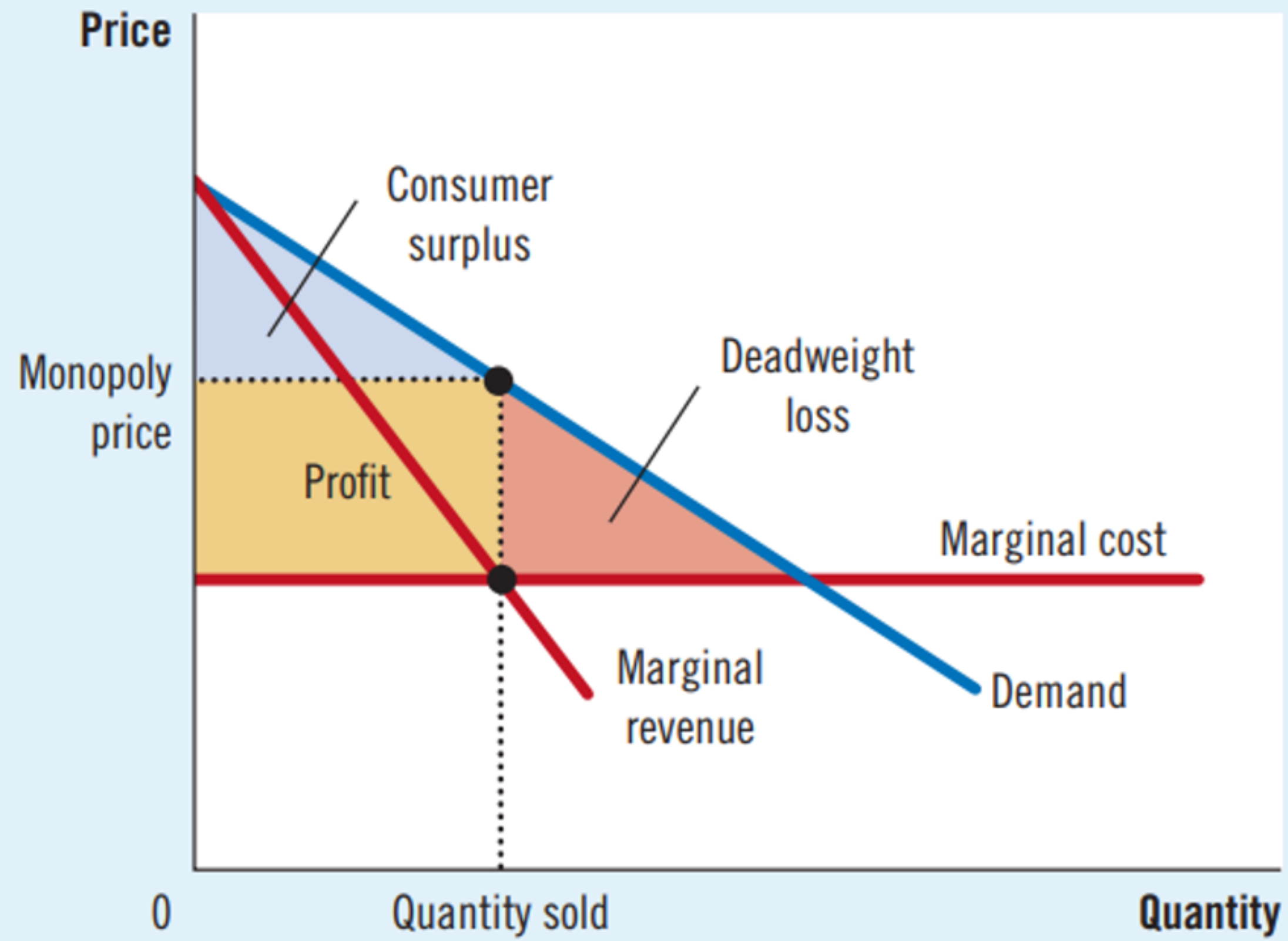


Perfect Price Discrimination

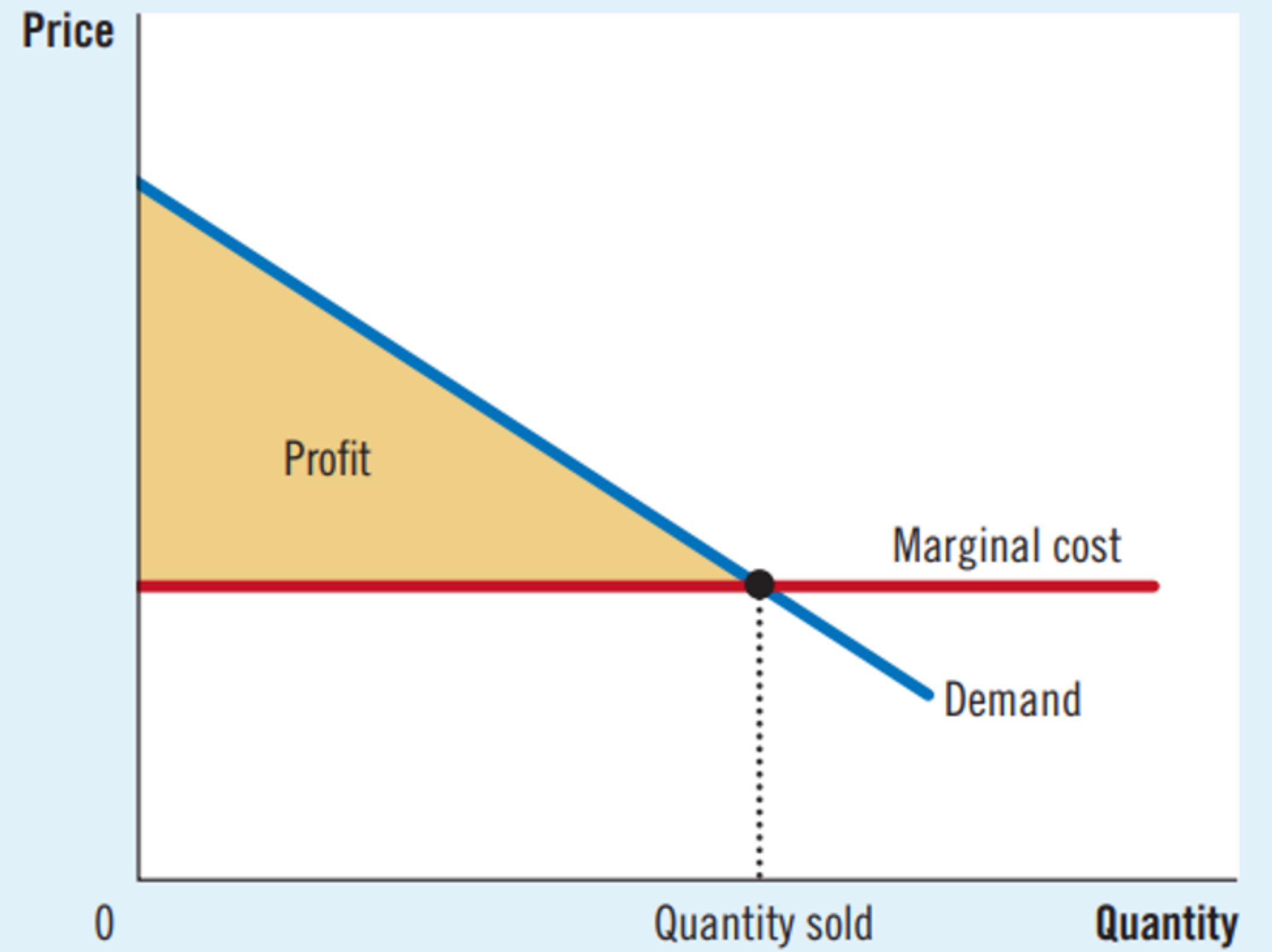
- The monopoly firm extracts ALL the surplus.
- No DWL at all.
- If a monopoly can perfectly price discriminate, CS & DWL transform into monopoly profits.



