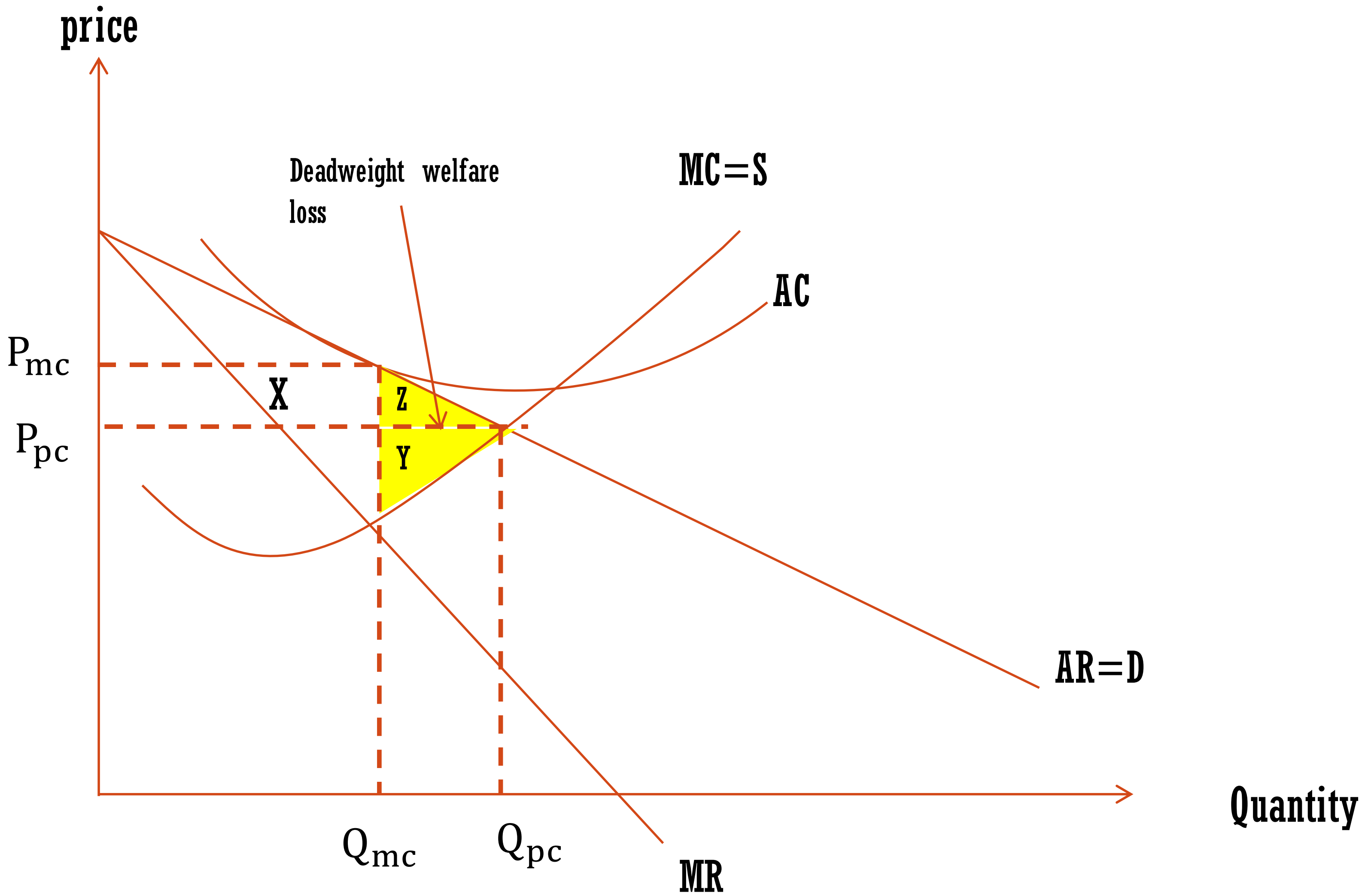
MONOPOLISTIC COMPETITION

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



- 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

- 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

- Assuming that the cost curves are the same under monopolistic competition as they are under perfect competition, which is an unrealistic assumption because the cost curves could be significantly different duet to the same of the producers, it is possible to compare the outcomes of each market structure

- The price under monopolistic competition will be higher and the output lower than under the more competitive structure

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

- 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

- 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 RELIANT ROBIN

- The Reliant Robin is a good example of such product differentiation
- Three wheeled vehicle was one in a range of cars manufactured and licensed by Reliant Motors Ltd since 1935
- It was launched in 1973 and was vastly different from the other products in the motor-vehicle market as it could be driven by people holding only a motorcycle license
- The advertising focuses on this advantage and that the vehicle would be good value for money and cheap to run

