

Natural Monopoly

1 Natural monopoly

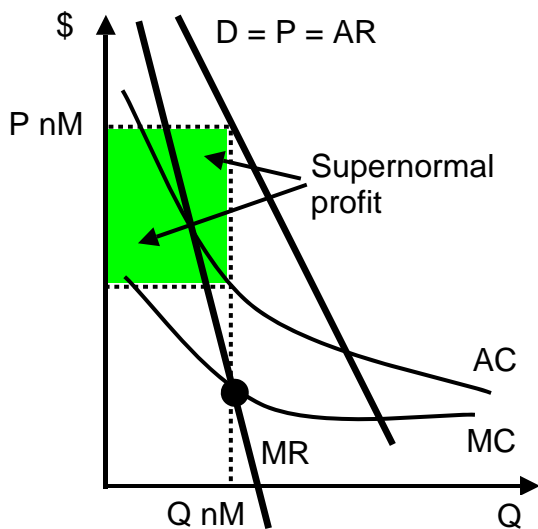
A natural monopoly exists if the only seller has a strong position, normally due to a cost advantage. Different reasons can result in such a situation.

2 Reasons for natural monopolies

21 The monopolist owns an important natural resource, like a mineral mine.

22 The monopolist has installed capital in the past, for example, for the electricity grid.

23 The production of goods or services can be characterized by economies of scale (falling AC).

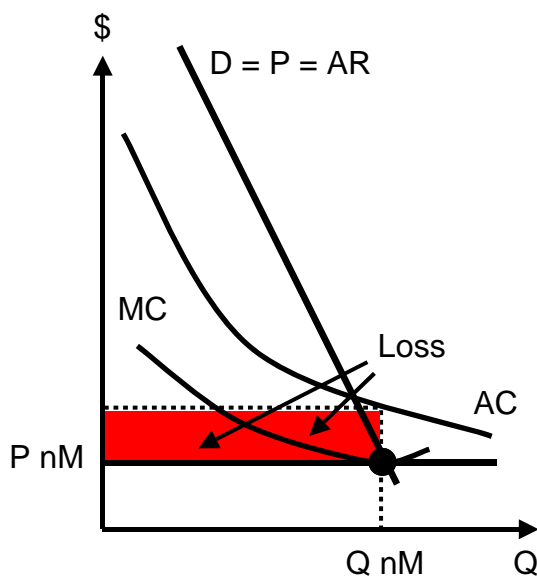


Abbreviations:

- P = Price
- nM = Natural monopoly
- Q = Quantity
- D = Demand
- AR = Average revenue
- MR = Marginal revenue
- AC = Average cost
- MC = Marginal cost

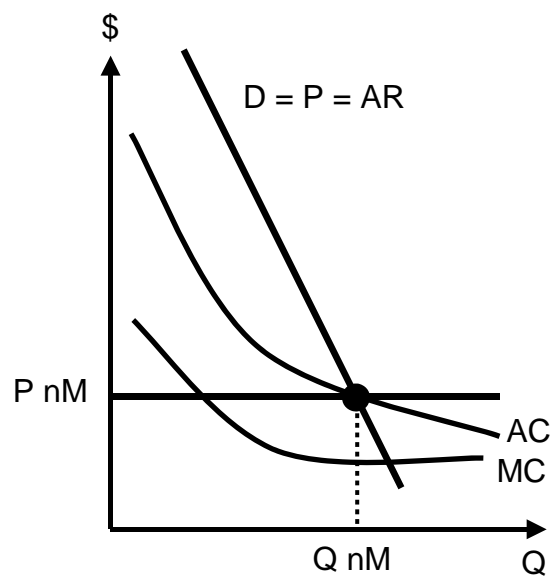
3 Regulations on natural monopolies by the Government

Marginal cost pricing: $P = MC$



- + Allocative efficiency ($P=MC$)
- Loss ($P < AC$); subsidies are necessary.

Average cost pricing: $P = AC$



- + No supernormal profit/no loss ($P=AC=AR$)
- No allocative efficiency ($P > MC$)