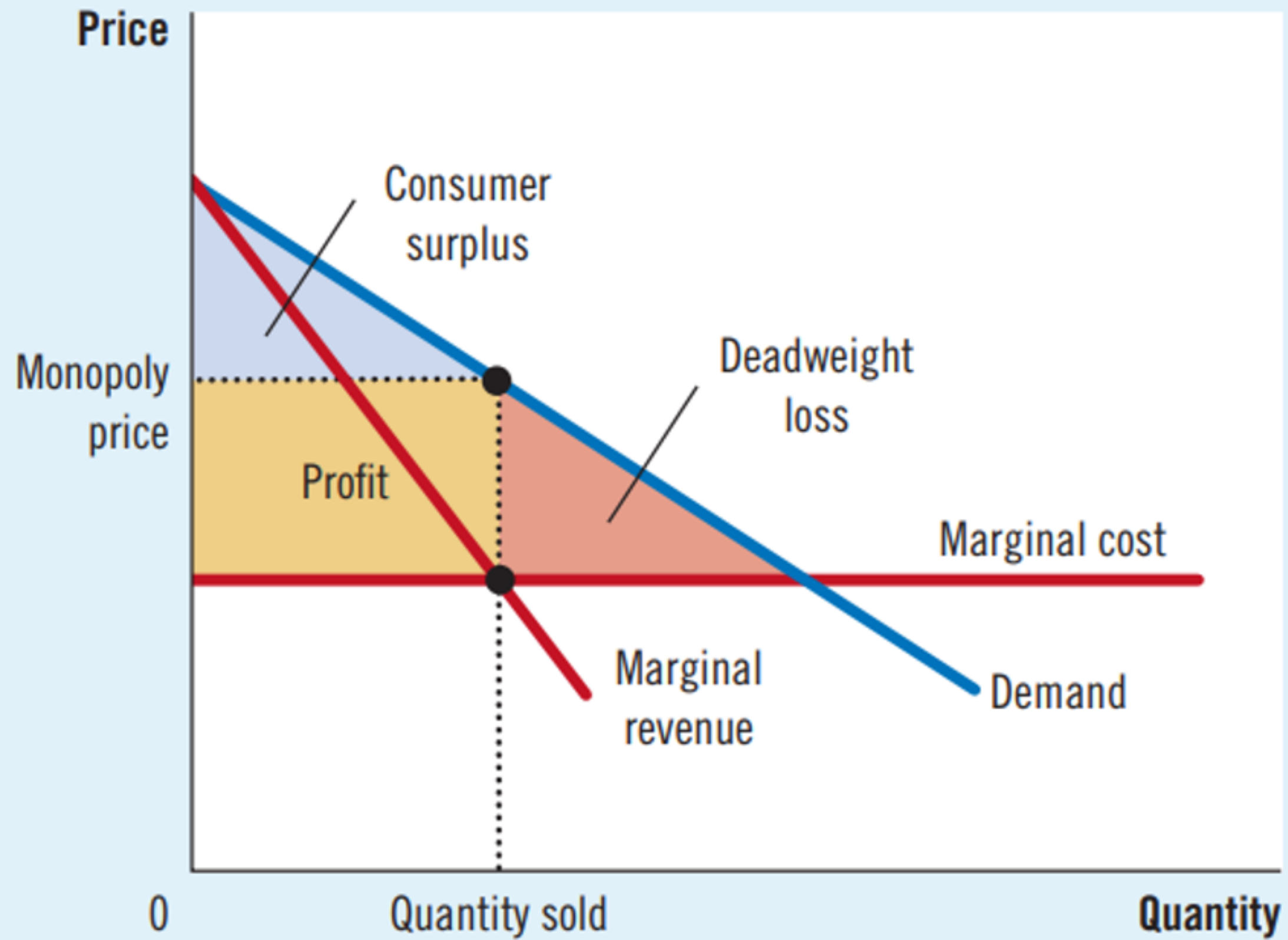
(a) Monopolist with Single Price



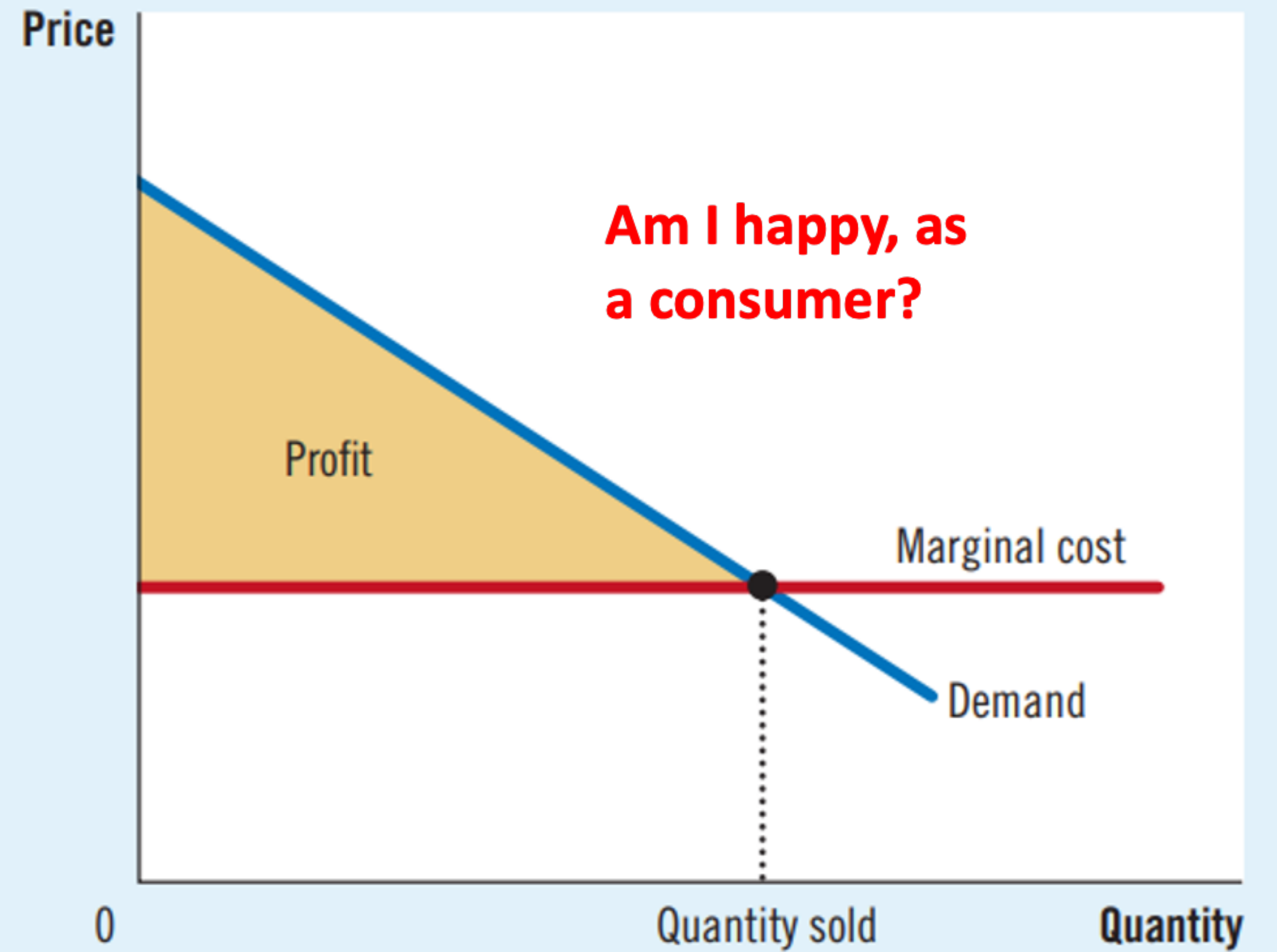
(b) Monopolist with Perfect Price Discrimination



