

EE401 Political Economy

Chapter 9 New Political Economy: Monopoly and Rent-seeking

Ploy Thammapiranon 2/2017
BE, Thammasat University

Chapter 9 Monopoly and Rent-seeking

1. Monopoly and sources.
2. Intervention and monopoly by the state.
3. Rent-seeking behavior.
4. What is to be done?

Monopoly and rent-seeking

- Everyone has **incentives** to avoid competition.
- Danger of private monopoly is overrated.
 - It is mostly temporary without government support.

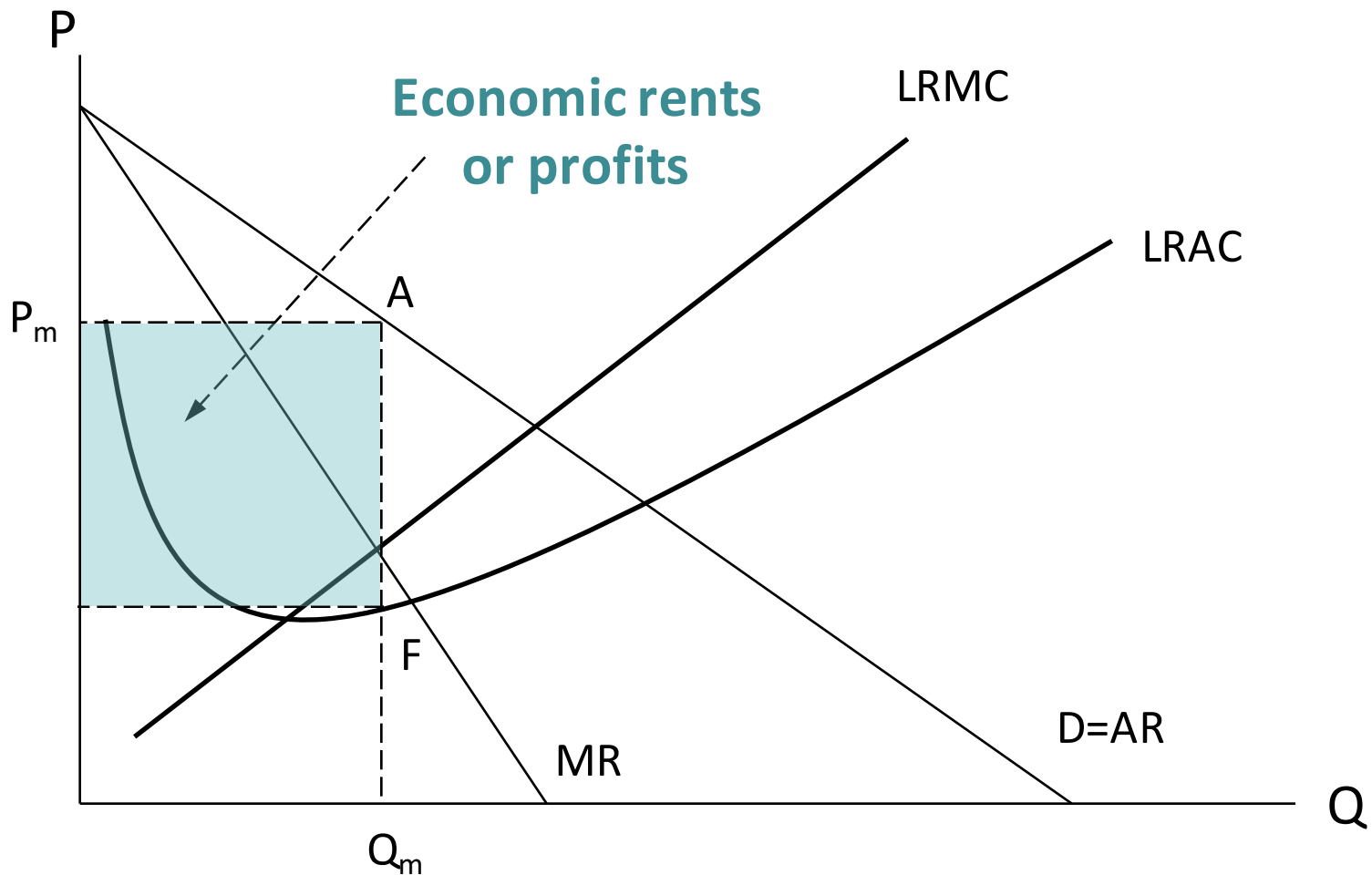
***Worst monopolies are created by government
for rent-seeking.***

1.1 Monopoly

- The **sole supplier** of goods or services.
- Price-makers: the firm faces the **downward-sloping** market demand curve.
- Inelastic market demand
 - Lack of close substitutes.
 - Consumers' taste and options.
 - **Barriers to entry.**
- Monopoly-like cartels: '**market power**'.

