

Monopolistic Competition

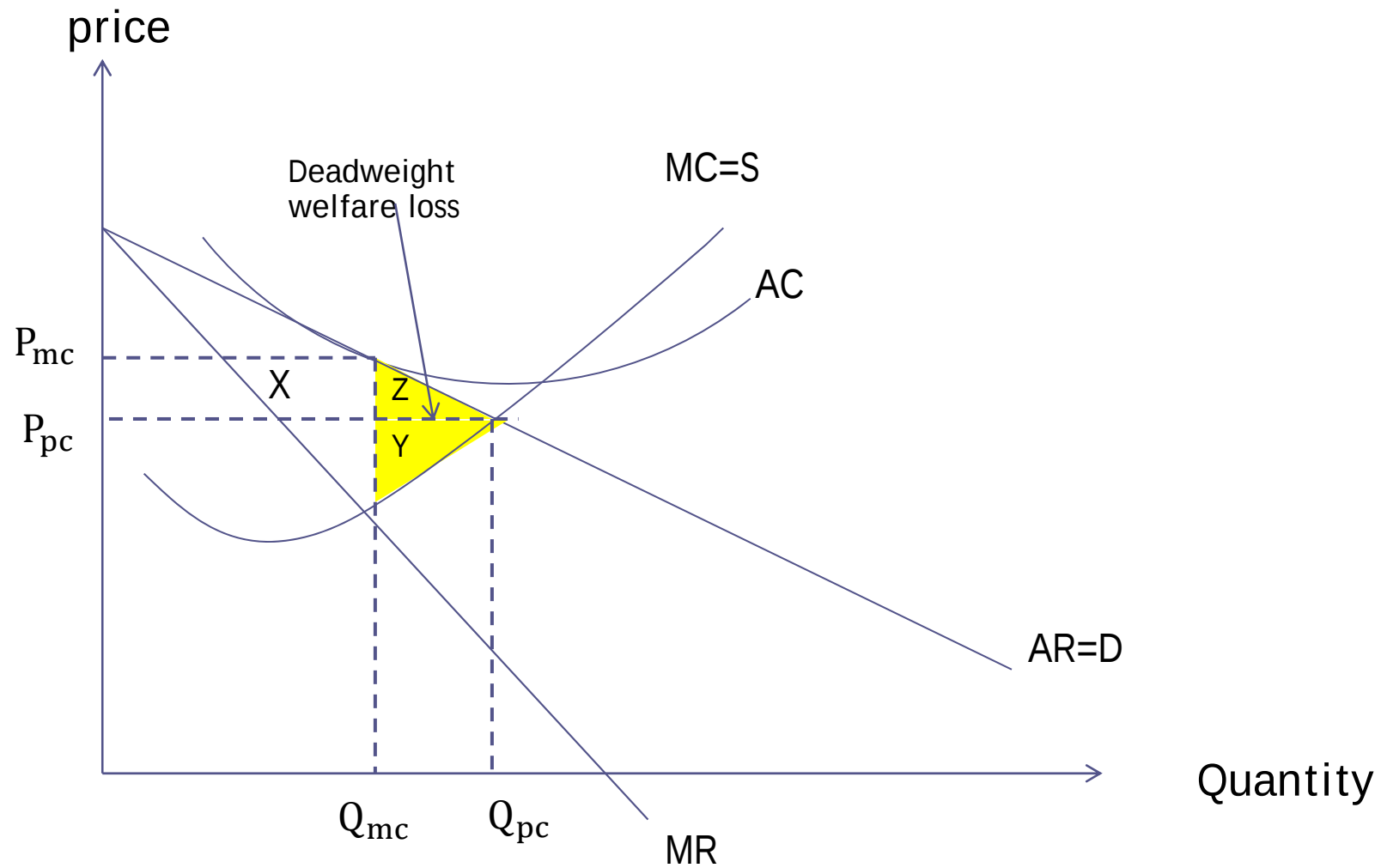
EE 382



The model and outcomes

- The middle structure between monopoly and perfect competition
- Many firms that are all supplying similar but not identical, products to the market
- Barriers to entry and exit but they are not completely prohibitive
- Possible for producers to earn abnormal profit in the short run