(a) Monopolist with Single Price



(b) Monopolist with Perfect Price Discrimination



Perception of A Monopoly

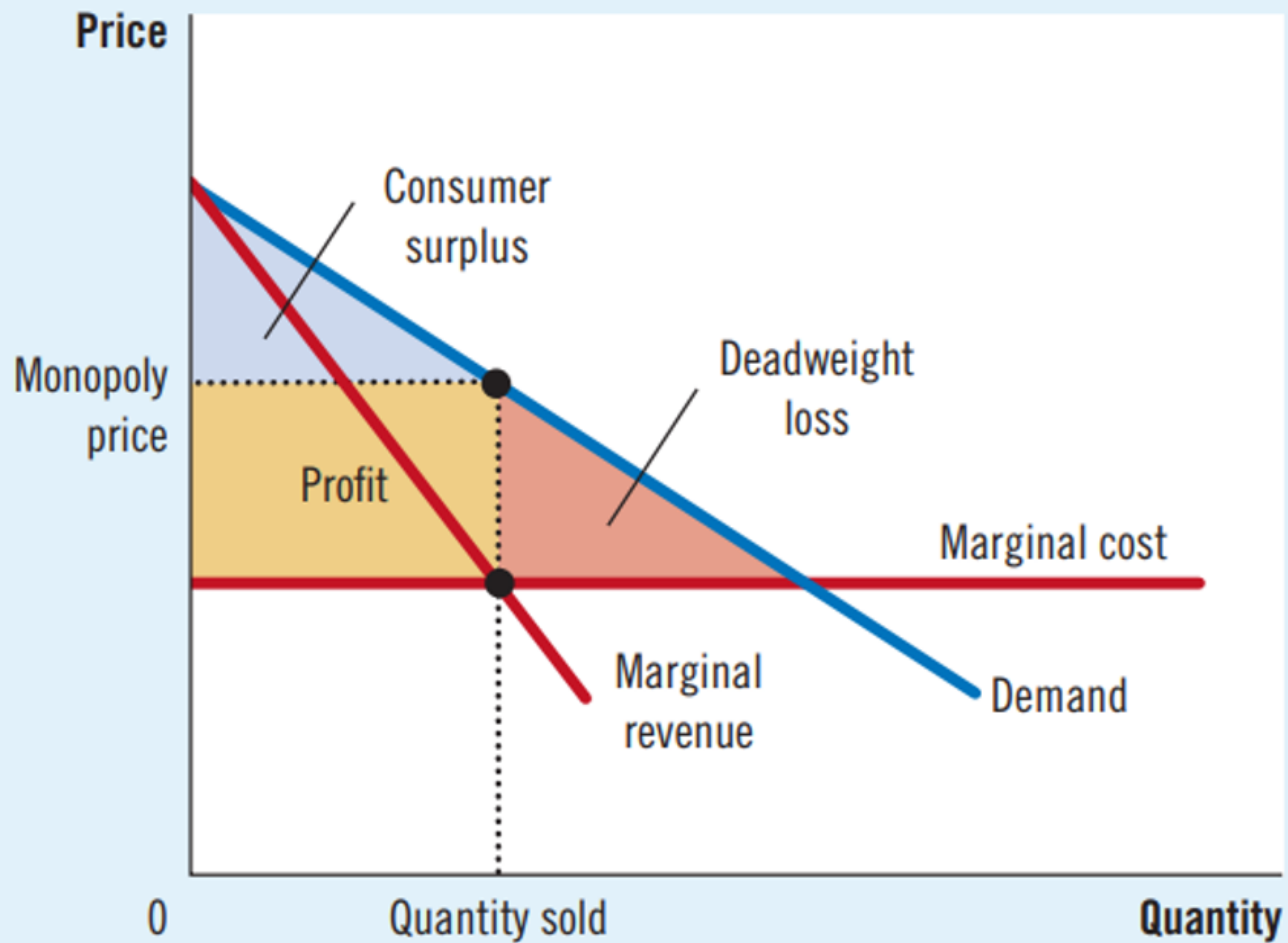


Perception of A Monopoly

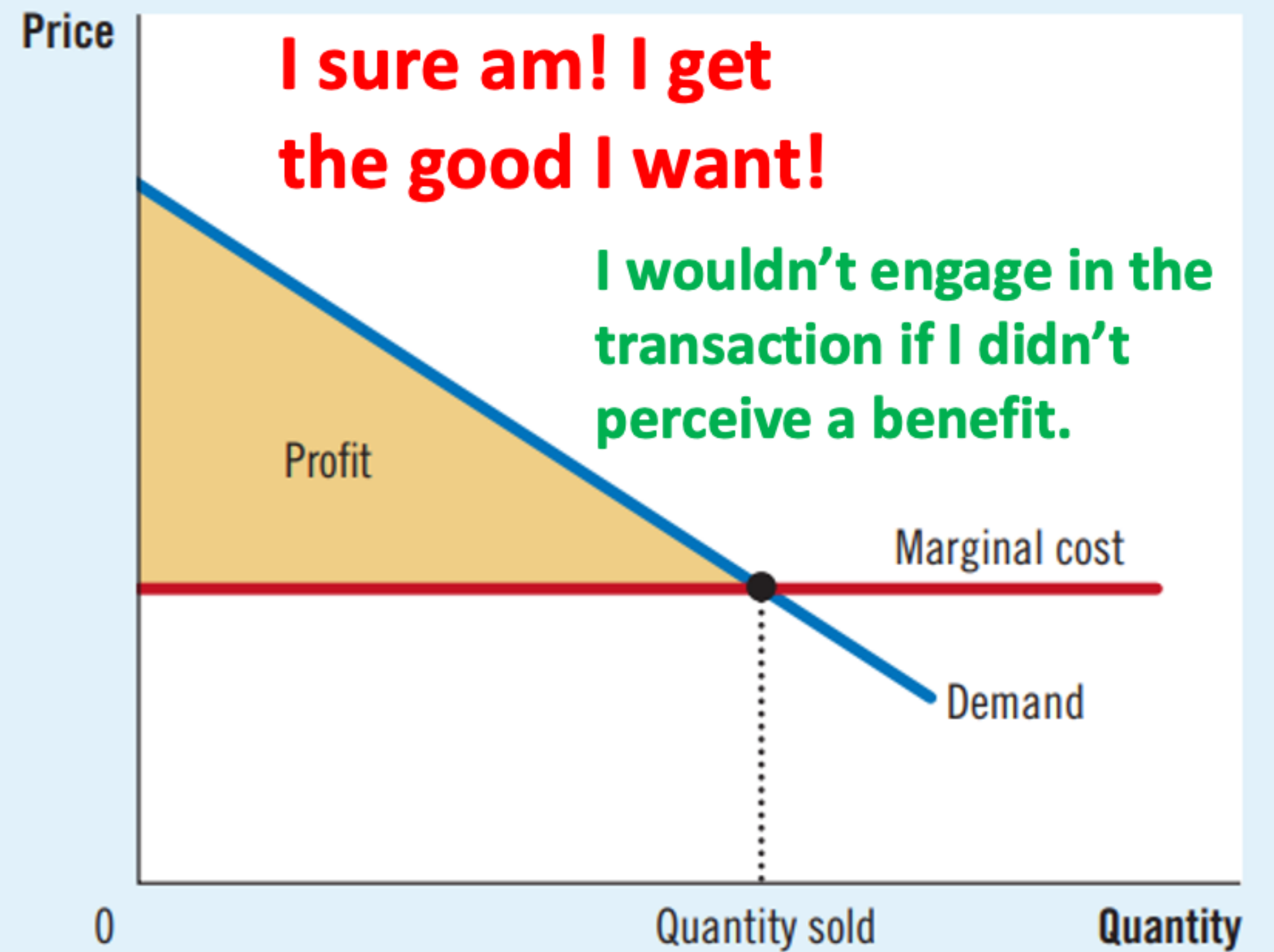
Monopoly from what point of view?



(a) Monopolist with Single Price



(b) Monopolist with Perfect Price Discrimination

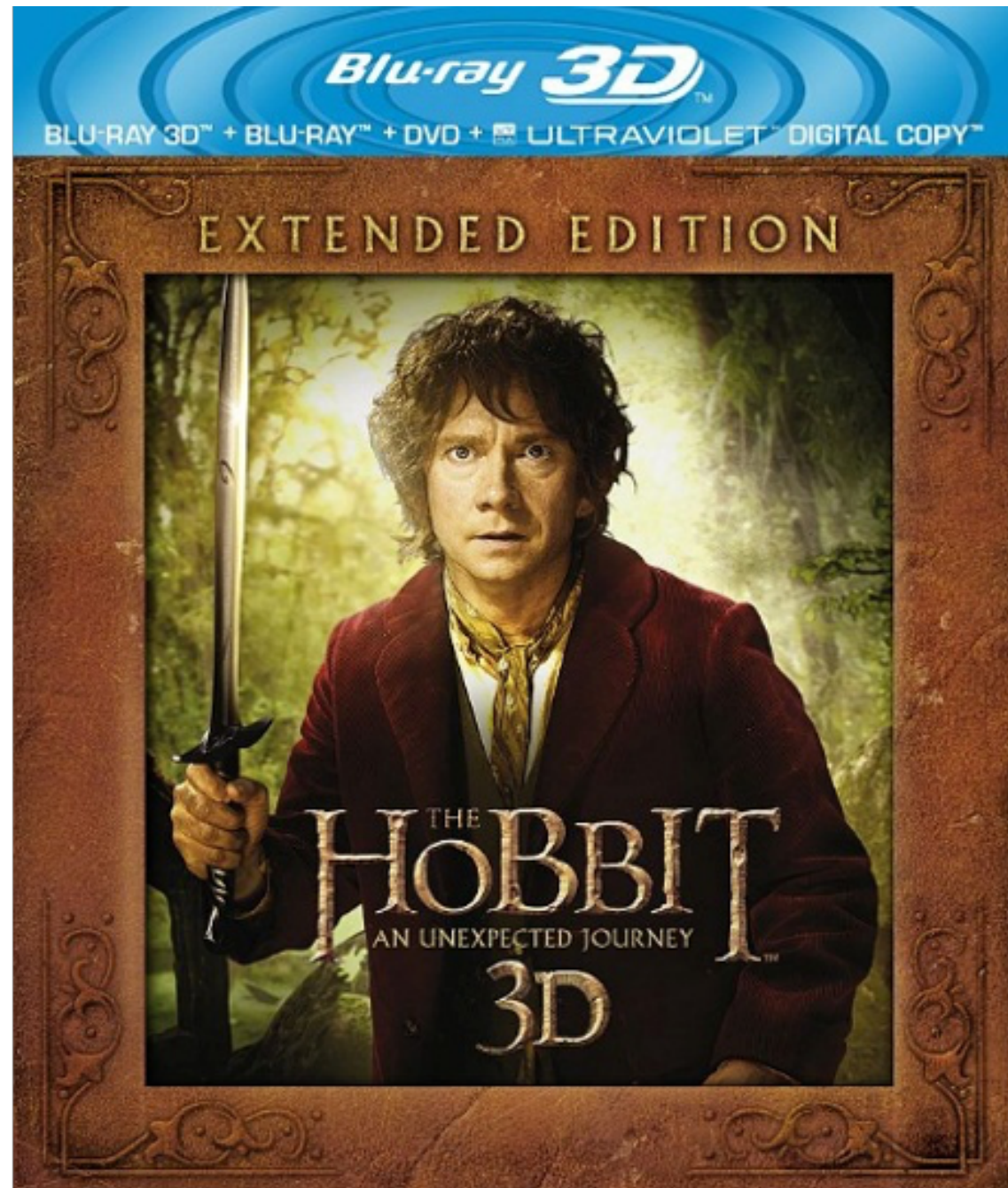


Perfect Price Discrimination

- Not very realistic.
- But there are certainly examples of (imperfect) price discrimination strategies in the real world....







Good Oct 13th - 17th

buy any grande/super specialty beverage & get the second **HALF OFF**
(hot, iced or frozen - of equal or lesser value)

FREE **WiFi**

for franchise information
www.biggy.com

Good at participating BIGGBY COFFEE locations. Not good with any other offer. Offer expires 10/17/2010.



A promotional advertisement for Biggy Coffee. The background is a vibrant, abstract pattern of pink, blue, and yellow. The text is white and black. On the right side, there is a white Biggy Coffee cup with a large black 'B' logo, topped with whipped cream and a cinnamon stick. The offer is for a half-off second beverage on weekdays in October. It also mentions free WiFi and provides a website for franchise information.