1.1 Monopoly

- Profit maximization

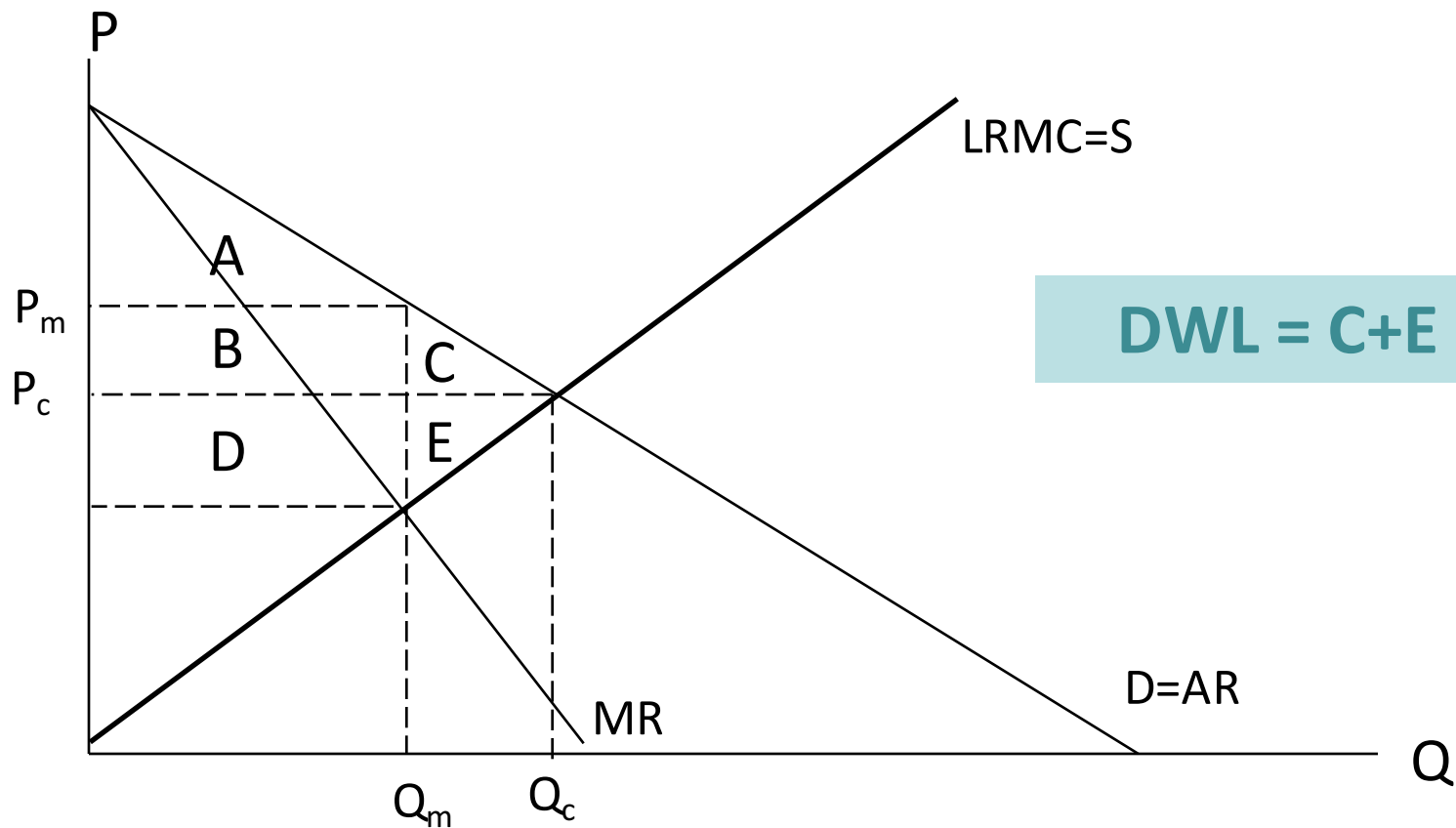


1.1 Monopoly

- **Market power**
 - Ability to *charge price above MC*: $P > MR = MC$
- **Welfare loss**
 - The output is lower and the price higher than the competitive levels.
 - Part of consumer surplus is *transferred to the supplier*.
 - Parts of consumer and producer surpluses are lost—*deadweight loss*.