- The Robin Reliant targeted consumers that no other car could do and so it earned Reliant Motors Ltd monopoly power within its niche market – that of the less wealthy consumers
- Even within its particular market Reliant Motors produced a variety of Robin models including the Standard Robin, the Super Robin and the Robin Van to add further differentiation to its image
- Today the vehicles are more collectors' items rather than being popular with road users

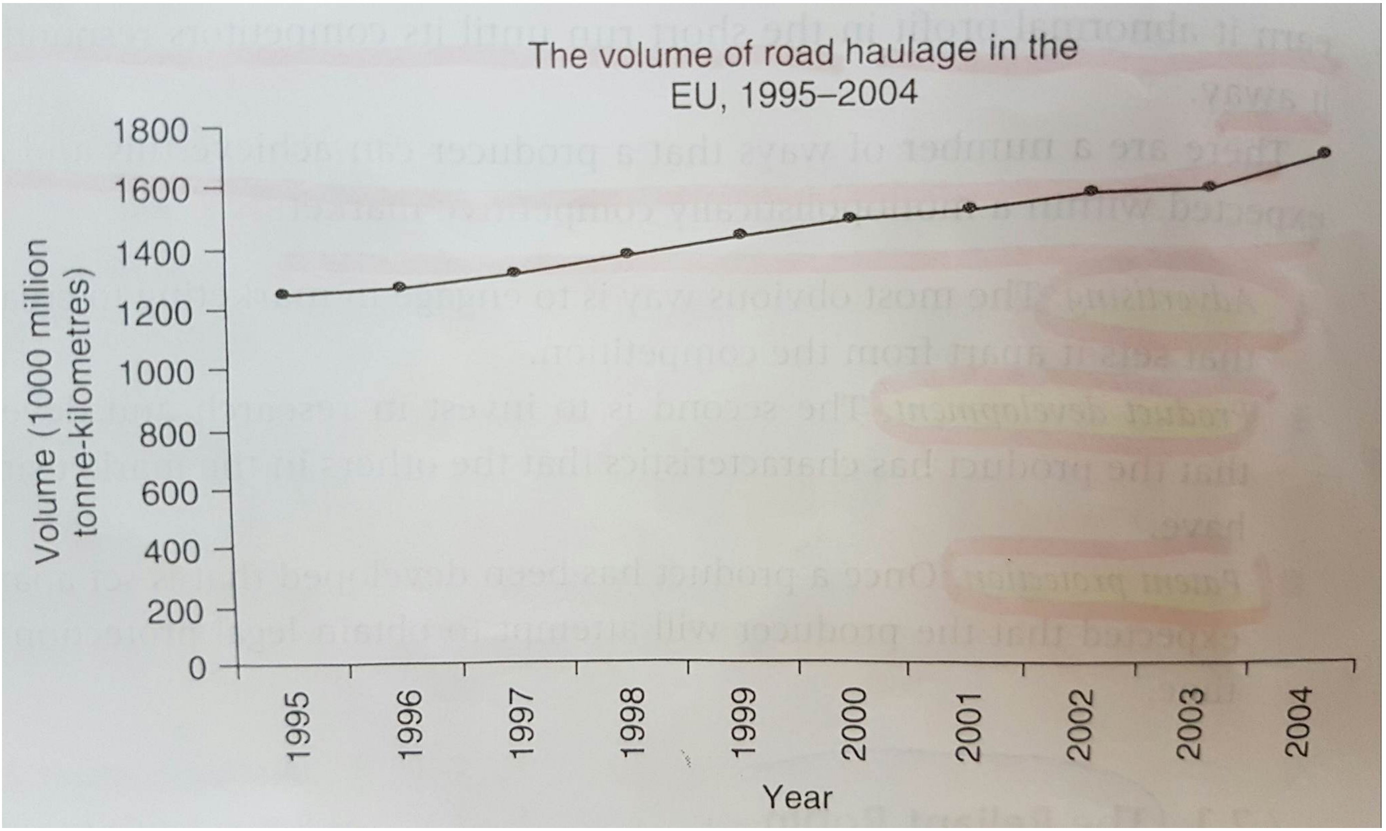
THE ROAD-HAULAGE MARKET IN THE EUROPEAN UNION AND GREAT BRITAIN

- The road haulage market in the EU is a good example of a monopolistically competitive market

- 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

THE GROWTH IN THE VOLUME OF FREIGHT TRANSPORTED BY ROAD IN THE EU



Source: European Commission, Directorate-General for Energy and Transport in co-operation with Eurostat, Energy and Transport in Figures, 2005