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FINE DINE BAR

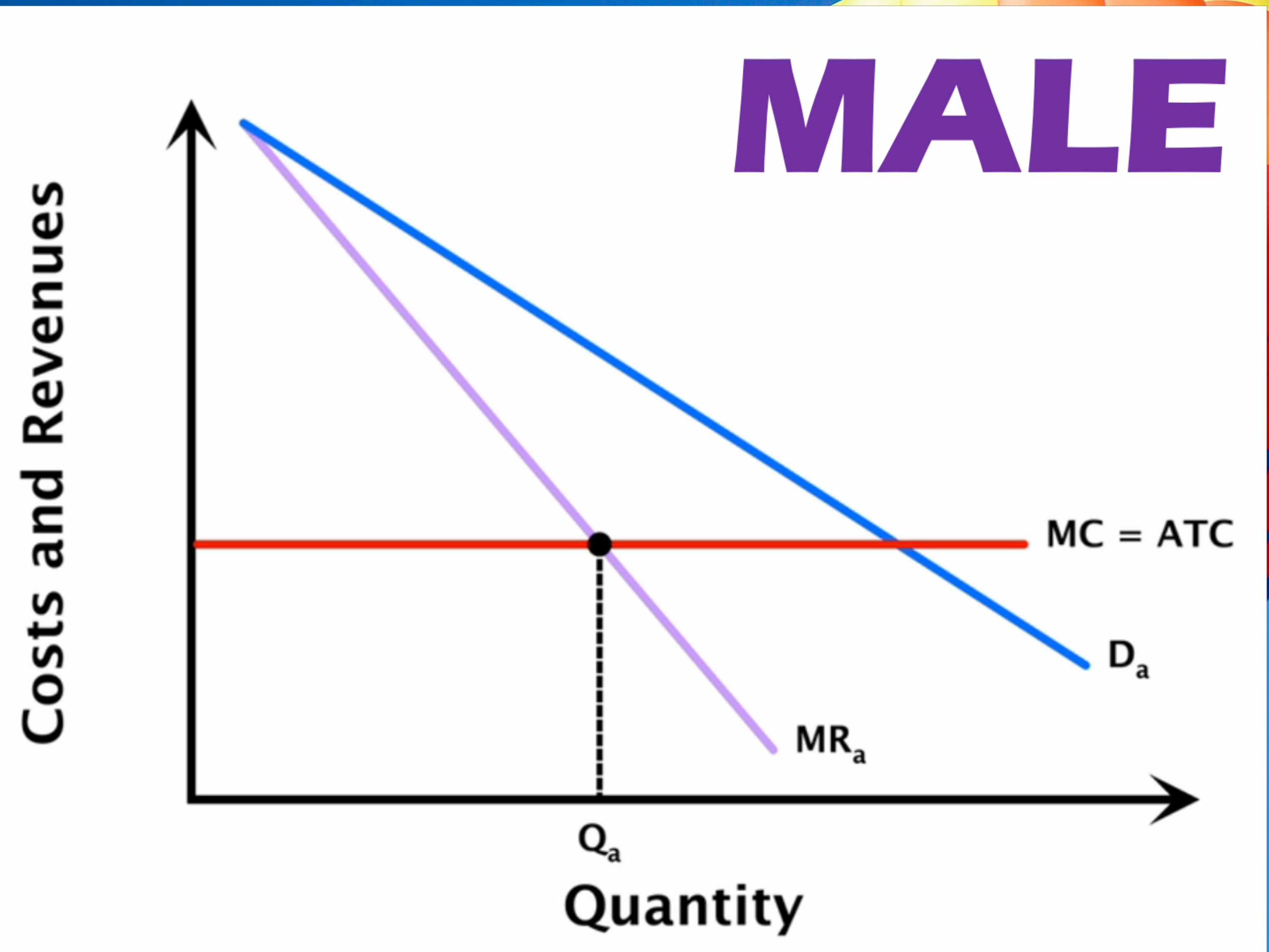
LADIES NIGHT



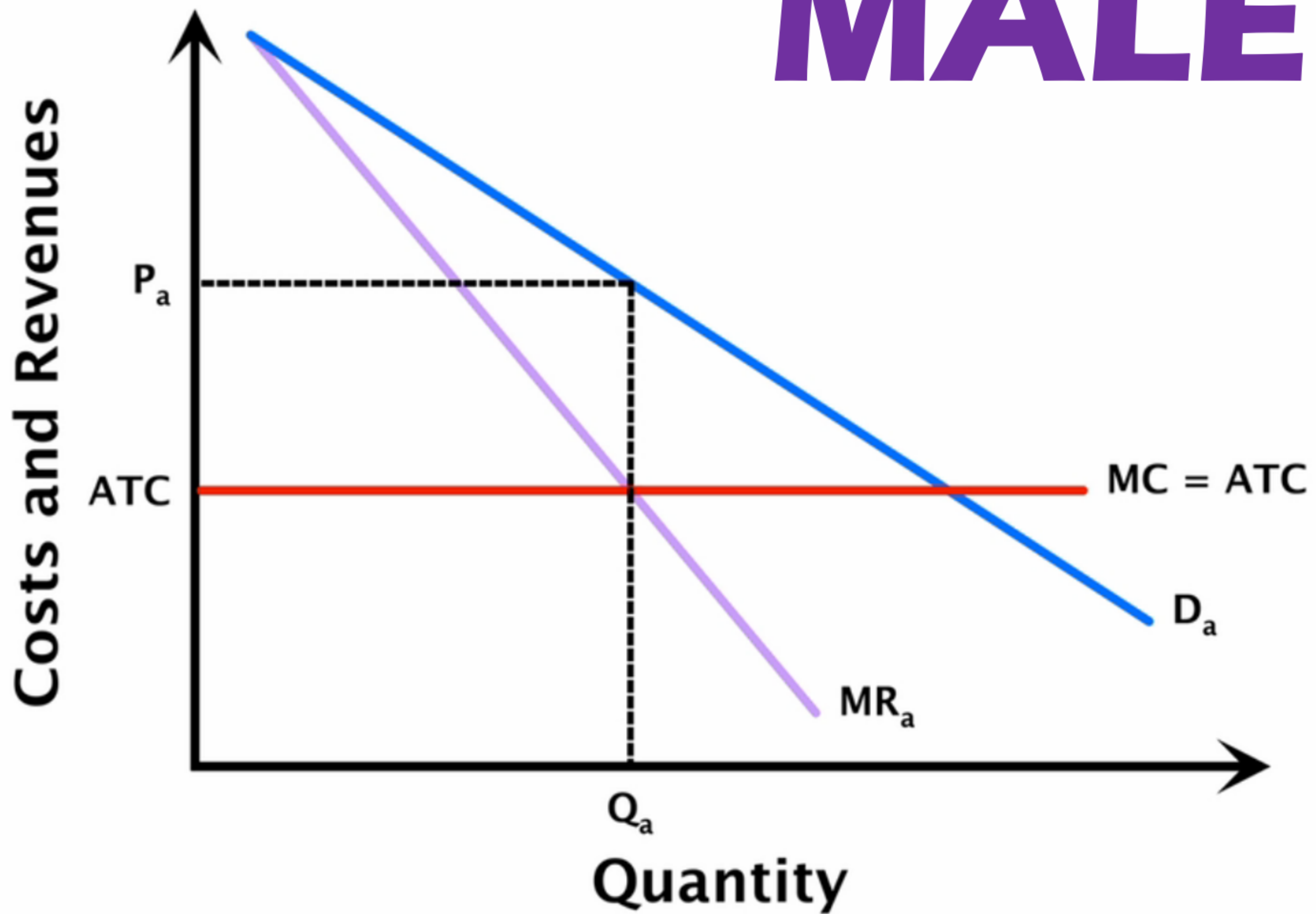
TUESDAYS

6PM-10PM

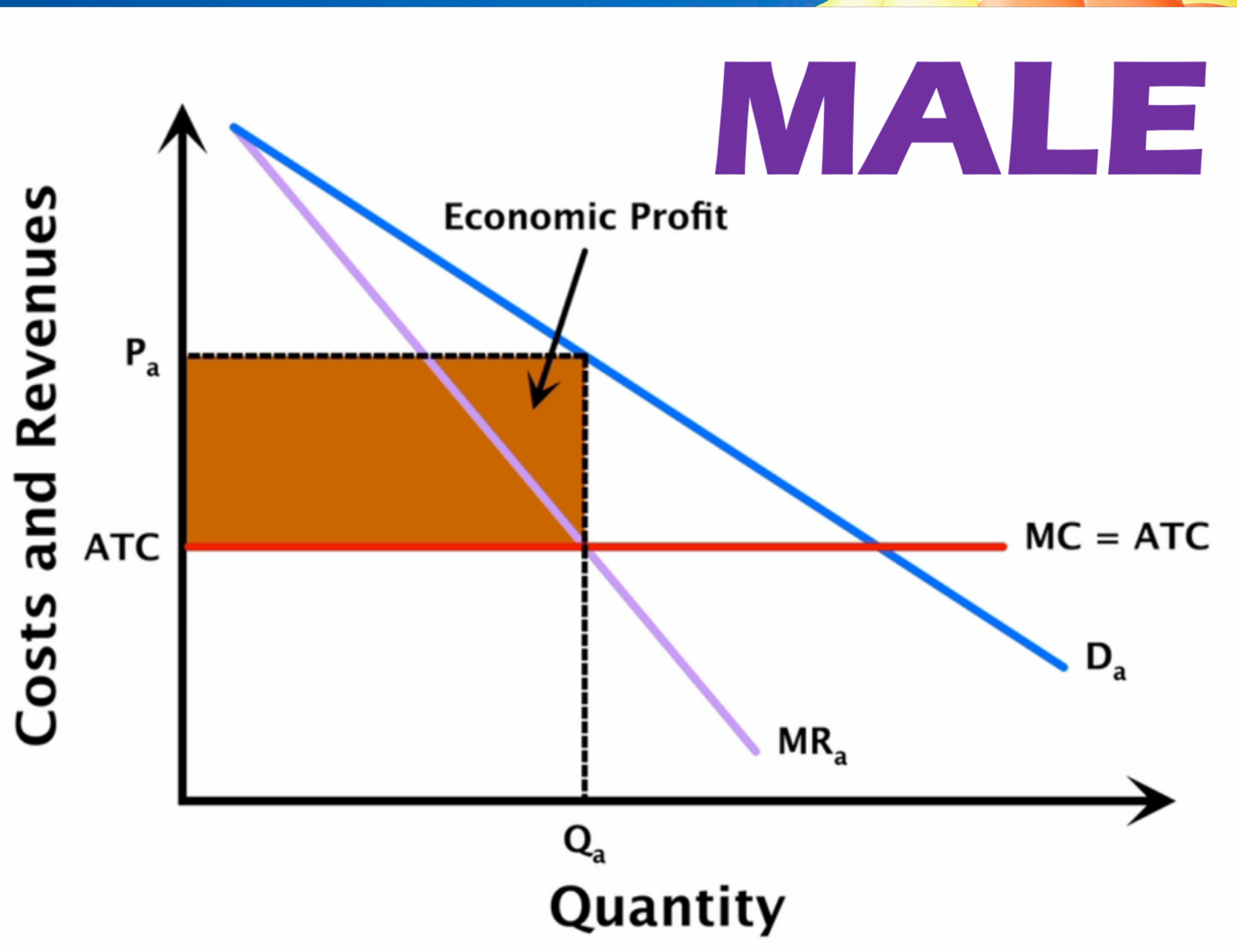
MALE



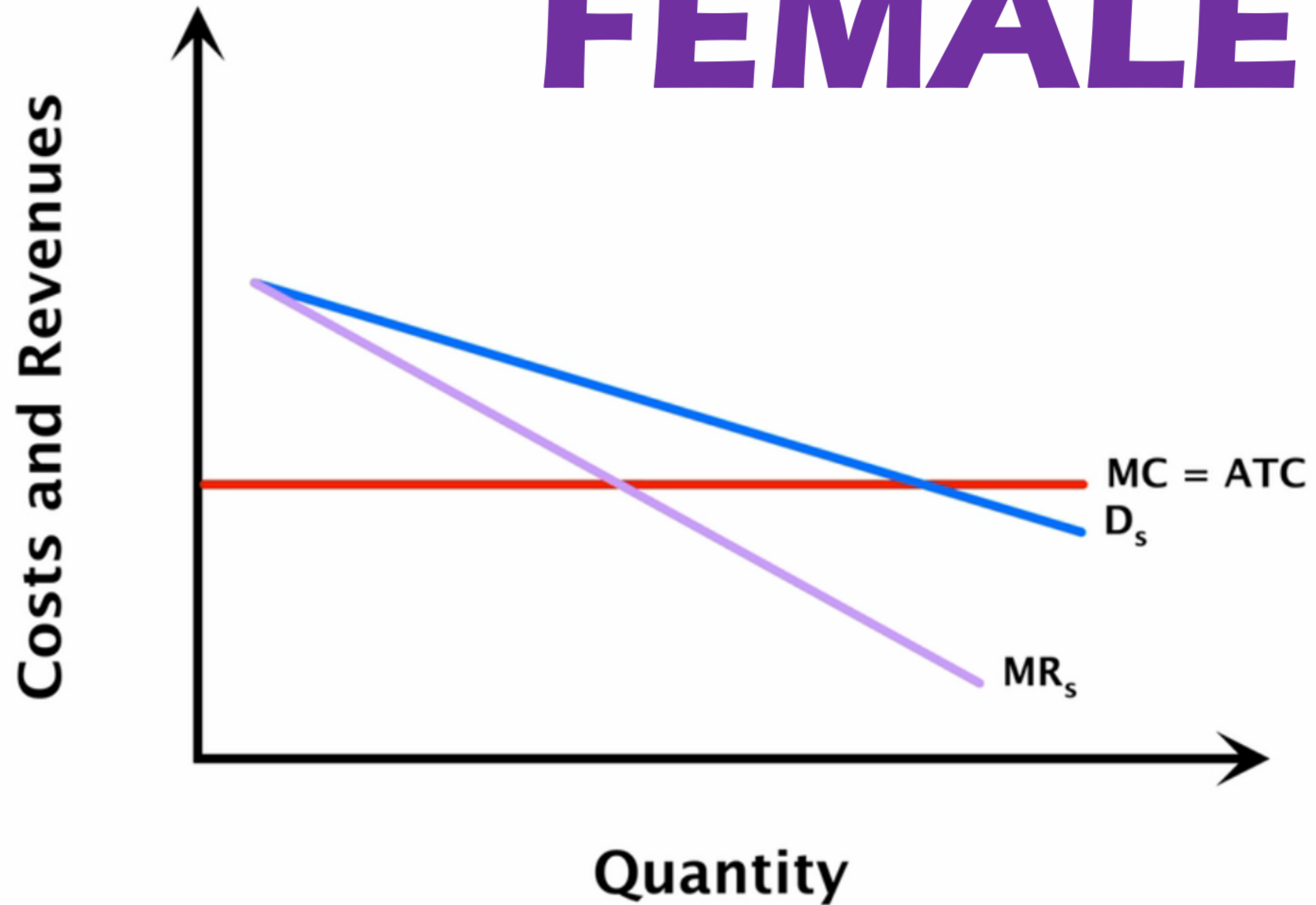
MALE



MALE

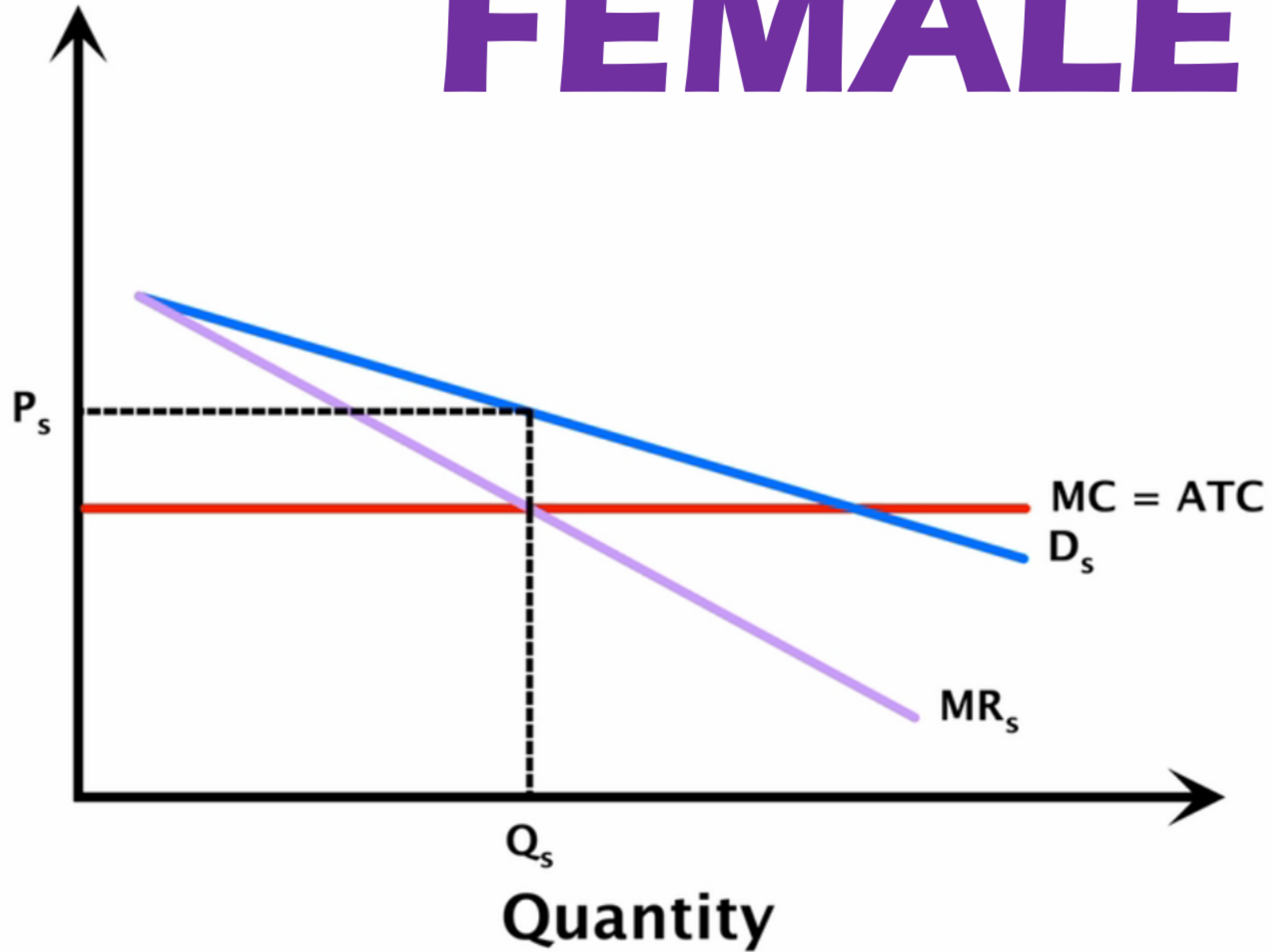


FEMALE

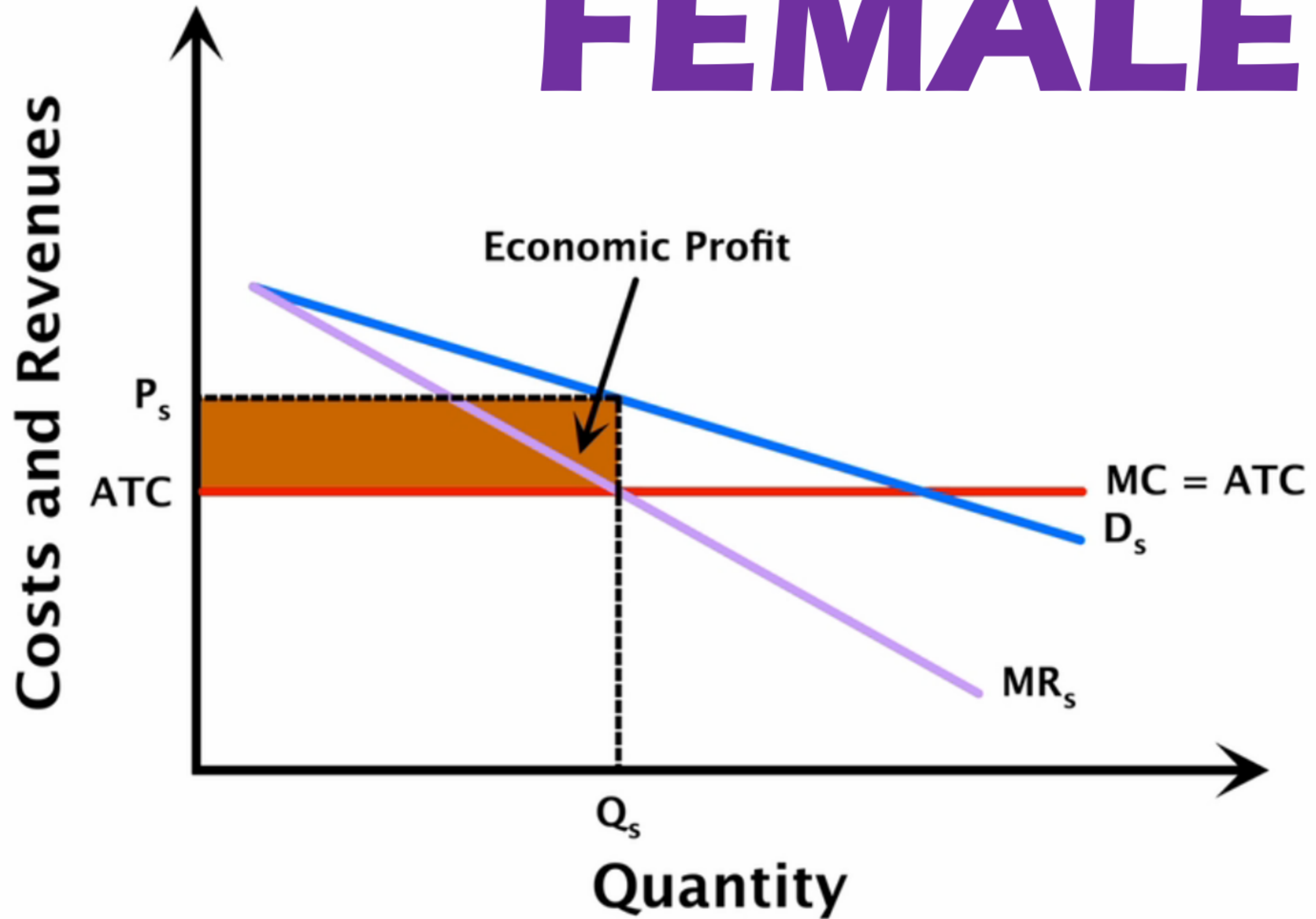


FEMALE

Costs and Revenues

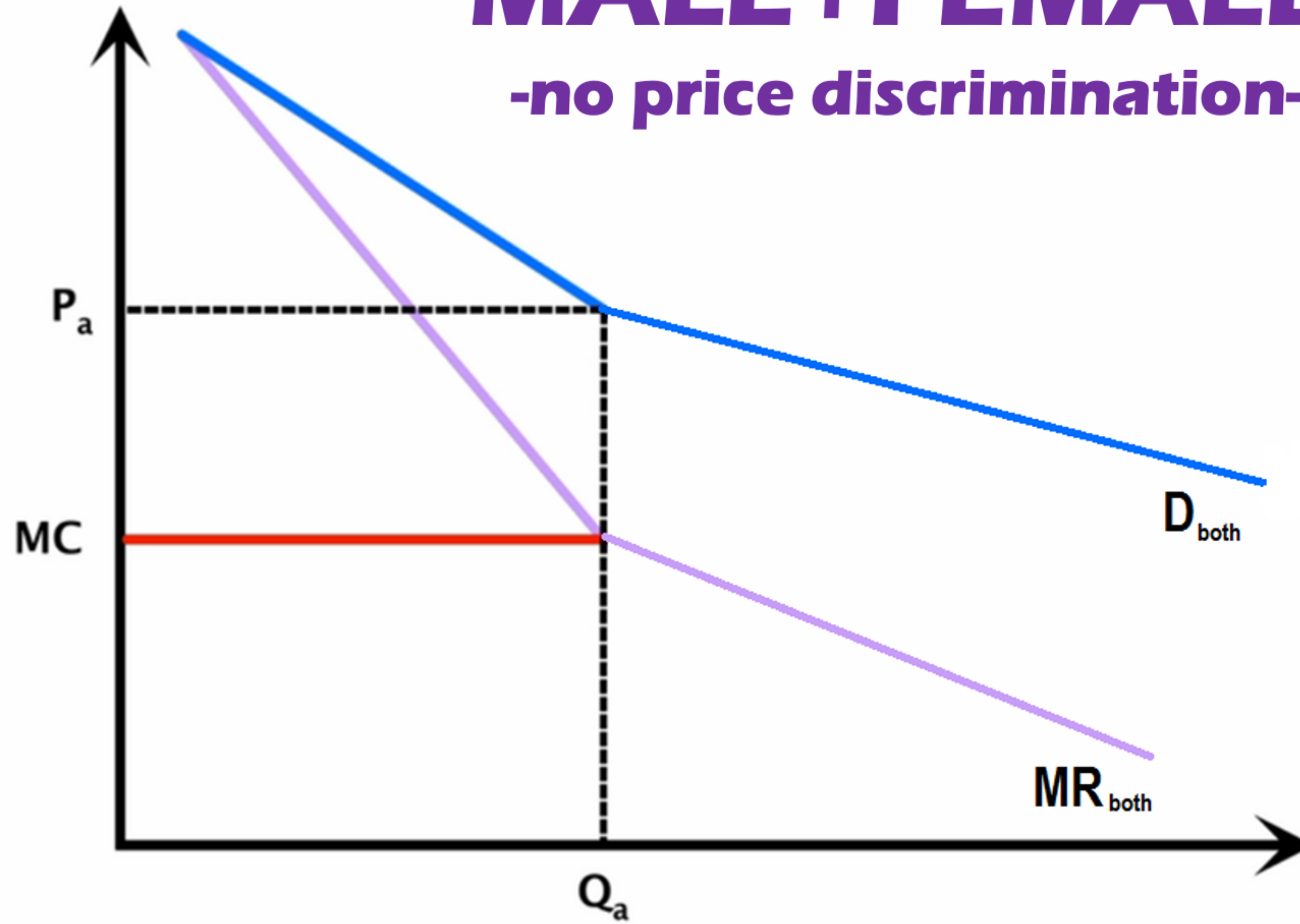


FEMALE

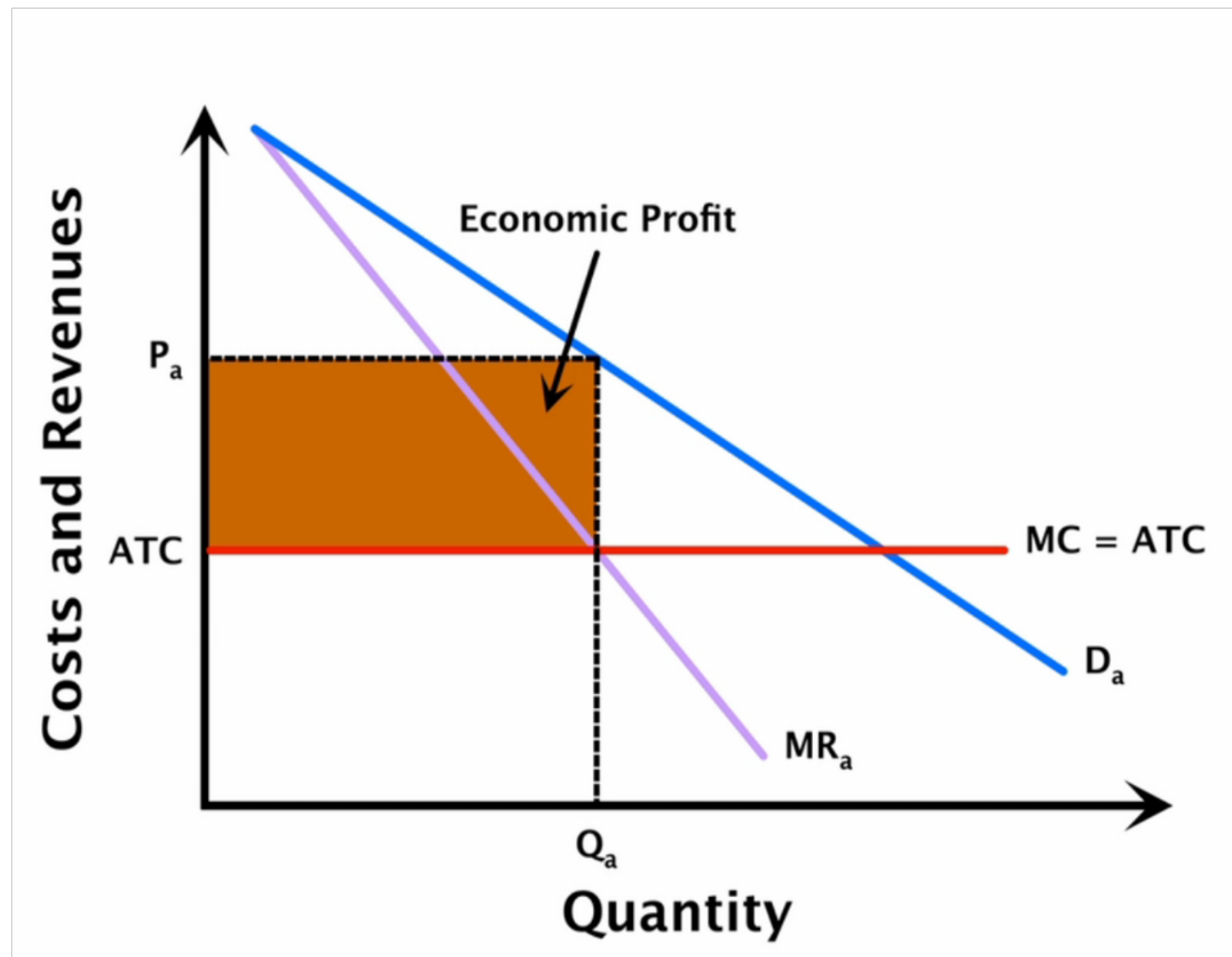