1.1 Monopoly

- Welfare loss



1.2 Sources of monopoly

1) Cost advantage.

- Ownership of special inputs.

2) New technology.

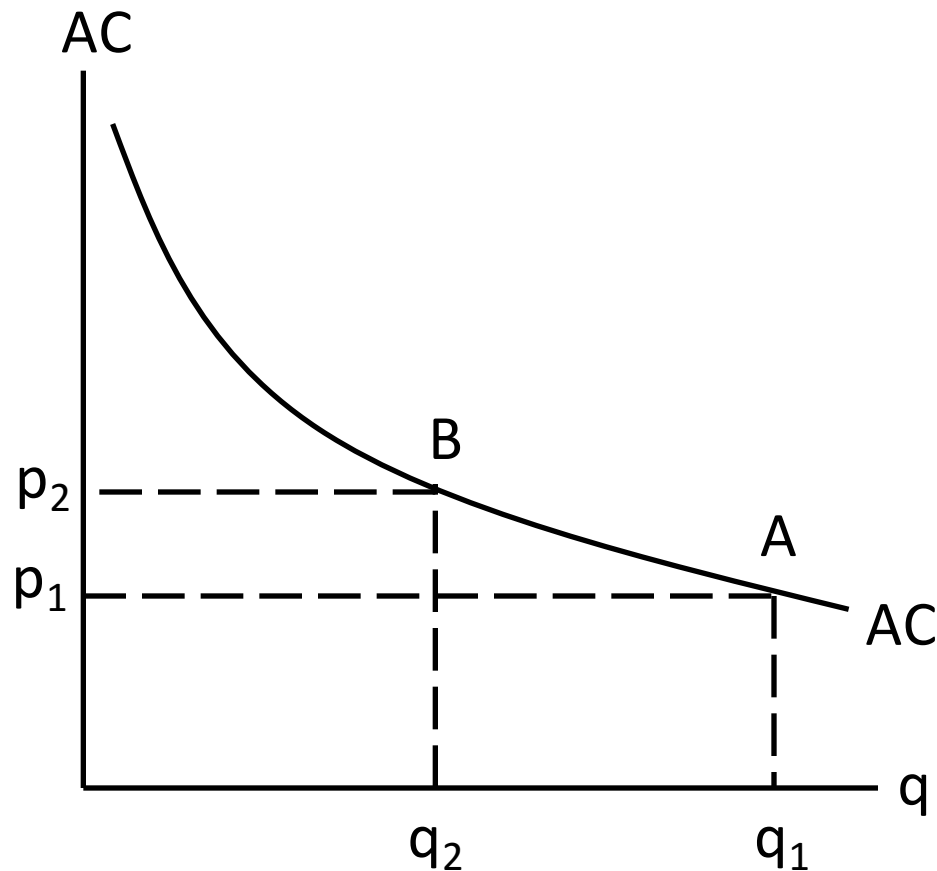
- New production process and organization.

3) Natural monopoly and economies of scale

- The average cost is decreasing as output expands.