- 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

- 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

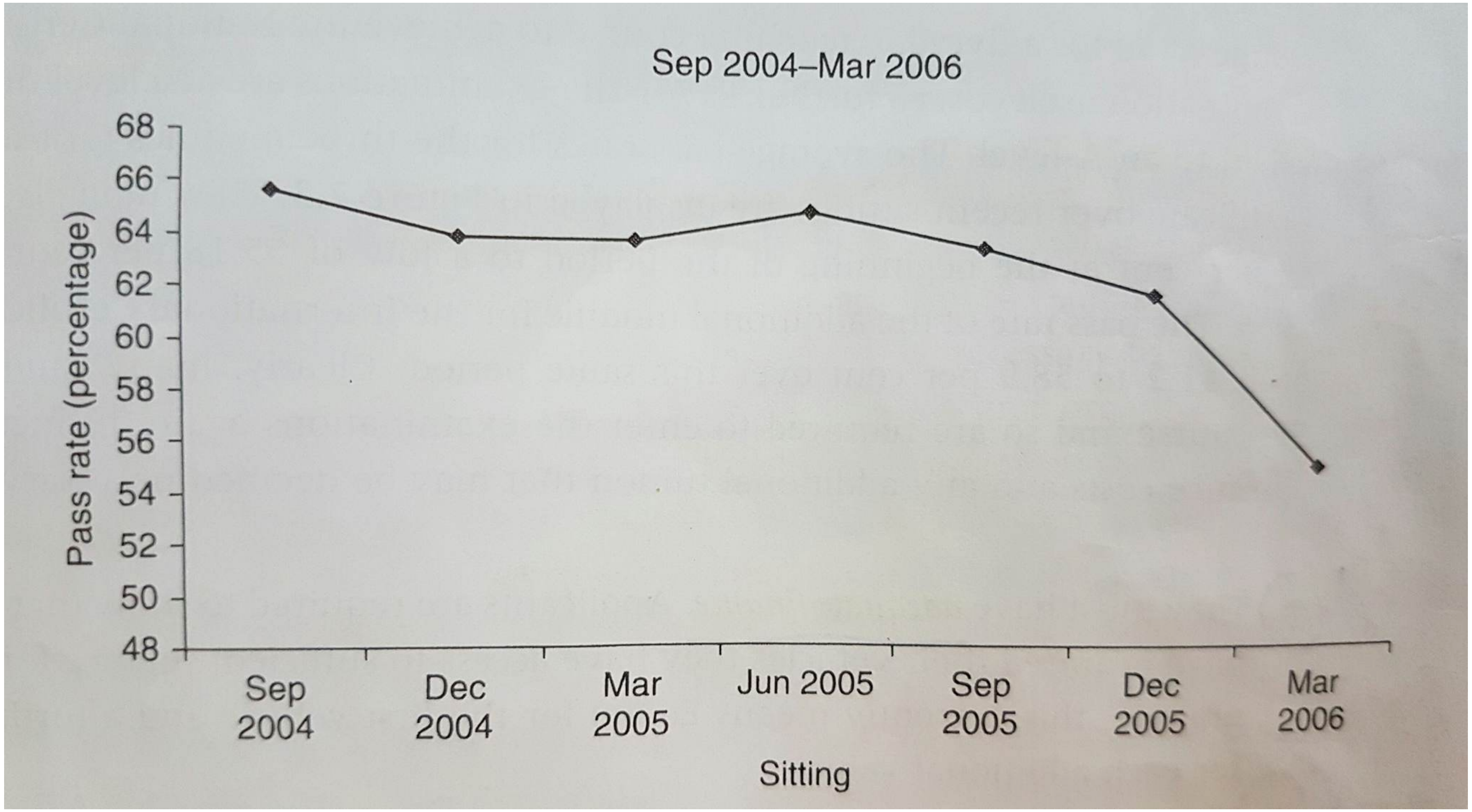
- Entry to the British road freight market is strictly controlled and had been since the Road Traffic Act of 1930

- This act established a number of Traffic Commissioners whose principal duties were to license road freight and passenger operators and to license and regulate the fares of bus companies

- There are seven Commissioners across the country that still grant licenses and hold their own disciplinary courts, called Public Inquires

- 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

THE RECENT AVERAGE PASS RATES ACROSS THE THREE MODULES OF THE OCR CERTIFICATE OF PROFESSIONAL COMPETENCE IN NATIONAL ROAD HAULAGE



