**KEY CONCEPTS AND SKILLS Theory of The Firm 4 – Monopoly**

**Definitions:**

*[Note: there are not many new terms presented in this unit, but make sure you know all of the terms from the previous Theory of the Firm units]*

* **Monopoly**: a market structure characterized by a single or dominant firm with significant power over price, no close substitute products, and high barriers to entry
* **Natural Monopoly**: when a single firm can produce for the entire market at a lower average cost than two or more smaller firms. This occurs if the market demand is at a level where there are still economies of scale to be captured.
* **Barrier to Entry**: Anything that can prevent a firm from entering an industry and beginning production.

**Concepts and Applications:**

1. ***Overview of Monopoly***
2. Describe, using examples, the assumed characteristics of *monopoly*.
3. Explain the role of barriers to entry in permitting a monopolist to earn economic profits.
4. Describe, using examples, the different types of *barriers to entry*.
5. ***Costs, Revenue and Profit***

*Note: The cost concepts learned for perfect competition also apply to monopoly.*

1. Explain the relationship between the market demand curve and the monopolist’s demand curve.
2. Explain, using a diagram, why a monopolist can set price or output quantity, but not both.
3. Explain, using a diagram, the relationship between demand, average revenue, and marginal revenue in a monopoly.
4. Explain, using a diagram, the short-run equilibrium pricing decision of a profit-maximizing monopolist, and identify the firm’s economic profit (or losses).
   * Explain how this pricing decision would change in the long-term
5. Compare and contrast, using a diagram, the output and pricing decisions of a profit maximizing monopolist and a revenue maximizing monopolist.
6. ***Natural Monopoly***
7. With reference to economies of scale, use both a diagram and examples to explain the meaning of “natural monopoly”.
8. ***Monopoly and Efficiency***
9. Explain, using diagrams, why the profit maximizing choices of a monopoly firm lead to allocative inefficiency (welfare loss) and productive inefficiency.
10. Explain why, despite inefficiencies, a monopoly may be considered desirable in some circumstances.
11. Using diagrams where appropriate, compare and contrast the advantages/disadvantages of a monopoly market with those of a perfectly competitive market.
12. Evaluate the role of legislation and regulation in reducing monopoly power.