The tendency of the firm in a monopolistic market

Literature, Russian Literature

The type of market in which an economy operates affect the social welfare of the given economy. There are two different market types of market which are perfect competition and imperfect competition. In a perfect competition there are very many firms involved competing with each where each action does not affect the industry. Their products are undifferentiated where each industry player have the perfect knowledge of the price, cost and other relevant information of the market. Sellers can also enter and exit the market without any barrier. The market is also at its optimum because supply meets demand at the most efficient level where price is equal to marginal cost of the product.

An imperfect market on the other hand is composed of three subtypes which are monopolistic competition where many firms compete, oligopoly where there are few firms competing and a monopoly where a single company dominate the market. In a monopolistic market, firm can charge at a higher price in the long run with a restricted output and is therefore inefficient. There are also barriers to entry in the market to protect the market share of the firms. Collusions are also common to maximize profits.

These differences between perfect competition and monopolistic competition has social welfare implications. In a perfect competition, marginal revenue is the same as price and this reflects the optimum utility of goods as price is also equal to marginal cost. Supply also meets the demand at the most efficient level. This is illustrated in Figure 1 where supply and demand achieved equilibrium.

The case is different in a monopolistic competition where there are few or no

competition. The tendency of the firm in a monopolistic market is to restrict production as can be shown in Figure 1 to drive prices up as represented by P1. The market then becomes inefficient because firms are not producing at a minimum cost where price is much higher than the cost of production. This has an implication in social welfare as inefficiency would mean requiring more resources to achieve the same utility of good thereby increasing the social cost.

Figure 1

This is not the case in a perfect competition where marginal revenue is the same as price. In the diagram in Figure 2, a competitive market achieves equilibrium where demand is met with supply (MC and AR intersect). It meant that the social service can be had at its cost and is therefore the most optimum level where the needed service is appropriately supplied without waste.

Thus comparing perfect competition with a monopolistic market, price in monopolistic market is higher as shown in P1 compared to Price of perfect competition in P2. Production is also inefficient in monopolistic market as shown by Q1 as it is deliberately restricted to drive the price or P1. Production is also at its optimum in perfect competition as shown in Q2 where price is the same as cost and the demand meets the supply in an equilibrium.

Figure 2

Conclusion

To be able to support welfare, we should consider the utility of the product as reflected in price and the resources needed to support welfare. Figure 2

shows that social optimum output level is reached when price equaled to marginal cost indicating that there is no welfare loss as represented in q**. In a monopolistic market as represented in q**, the social cost is significant as the price needed to avail a certain unit of social welfare is high. The figure shows that fewer utility of welfare is availed with a higher price resulting to less than the social optimum in supporting welfare.