MALE+FEMALE

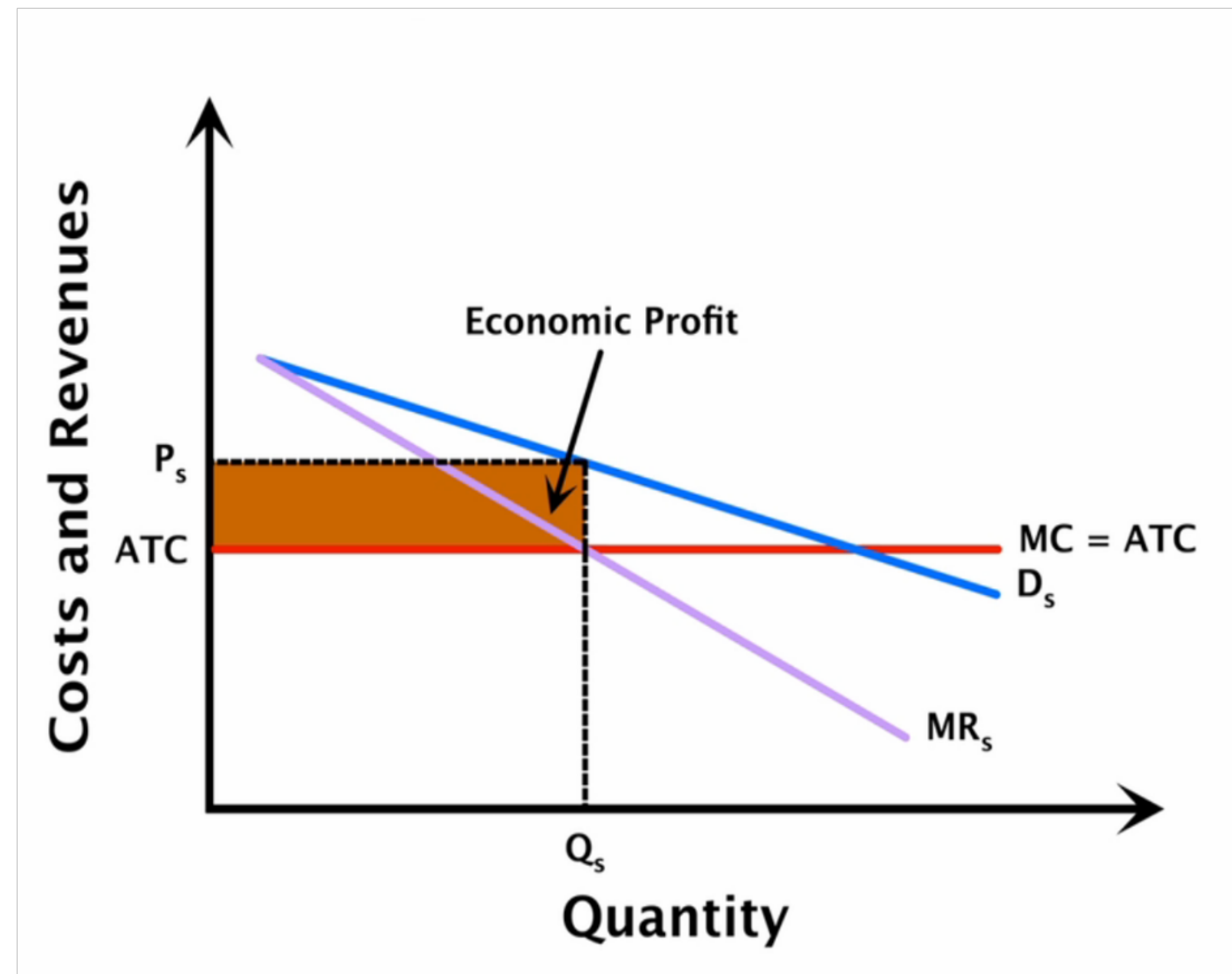
-no price discrimination-



MALE



FEMALE



What's the point, here?

- Monopolists have an incentive to sell more quantity!
 - Often, monopolists (or innovators) don't get very much of the gains (think of all the costs they have to pay).
 - The usual profit monopolies get isn't always enough!
- Price discrimination...
 - 1. Allows producers to get more profit...
 - 2....and consumers to get more goods!
- **INCENTIVES MATTER!**

Recap

Perfectly Competitive vs. Monopoly Markets

	Competition	Monopoly
<i>Similarities</i>		
Goal of firms	Maximize profits	Maximize profits
Rule for maximizing	$MR = MC$	$MR = MC$
Can earn economic profits in the short run?	Yes	Yes
<i>Differences</i>		
Number of firms	Many	One
Marginal revenue	$MR = P$	$MR < P$
Price	$P = MC$	$P > MC$
Produces welfare-maximizing level of output?	Yes	No
Entry in the long run?	Yes	No
Can earn economic profits in the long run?	No	Yes
Price discrimination possible?	No	Yes

SO WHAT?

