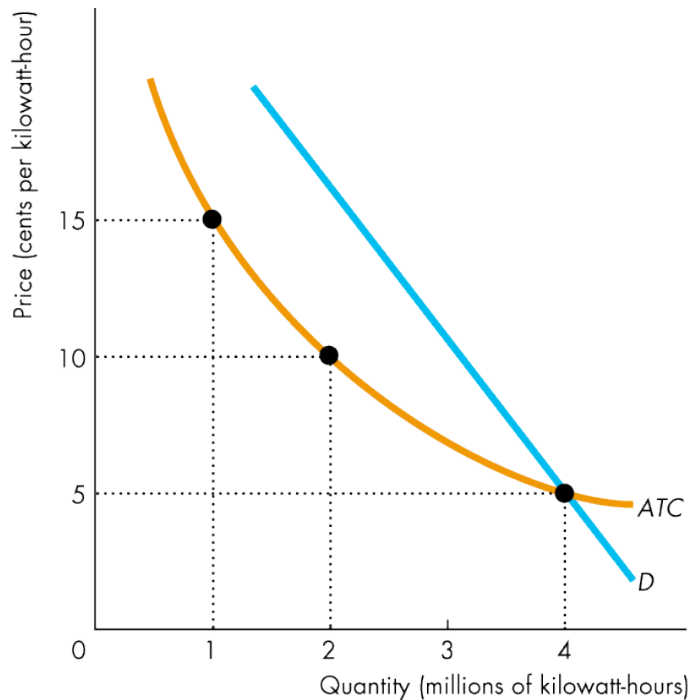


# Natural Monopoly Notes

Characteristics:  
a **natural monopoly** is an industry in which one firm can supply the entire market at a lower price than two or more firms can.



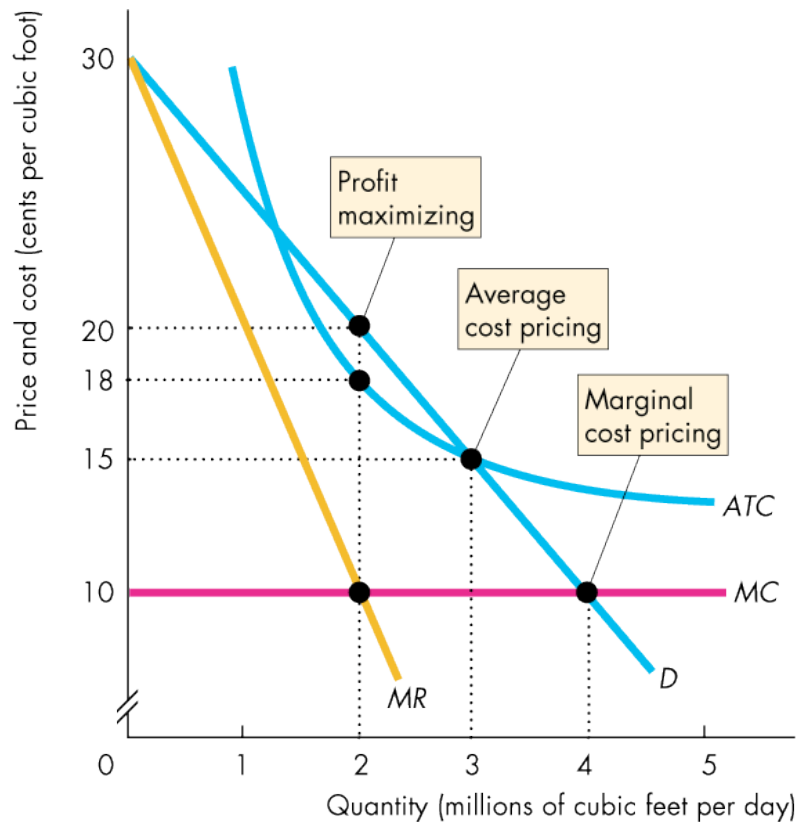
- In a natural monopoly, economies of scale are so powerful that they are still being achieved even when the entire market demand is met.
- The ATC curve is still sloping downward when it meets the demand curve (ATC slopes downward over the relevant range of demand).
- An example would be South Carolina Electric and Gas (SCE&G).

## Regulating Natural Monopoly

- When demand and cost conditions create natural monopoly, government agencies regulate the monopoly.

The following statements describe the graph on the next page.

- With no regulation, the monopoly maximizes profit. It produces the quantity at which marginal revenue equals marginal cost.



- Regulating a natural monopoly in the public interest sets output where  $MB = MC$  and the price equal to marginal cost.
  - This regulation is the marginal cost-pricing rule, and it results in an efficient use of resources.
  - With price equal to marginal cost,  $ATC$  exceeds price and the monopoly incurs an economic loss.
  - If the monopoly receives a subsidy to cover its loss, taxes must be imposed on other economic activity, which create an equal or larger deadweight loss on some other part of society.
- Where possible, a regulated natural monopoly might be permitted to price discriminate to cover the loss from marginal cost pricing.
- Another alternative is to produce the quantity at which price equals average total cost and to set the price equal to average total cost—the average cost pricing rule.