Monopolistically competitive producer in the long run



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- The price under monopolistic competition will be **higher** and the output **lower** than under the more competitive structure
 - A monopolistically competitive producer is **unlikely to be productively efficient** because there is not the same degree of competitive pressure as in perfect competition
 - The producer is **not operating at the lowest point on its average cost curve**
 - It is producing an output that is lower than that necessary for productive efficiency so that it is able to charge a higher price for it

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- The producer does that because it increases the size of its producer surplus
 - Compared to the producer surplus under perfect competition it loses area Y but gains area X, causing a significant net gain
 - This gain is at the expense of the consumers, though, who experience a reduction in surplus of areas X and Z
 - There is a reduction in total market welfare of areas Y and Z – the deadweight welfare loss
 - Not Pareto efficient

Competition

- In perfect competition the products are homogenous – the only form the competition can take is that of price competition
- In monopolistic competition – there will be price competition and in the long run producers are unable to charge a price higher than that leading to normal profit
 - New entrants would come into the market to compete the abnormal profit away

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- Products are **not homogenous** in monopolistic competition – there will be brand competition
 - Producers will attempt to **differentiate** their product from those of their competitors
 - If consumer view it as being different in some way the producer will effectively have a niche market monopoly within the wider market
 - Able to use this market power to charge a price that will earn it abnormal profit in the short run until its competitors respond to compete it away

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- A number of ways that a producer can achieve this and all are to be expected within a monopolistically competitive market
 - Advertising
 - Produce development
 - Patent protection



The road-haulage market in the European Union and Great Britain

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- The road haulage market has experienced strong and consistent growth in terms of the volume of freight that it transports, rising from 1.248 billion ton-km in 1995 to over 1.6 billion ton-km in 2004
 - Its share of the total freight transported by all the modes of transport to increase from 42.1 per cent in 1995 to 44.3 per cent in 2004

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- Road-haulage companies have diversified
 - Compete in their provision of logistics services and warehousing
 - Such diversification and competition to differentiate their products- **Monopolistic competition model**

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- To establish a road-haulage company it is necessary to obtain
 - An operator's license
 - To purchase or hire a fleet of vehicles
 - To employ the drivers and admin. Staff
 - To conduct the necessary marketing
 - These costs can be significant indeed and so there are clearly barriers to entry in the road-haulage market, but these are by no means entirely prohibitive

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- In order to obtain an operator's license, applicants must satisfy the following conditions
 - Must be of Good repute
 - No serious criminal conviction
 - Must be professional competent
 - Holds a certificate of professional competence in road haulage
 - Candidates whom fail the course and are required to enter the examination again, re-incurring the entrance costs and any additional tuition

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- They must have adequate finance
 - They must have a center from which to operate that has sufficient off-street parking for all vehicles allowed on the license
 - They must have maintenance facilities, which can take the form of a legally binding agreement with a commercial repair garage or agent
 - They must advertise their intention to use the proposed premises as an operating center in a local newspaper, asking for objections from the local populous on environmental grounds