Perception of A Monopoly

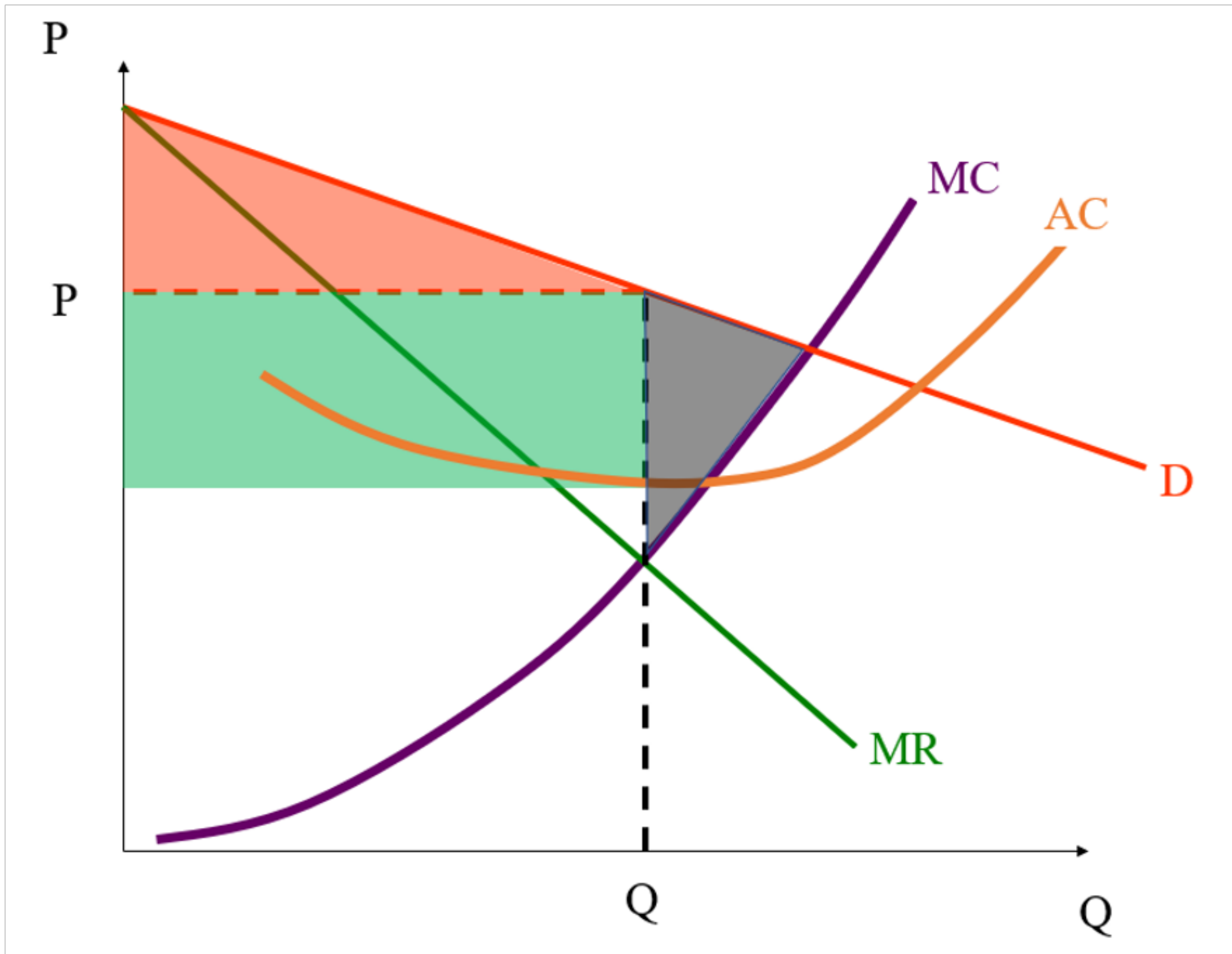


Perception of A Monopoly

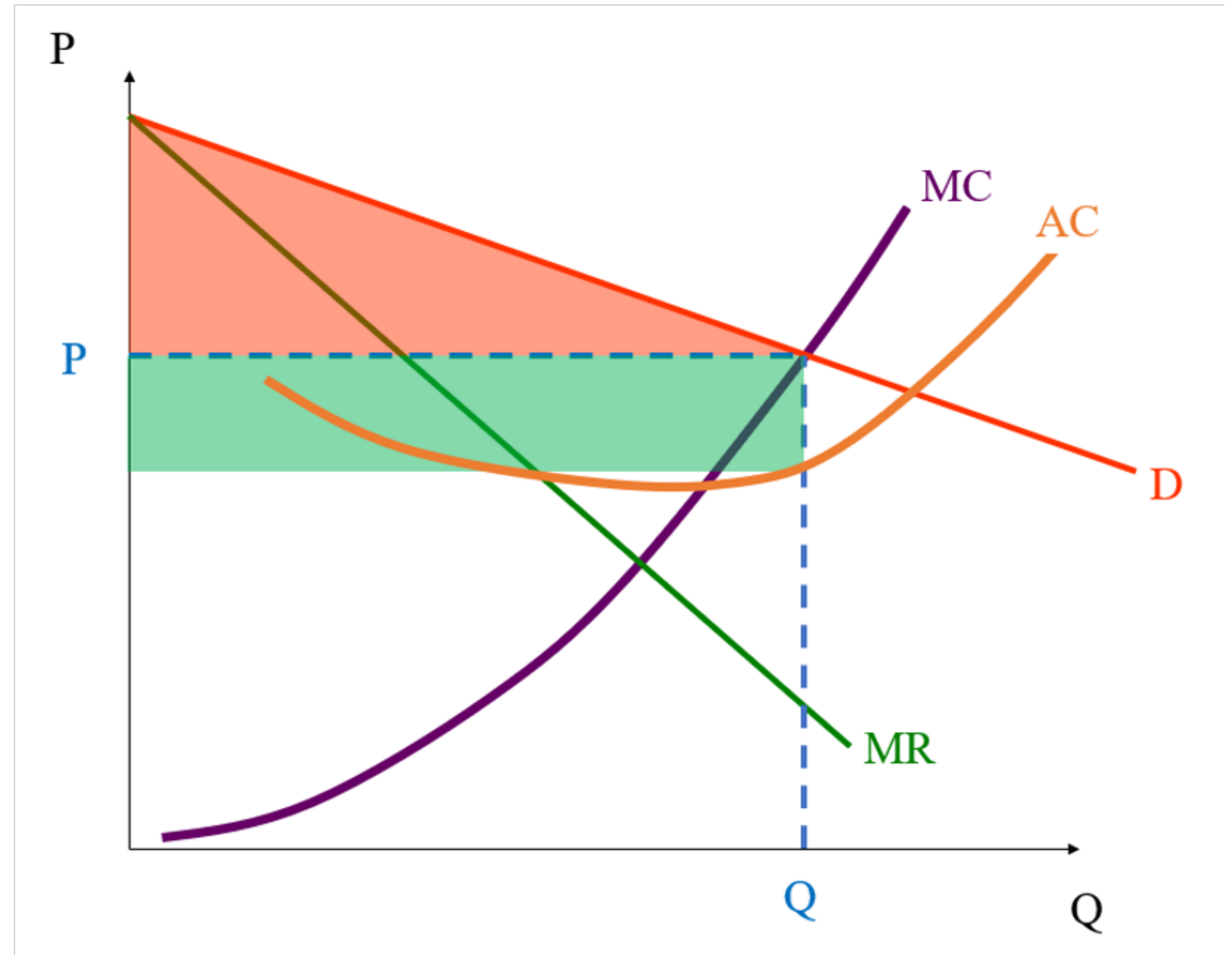
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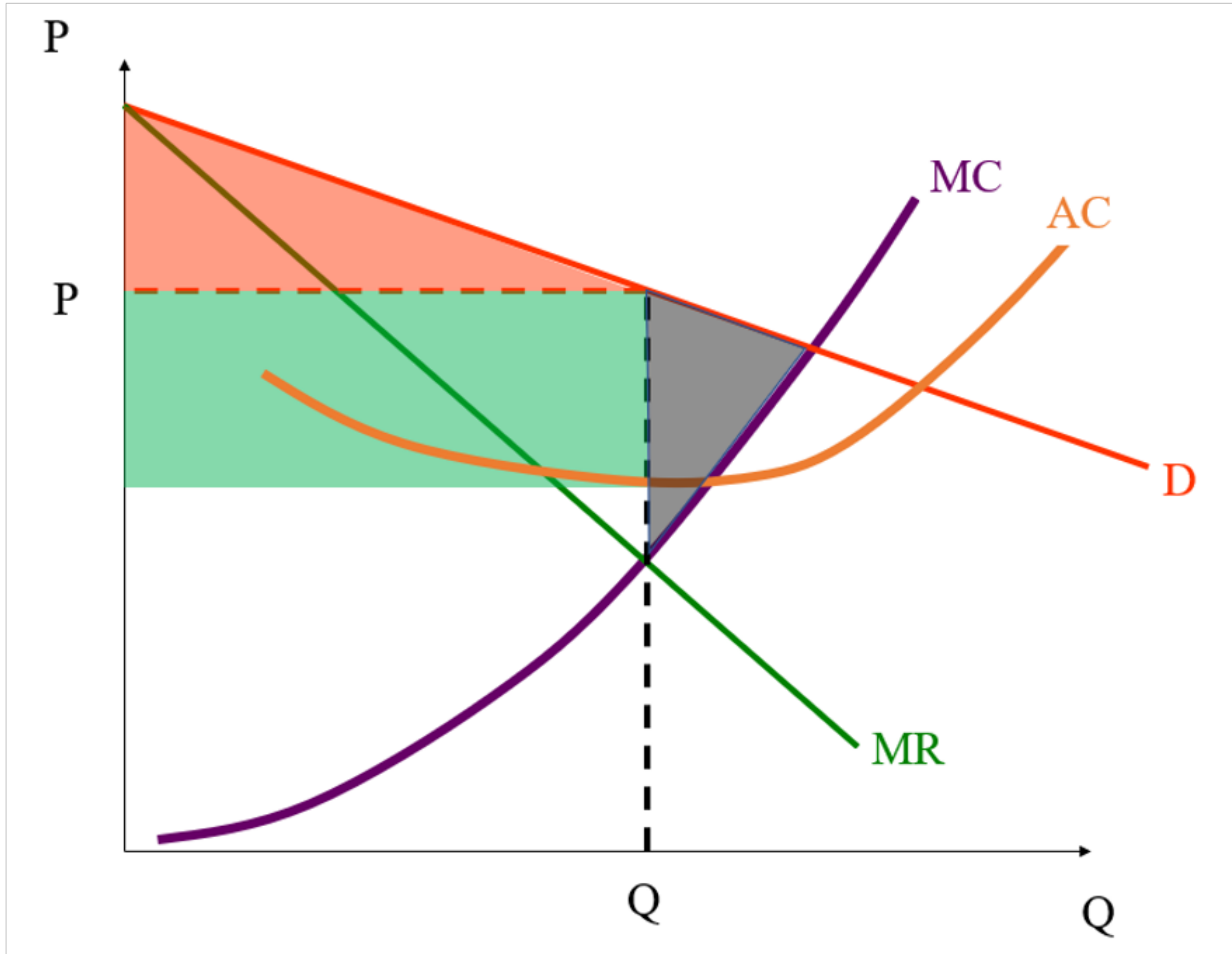
Monopoly Market Equilibrium



