Microeconomics, Module 11, “Monopoly”

Costs and Benefits of Monopoly

(The attached PDF file has better formatting.)

Question: How do monopolies hurt consumers?

Answer: The competitive output maximizes social welfare, which is consumers’ surplus plus producers’ surplus. Monopoly increases producers’ surplus; if it did not, the firm would produce the competitive output, not the monopoly output. So consumers’ surplus declines for two reasons:

- Total social welfare declines.
- Producers’ surplus increases.

Question: Does monopoly ever help consumers?

Answer: Landsburg argues that monopolies sometimes achieve economies of scale that reduce marginal costs and may reduce market prices and increase output. This is possible, but it is rare.

Question: Does this mean that mergers creating fewer firms are not socially beneficial?

Answer: On the contrary; many industries have too many firms. Industry consolidation can benefit consumers. The U.S. anti-trust laws were written 100 years ago for an era when competition was national. The classic U.S. trust (railroads, oil, steel) developed from mergers of dozens or hundreds of smaller firms. They were designed to create market power and eliminate competition. The rise of global competition from lower transportation costs and better communication makes domestic monopolies a smaller problem; even with only 2½ U.S. car manufacturers, we don’t fear monopolies in auto production.

Question: What type of monopolies are most harmful now?

Answer: Monopolies stemming from government licenses are the most harmful. Examples are monopolies for physicians and attorneys, which raise medical and legal costs without creating benefits for the public.