1.2 Sources of monopoly

3) Natural monopoly and economies of scale

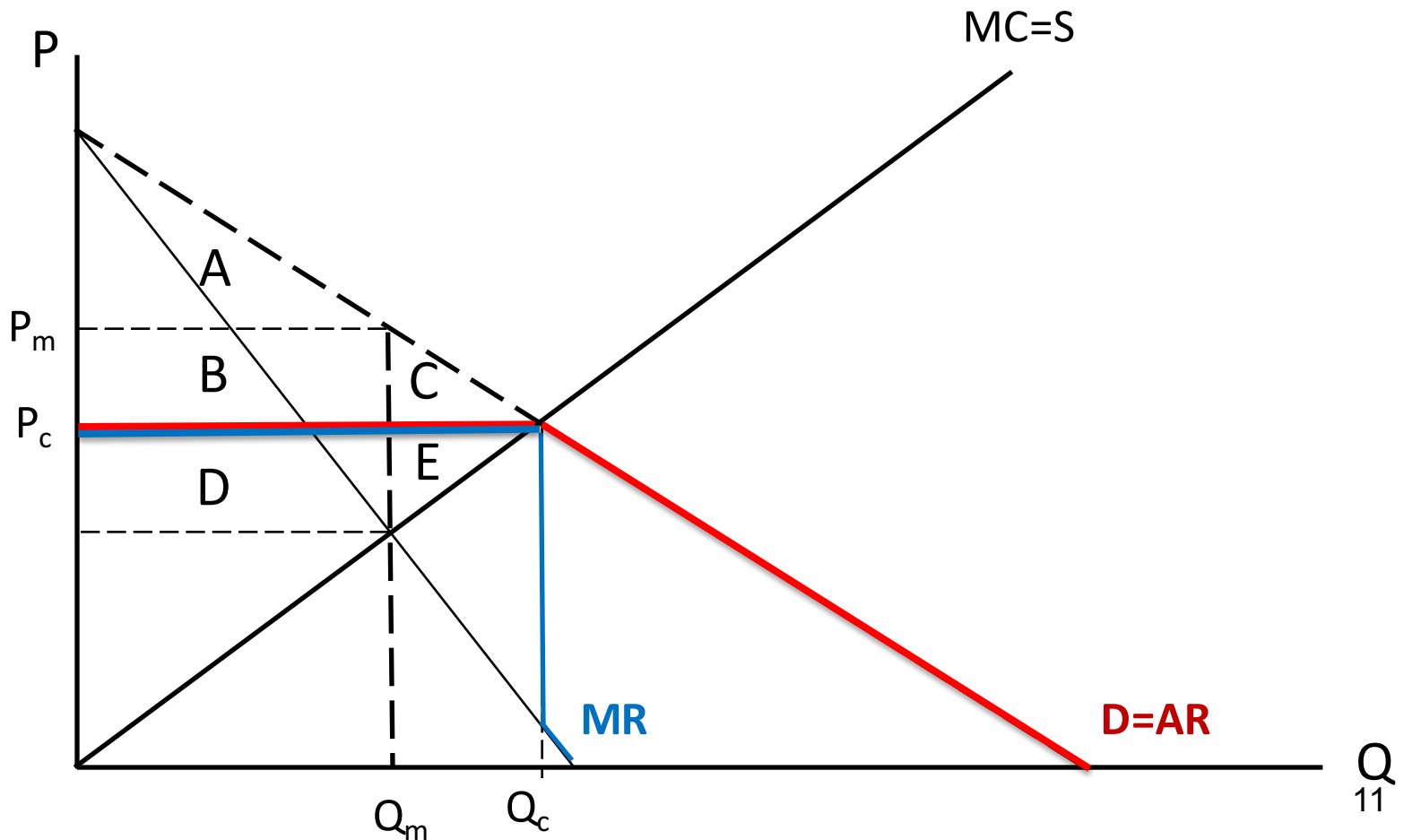


2.1 Government intervention: optimal pricing

- Government sets the price ceiling at the optimal $P=MC$ to emulate the competitive solution --- *optimal pricing*.
- The output, price and consumer and producer surpluses are the *same as the competitive outcome*.

2.1 Government intervention: optimal pricing

- Optimal price regulation



2.1 Government intervention: optimal pricing

- **Problems of optimal pricing**

- 1) The monopolist often has *influence* over the regulator.
- 2) The demand curve and MC are not known.
 - If regulated price is too high, monopoly profits.
 - If too low, small output with deadweight loss.

2.2 Government-created monopoly

- Private monopoly tends to erode rapidly.
 - Monopoly profits attract newcomers.
- Private monopoly needs **government support** to persist.
- Monopoly is used to justify government action.

Benevolent government??

2.2 Government-created monopoly

- Government creates **barriers to entry**.
 - Licensing, concessions, franchises .
 - Trade protectionism to support *infant industries*.
- Government is the monopolist itself: **state enterprises**.
- Government grants *intellectual property rights*.