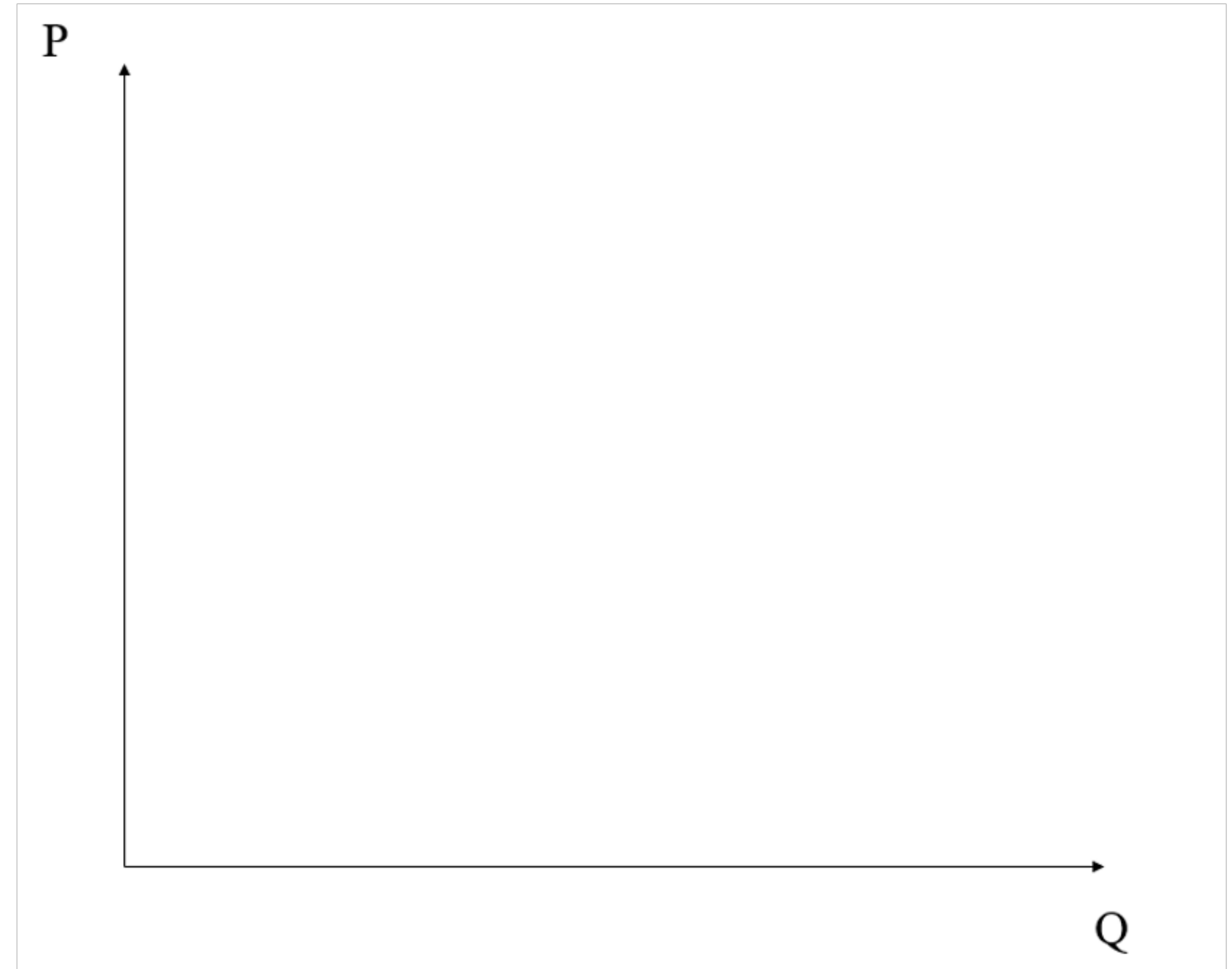
Competitive Market Equilibrium



Monopoly Market Equilibrium



Market without the Monopoly Firm



COMPARED TO WHAT?!

- This is a fundamental question all economists should ask, especially when dealing with problems related to monopoly and market power.
- “Monopolies are inefficient...compared to what?!”

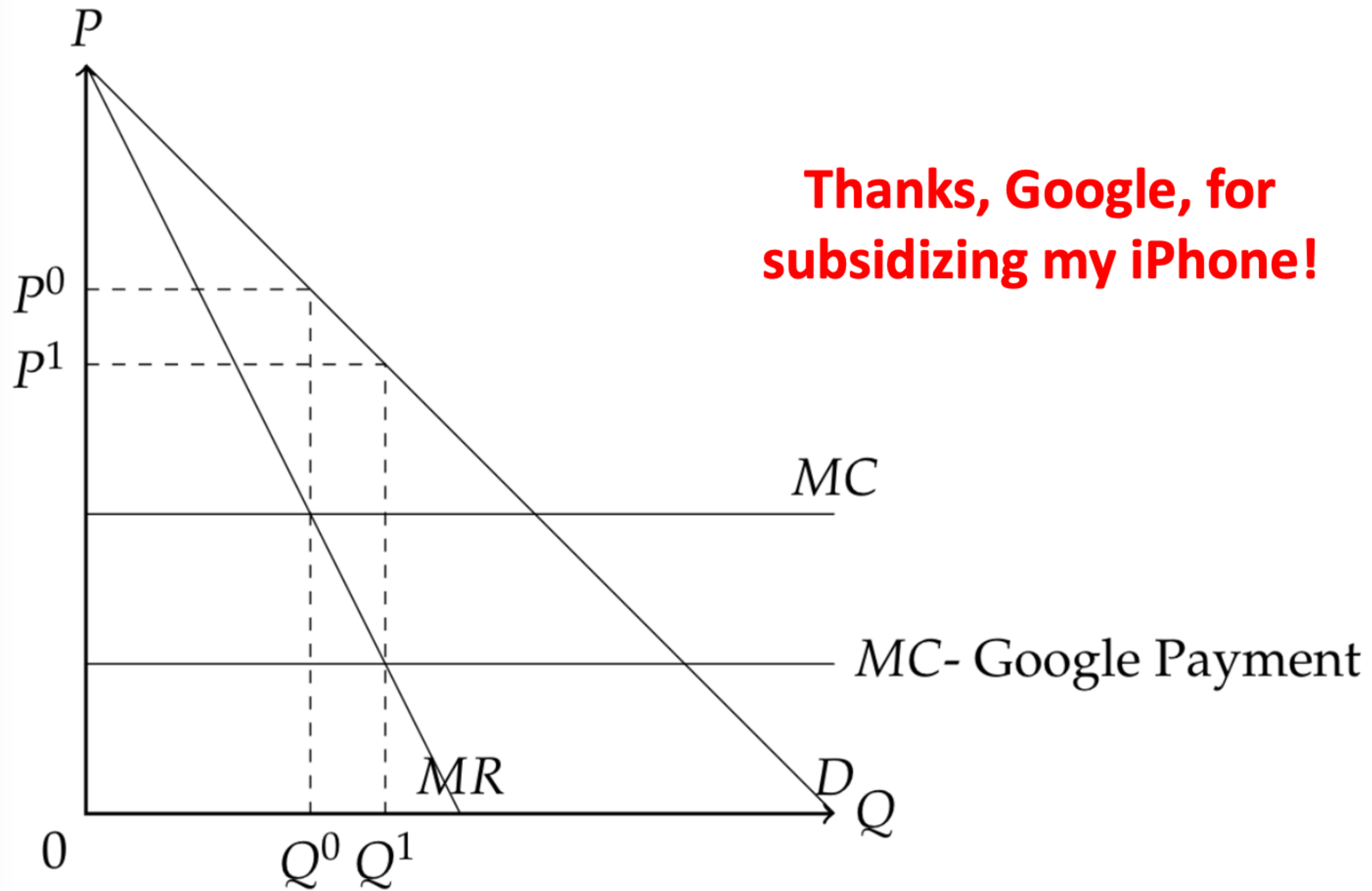
Is Google a monopoly?

- Two major complaints (legally and ethically) with Google
 - 1. Google pays Apple to be the default search engine for iPhones.
 - 2. The agreements are exclusive and prevent Apple from contracting with other search engines (e.g., Bing).
- Is this necessarily bad, though? Anti-competitive?

Is Google a monopoly?

- Google clearly benefits, or else they wouldn't do it. But this isn't enough to say "bad."
- Consumers may be worse off (less surplus) since they can't use Bing or other alternatives.
- However, Apple does not control its customers. It competes for them.
 - This payment from Google means Apple can lower its prices and better compete for consumers!

Thanks, Google, for subsidizing my iPhone!



Thanks, Google!

- Google subsidizes our iPhones, at least in the short-run. What about the long-run?
- Long-run, Apple develops a reputation for good quality and competes for a lot of consumers.
 - They go to Google and say, “our customers use us no matter what.”
 - So, they bargain Google to pay them even more for the default search engine, or else they’ll move to Bing.
 - This larger subsidy is passed onto consumers in the form of lower prices!

Thanks, Google!

- Paying \$\$ to other firms and restraining each other's behavior(via contract) are completely natural parts of a competitive process.
- Google is offering better terms to Apple and customers than Microsoft can. That's how competition works!
- In markets, you're rewarded for serving others!

Is mazon a monopoly?

- Amazon is big, but it controls only 5% of all retail sales in the US and 1% globally.
- According to the DoJ, a firm must have a market share >50% to be addressed in court as a monopoly.
- Even if Amazon were >50% of the market, that does not necessarily mean it's a monopoly.

Is amazon a monopoly?

- Amazon can only be considered a monopoly if it restricts competitive behavior (prevents others from offering competing products).
- But Amazon is not restricting trade! It's ENHANCING trade!
 - Amazon is a platform for small sellers to sell their good.
 - Breaking up Amazon would effectively eliminate their economies of scale, and thus, the benefits they provide from operating as a single corporation.

Is mazon a monopoly?

- Finally, if Amazon were a monopoly, wouldn't we be paying more & receiving less?
- Amazon charges LOWER prices and provides MORE options.

**Good economics is comparative
economics.**

Thanks for your
attention!
End of class.

