

What determines
price of a diamond?



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A diamond is one of the most well-known and favourable gemstones desirable as jewellery and also seen as a highly traded commodity. What then determines the price of a diamond? This essay will discuss the major determinants of price for a diamond, it will focus on the psychological and social factors in the sense that it will determine what satisfaction consumers derive from purchasing a diamond. Furthermore, it will consider its economic factors that influence price and also discuss its target market based on income, occupation and gender, and finally have a conclusion on the factors discussed in the essay.

Prices of goods are mostly determined by two factors (supply and demand) which are influenced by internal and external factors of a business. One major component that affects prices placed on goods and services is how much of a consumer's income they are willing to trade for the good. The theory of individual rationality that affects consumption behaviours of a diamond is the internal factor which involves the consumer's desire to maximise their satisfaction and also be a part of a trade-off that makes them better off. However, the consumption decision of individuals can also be affected exogenously which is not explained using the theory of rationality, which are culture, social norms and the need to conform and so on.

Diamonds are prestigious luxurious goods which have a certain level of social approval, therefore this may conclude that the social respect gained in purchasing a diamond is the personal satisfaction an individual gets. This satisfaction consumers derive must be equal to or greater than the utility of the money they traded it for, because they always maximise their utility by choosing the best optimum basket available for them which is shown

through the indifference curve (Hartmen et al, 1991). Also, Sherwin Rosen (1974) stated that goods are priced on their ' utility-bearing attributes or characteristics' this means that the utility derived from purchasing a good has a major influence on how much they are willing to sacrifice to maximise their utility.

Economic factors are one of the significant determinants of the price of a diamond, government policies such as taxation also impacts the prices placed on a diamond. The taxes placed on a diamond varies as the government imposes a higher or a lower taxation rate depending on a country's economic policy such as price control. When a higher tax is placed, firms tend to increase the price of their product to maximise profit and on the other hand, the price of a diamond is lower because they pay a lower tax. This explains the difference of prices placed on a diamond in different countries, in Nigeria the sales tax of a diamond is 5 percent while in the United Kingdom the sales tax is 20 percent which is 15 percent higher than that of Nigeria (DutyCalculator, 2015). It however explains that the price of a diamond in Nigeria would be low while on the other hand the price of a diamond in the United Kingdom is higher, this shows that the rate of tax in a country also determines the price of a diamond in a country.

Another factor which influences price is the type of market structure the firm is in, which does not involve the consumers. The uniqueness of a diamond suggest that it is a monopolist and has no substitutes, which means they face a downward sloping demand curve and at higher prices they sell less output. The firm is a price maker, the prices it charges are greater than marginal costs (depending inversely on its elasticity of demand), the prices it

can charge however depends on the quantity it sells. As they increase their monopoly power, the attraction of low output and higher prices results to a higher and even super normal profits (Blanchard, Kiyataki 1987). Another economic factor that decides price of a diamond is cost of production, diamonds are the most common gemstone but when priced, it seem a lot rare. The world's main supplier of diamonds is the De Beers Company who controls most of the world's diamond mines and limits the quantity of diamonds supplied in the market as it has 80 percent of the market share similarity of products. Diamonds have to go through a certain chain of production before reaching the final consumers, rough diamonds are mined then sorted and sold to cutters and polishers who cut and polish the diamonds, jewellery manufacturers create the finished pieces before passing it to the retailers who sell the finished Jewelleries to the consumers. This process alone determines the price of a diamond, if the cost of production increases it will shift the supply curve to the right and this would increase price.

Budget constraints which is seen to be one of the major factors and arguable the most important factor in individuals ultimate consumption decision which limits consumer choice. Rational choices theory would dictate that consumers are better off if they make consumption decision within their budget line. The budget line shows the combination of available basket a consumer can make decision to fully utilize their budget and maximize utility, however, the target market of a diamond are wealthy individuals who may not be affected by budgets but there will be an opportunity cost that is incurred. No matter how wealthy an individual is, as long as all resources are

limited forcing individuals to consider to forgo a satisfaction or an alternative they could have gained from purchasing another good.

In conclusion, a price of a diamond is influenced by various factors. The main factors which were discussed in the essay are the percentage of income a consumer is willing to trade with to own a diamond jewellery, the theory of rationality which describes how consumers purchase a diamond to gain a level of satisfaction. It also explains its market structure and its monopolistic power giving it the ability to charge high prices, economic factors such as government policies and cost of production. Finally, it is vital to understand the complication of model which involves a large number of individuals subjected to free will, therefore they have their personal reason for making a choice which is difficult to explain in a graph and involve everyone in the market.

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