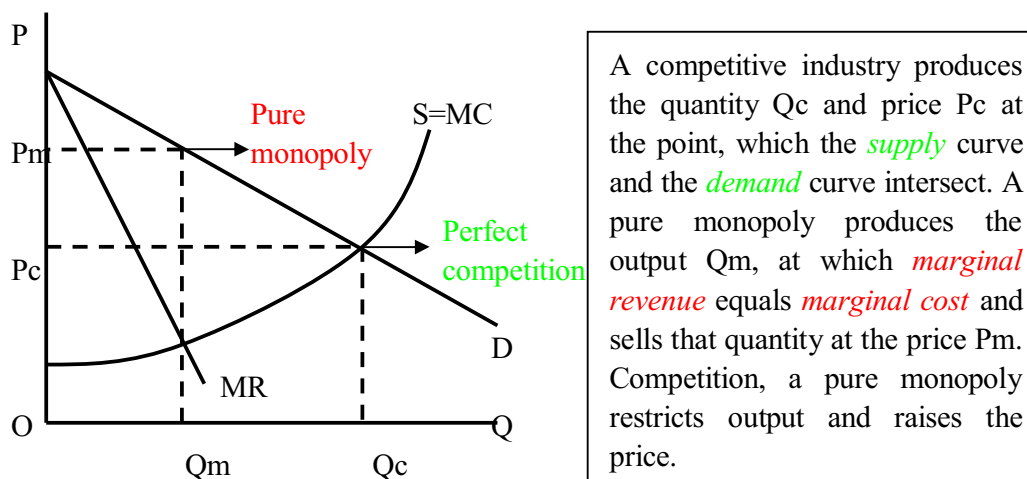


Economists always analyse economic situation through looking at the market structure, which is a description of the degree of competition in a market. Two extreme models of market organization are perfect competition and pure monopoly. In substance, the difference between the two models above will cause the different performance and efficiency in the use of scarce resources. As a result of this, the economic welfare, (means the benefit which two individuals both get from a voluntary trade.) will be different. This essay will explain what the implications for economic welfare of a market structure changing from perfect competition to a monopoly charging a single price are, and modify the conclusion when the monopoly practiced price discrimination.

The explanation of perfect competition and pure monopoly is the starting point of this essay. In perfect competition, first of all, there are many competing firms in the industry; so any of them do not have enough power to affect the price of the product. Secondly, it is absolutely free for a new firm to entry or exit the industry. Thirdly, the firms produce homogeneous products, which means there is no branding or advertising. Fourthly, every buyer and seller is aware of the prices throughout the market. At last, there are two additional requirements as follows: every firm is a profit maximiser, and every consumer is a utility maximiser. On the contrary, a pure monopolist is the single seller of a product in a certain market and produce unique products. There are strong barriers to enter the industry if the monopoly is to persist. Two strongest barriers tend to be: government regulations and patents and economics of scale. As a price maker, monopolist can therefore charge a relatively high price.

Although maximising profit is the aim of both perfect competition and pure monopoly, they have quite a lot of differences in price and output determination, and efficiency.

Figure 1. Output and Price Compared

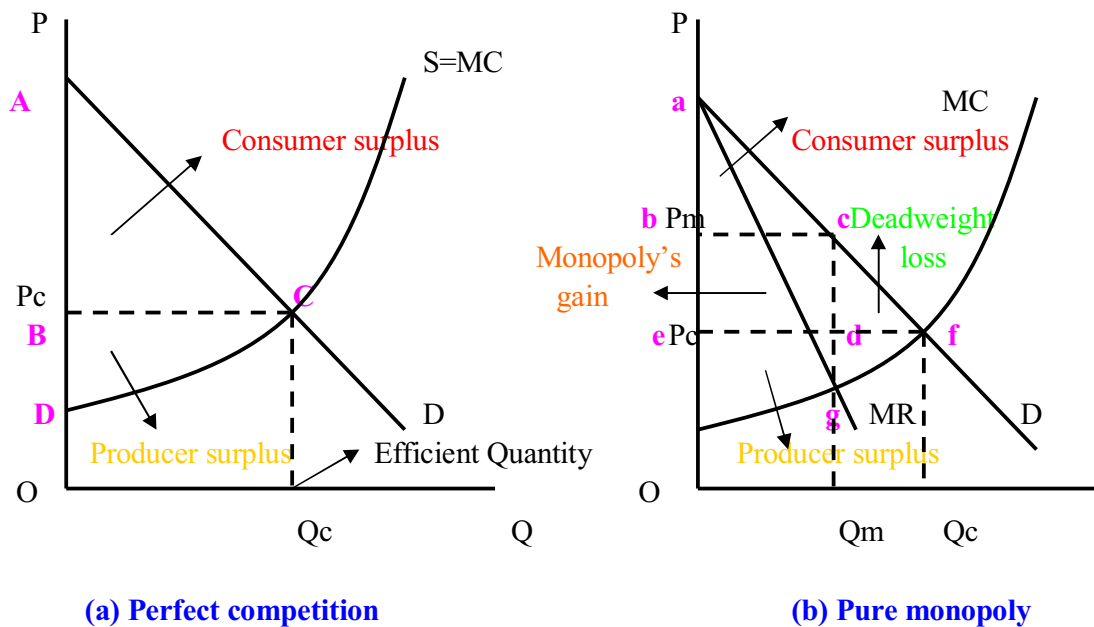


The compare of output and price can be seen from Figure 1. It shows the market demand curve (D) is the same in perfect competition and pure monopoly. However,