2.2 Government-created monopoly

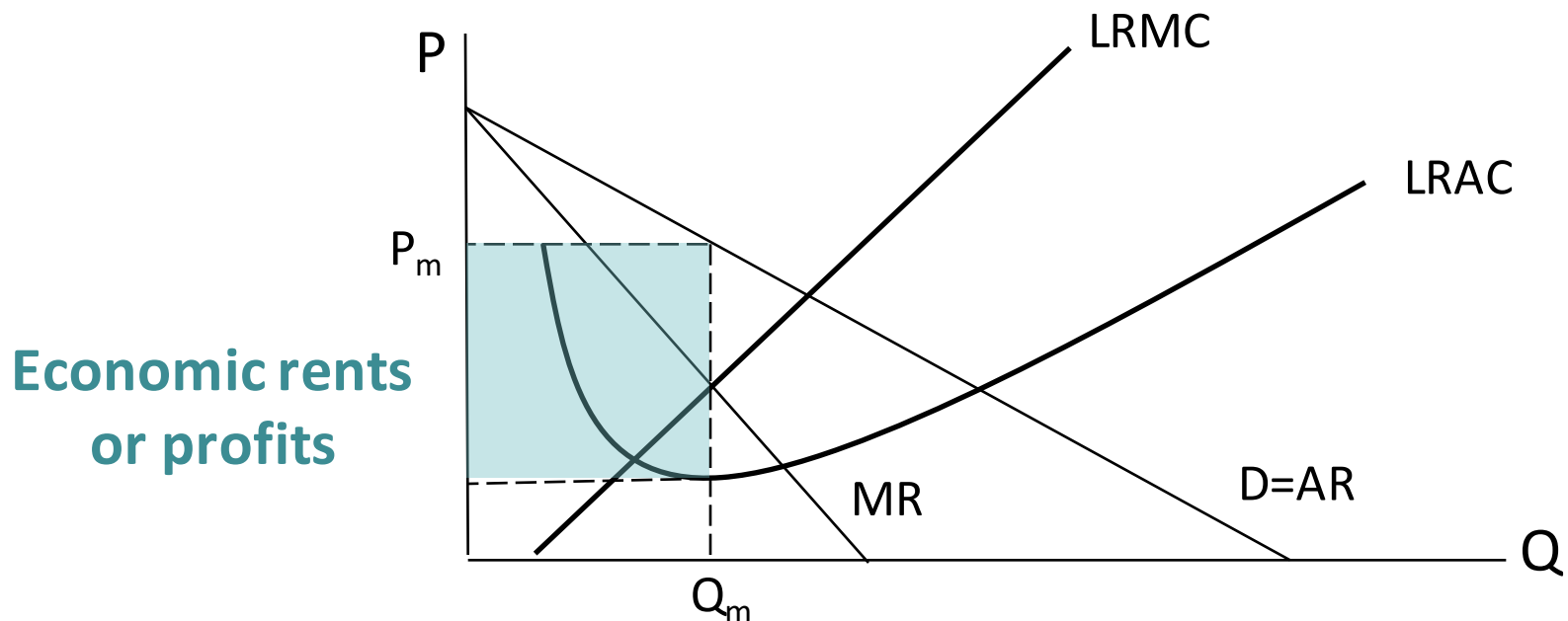
- State enterprises:
 - Bloated organization and overinvestment.
 - High pays and benefits but low productivity
 - Rampant corruption.
 - Chronic loss-making requires fiscal subsidies.



STATE RAILWAY OF THAILAND

3. Rent-seeking behavior

- Monopoly transfers part of the consumer surplus into *rent (monopoly profit)*.
- Government creates monopoly to share rent with the monopolist.



3. Rent-seeking behavior

- The market for monopoly rights:
 - **Supply:**
 - **Demand:**
 - **Rent** is the *value* of the *monopoly rights* demanded by the firm.
- The monopolist requires government power to enforce **barriers to entry**.
 - *Rent-sharing*

4. What is to be done?

- Private monopoly is mostly temporary.
 - Cost-based private monopoly erodes as *competition* develops.
 - Cartels without government support induce *cheating*.
- **Deregulation** and more competition.
- **Privatization** of state enterprises.



4. What is to be done?

- **Private goods:** privatization, deregulation, and government retreats.
- **Public utilities:**
 - *Corporatization.*
 - *Separation* of state-owned network infrastructures from private service provisions.
 - *Auction* of the provision rights.

4. What is to be done?

- **Privatization experience**
 - **Private goods**: public auction.
 - Privatization and share distribution.

THE IRON LADY'S SHAREHOLDER REVOLUTION

The privatisation programme

% of UK shares owned by individual investors

1963

54pc

1981

28pc

1991

20pc

2010

11.5pc

Source: ONS

Oct 1981

Cable & Wireless

Nov 1982

Britoil

Oct 1984

Enterprise Oil

Nov 1984

British Telecom

Feb 1987

British Airways

July 1987

BAA

Dec 1989

Regional water companies

Feb 1982

Amersham International

Feb 1983

Associated British Ports

July 1984

Jaguar

Dec 1986

British Gas

May 1987

Rolls-Royce

Dec 1988

British Steel

Dec 1990

Electricity distribution firms