The taxi market in the City of Leicester



The market will comprise of two distinct operations

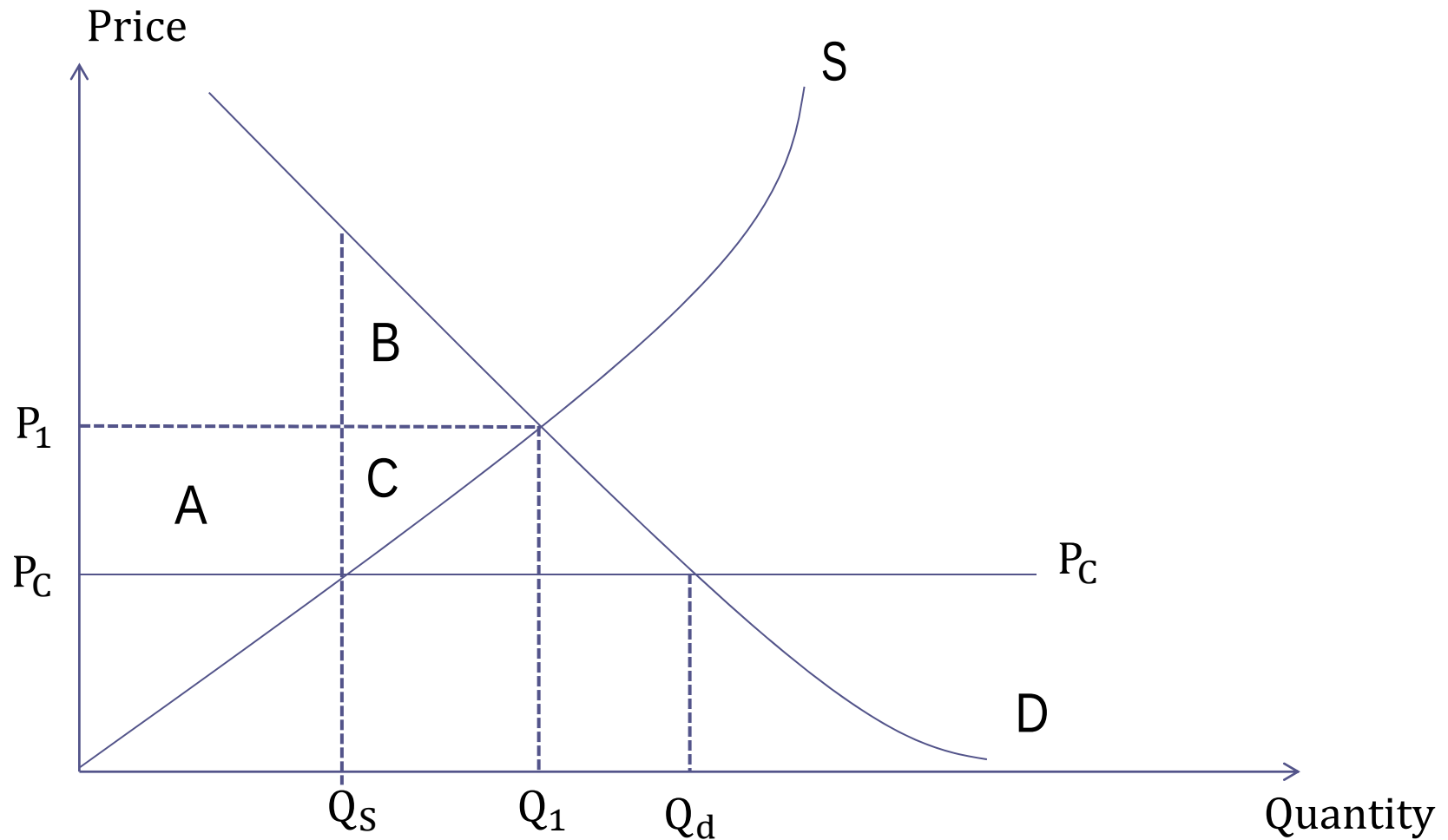
- Hackney carriages
- Private hires

Hackney carriage fares within the boundaries of the City of Leicester, 2006

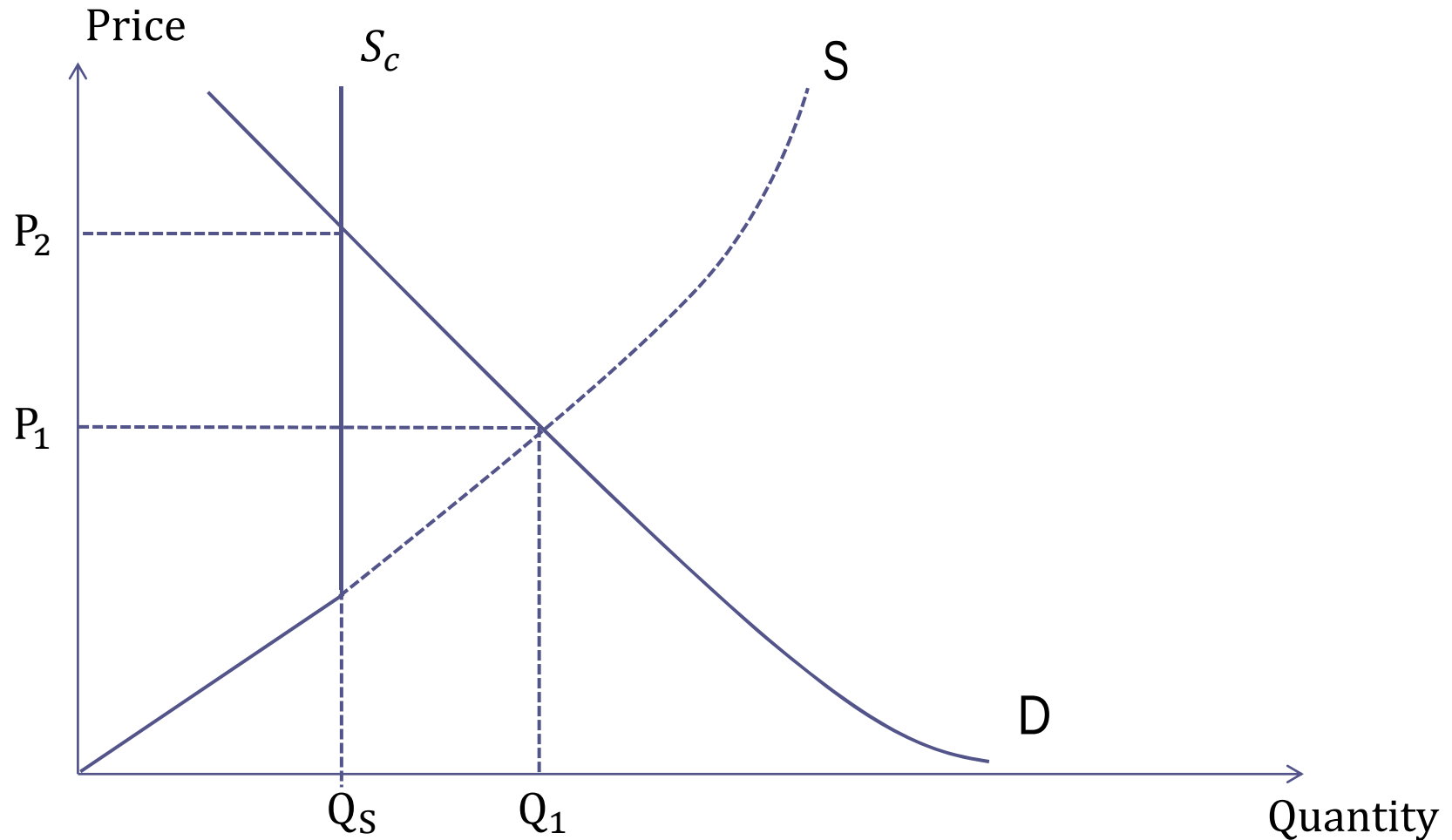
	Tariffs(£)		
	Switch-on	Each 115 meters of part thereof	Each 25 seconds waiting time
Day times: Monday to Saturday (0600 to 2200)	2.20	0.10	0.10
Night-time (2200 to 0600)	2.70	0.10	0.10
Sunday	2.70	0.10	0.10
Bank-holidays	2.70	0.10	0.10
24 and 31 December from 0600 to 2100	5.20	0	0
25 and 26 December and 1 January from 0600 to 2100	5.20	0	0
24,25 and 31 December and 1 and 2 January from 2100 to 0600 and 26 December from 2100 to 0000	5.70	0	0
Soiling charge		50	

Source: Leicester City Council

Price ceilings



The imposition of a supply constraint





Private hire operators

- Premises must be licensed as a private hire operators base
- All vehicles to run from the business must be licensed as private hire vehicles
- All drivers must be licensed as hackney carriage and private hire vehicle drivers

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- In 2006/2007 – 166 private hire operating companies advertising in the City of Leicester
 - Offer a wide array of slightly differentiated services
 - Specialized for the disabled or executive and luxury operations
 - Use more expensive vehicles
 - Larger vehicles for transporting
 - Services guaranteeing female drivers etc.
 - The fares charge are far from uniform



With such a volume of operators in the market

- offering slightly differentiated services
- investing in advertising and charging different prices
- with the existence of non-prohibitive barriers to entry in the form of licenses and fees

the market is clearly one of monopolistic competition



Reference

- Mallard G., and Glaister S. (2008). Transport Economics: Theory, Application and Policy. Palgrave Macmillan.