the market supply is different under the two situations. Equilibrium occurs when the supply curve and the demand curve intersect in the case of perfect competition. At that time, every firm can take price P_c and maximises its profit by producing the product Q_c at which the marginal cost (the cost of producing one more unit of output) equals the price. To quote Tutor2u (2003) ‘*The value consumers place on a good or service (reflected in the price they are will to pay) equals the cost of the resources used up in production*’, and production levels are just right. On the other hand, the pure monopoly maximised profit by producing the quantity Q_m at which marginal revenue (the extra revenue gained by selling one more unit per period of time) equals marginal cost. This output is smaller than the competitive output. The monopoly therefore charges a higher price P_m .

The compare of efficiency can be seen from Figure 2. Parkin (2003) has pointed out that ‘*in perfect competition, along the demand curve, consumers are efficient. Along the supply curve, producers are efficient. Where the curves intersect- the competitive equilibrium- both consumers and producers are efficient.*’ At the first place, the sum of consumer surplus (triangle **ABC**) and producer surplus (triangle **BCD**) is maximised and price equals marginal

Figure 2. Efficiency of Perfect Competition and Pure Monopoly



In perfect competition (a), consumer surplus is triangle **ABC**. With free entry, firms' economic profits in long-run equilibrium are zero. Consumer surplus is maximised. Under a pure monopoly (b), consumer surplus is reduced to the smaller triangle **abc**. The monopoly takes the rectangle **bcde** for itself. Triangle **cfg** is a deadweight loss. Part of the deadweight loss (**above Pc**) is a loss of consumer surplus, and part (**below Pc**) is a loss of producer surplus.

cost, which has been provided above from Figure 1. It shows that resources are used efficiently. In addition, as Slaman (2001) said ‘ *the combination of (long run) production being at minimum average cost and the firm making only normal profit, keeps prices at a minimum.*’ In other words, perfect competition is productive efficiency, too. Last but not least, competition keeps people ‘on their toes’. Every firm in a perfect competition situation can always aware of crises. Inefficiency means ‘out of action’. So they must improved technology then keep productive efficient. As mentioned in the first paragraph, economic welfare can also be defined as follow: economic welfare is the consumer surplus (the benefit to the buyers) plus the producer surplus (the benefit to the producers). Therefore, in the case of perfect competition, economic welfare is maximised. In Figure 2 (b), a monopoly model, consumer surplus (triangle abc) is decreased. One reason is that consumers lose partly by having to pay more money for the goods or services; the other reason is that they also pay extra for the original producer surplus loss. The total loss resulting from the smaller output in a monopoly is triangle cfg, which is called the deadweight loss. Pure monopoly limits production below the competitive level and charges a higher price. Because monopoly pushes the price up, the consumer surplus is lower and the producer surplus is higher than the perfect competition industry. Because monopoly lowers the output, the monopoly will lead the economic welfare to a relative low level. In fact, marginal revenue will be less than the price as a monopoly.

As Stiglitz and Driffill (2000) observed ‘ *Price discrimination means charging different prices to different customers or in different markets.*’ Basically, there are three different degrees of price discrimination. In the first degree, the firm sells each unit at the maximum price that the consumer is willing to pay. With this degree, marginal revenue equals the price as the case in perfect competition. Yet it is difficult to achieve in practice due to a lack of information about consumers’ reservation prices; the second degree is charging different prices for ‘blocks’ of output; the third degree is the seller divides consumers into groups or segments and charges a different price to each group. The purpose of price discrimination is to transfer consumer surplus producer surplus or profit. As Parkin (2003) indicated ‘ *demand curves slope down because the value that an individual places on a falls as the quantity consumed of that good increase.*’ The consumers get the benefit (consumer surplus) when all the goods or services can be bought at a certain price. Price discrimination is the action that a monopoly attempts to get consumer surplus for itself as much as possible. If monopoly carries out price discrimination, output will be much higher than with a non-discrimination monopoly. The deadweight welfare loss will be reduced to the minimum limit or even eliminated. There is increased allocative efficiency. And also the increased output may lead to economies of scale and increased productive efficiency. As things are, the total economic welfare will stay at the same level although the proportion of consumer surplus and producer surplus will change. Yet to collect the entire consumer surplus from every buyer, the monopoly have to offer each individual customer a single price, which is based on customer’s own willingness to pay. Obviously, such price discrimination cannot be enforced in practise because of

the lack of individual information about each consumer's demand curve.

Judging from the above, economic welfare will reduce during the process of changing from perfect competition to a monopoly charging a single price. The essential reason is deadweight loss, which is caused by monopoly inefficiency. But there is no implication to economic welfare if the monopoly practices price discrimination. Market economies need reasonable competition to keep it running effectively. Without proper competition, firms become inefficient, which will slow down the economy development and lead to a serious social X-inefficiency..

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