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Monopoly – price discrimination Monopoly is a market structure where one firm serves the entire market. A monopolist can maximizes their profit withtheir knowledge of the market demand and the power of single operation in the market. A monopolist can set the price at a level they desire and the price decision is determined by their output decision. (Chakraborty, 351-354) Pricing Decision of a Monopolist A monopolist faces the negatively sloped market demand curve unlike in perfect competition where a firm faces the market competitive price. Therefore a monopolist sets the market price where its MR= MC. The logic is that the cost required to produce another unit of the output should be equal to the revenue generated from that additional unit. It is illustrated as follows. AR MC MR AC P P’ Q Q’ In the above diagram, the monopolist decides output at the point where MR= MC. The corresponding price from the demand curve is then set which is P > P’. P’ is the perfect competition price and Q is the corresponding output. (Chakraborty, 351-354) Monopoly and Deadweight Loss The monopolist makes a higher profit due to the single market and manages to appropriate a part of the consumer’s surplus. D P M P’ E C O Q MR AR In the above diagram the consumer surplus was DP’C under perfect competition. The monopolist appropriates PMEP’ amount of consumer surplus. Its producers’ surplus is P’EQO. Therefore loss of social welfare or the deadweight loss is EMC. This is lost from the society due to inefficiencies of monopoly. (Chakraborty, 351-354) Perfect Discrimination Perfect price discrimination is a special case of monopoly where the producer can extract the maximum price from each buyer. The producer in this case deals with each consumer individually. He has perfect information about the buyers. Therefore he is able to charge a price high enough from each buyer. The prices in this case differ from buyer

to buyer. In other words each unit is sold to the consumer who pays the highest price, ie, the individual who values that unit the most. Thus the consumer does not have a remaining surplus. The price to the last buyer will be equal to the marginal cost. Before that the monopolist makes profit on each unit sold. In this way the marginal revenue curve becomes the demand curve. Under perfect price discrimination a monopolist produces the same amount of good that would have been produced under perfect competition. It can be explained by the fact that the consumer will keep buying the product as long as it is above the marginal cost. In this way he successfully takes away the entire consumers surplus. Therefore under perfect price discrimination the sum of producer's surplus and consumer's surplus is maximum. Therefore there is no deadweight loss. This is illustrated by the following diagram. (Chakraborty, 351-354) A E P O Q Under perfect monopoly the firms extract the maximum price the consumer is willing to pay for each unit. Therefore the marginal revenue curve is the same as the demand curve. The Producer's surplus is given by AEO. The monopolist takes the complete consumers' surplus away. Therefore there is no deadweight loss. (Chakraborty, 351-354) Bibliography Chakraborty, Satya R., Microeconomics, Kolkata, Allied Publisher, 2009.