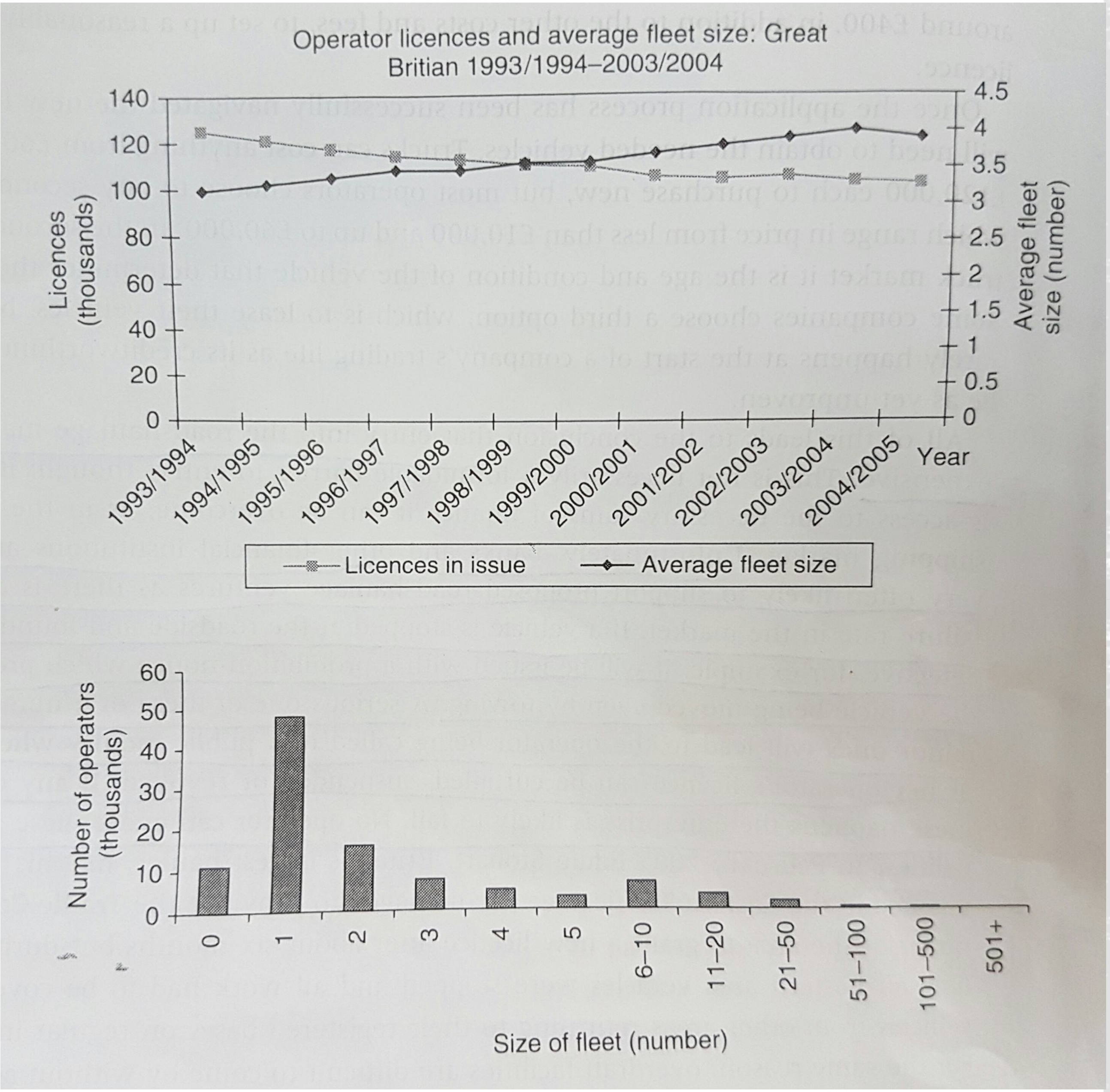
Source: The Oxford, Cambridge and Royal Society of Arts Examination Board (OCR)

- 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

All of this leads to the conclusion that

- entry into the road-haulage market is expensive - this is not necessarily a formidable barrier to entry, though; if there is access to the necessary sums of finance it can be overcome
- Banks and other financial institutions are not very often likely to support proposed road-haulage ventures as there is a high failure rate in the market

- There are barriers to entry into the road-haulage market: bureaucracy, licenses, capital costs with scarce sources of finance and sunk costs



Source: UK Department for Transport 2006

FIGURE 1:THE COMPOSITION OF THE ROAD-HAULAGE MARKET IN GREAT BRITAIN

FIGURE 2:OPERATOR FLEET SIZES IN GREAT BRITAIN, 2003/2004

THE TAXI MARKET IN THE CITY OF LEICESTER

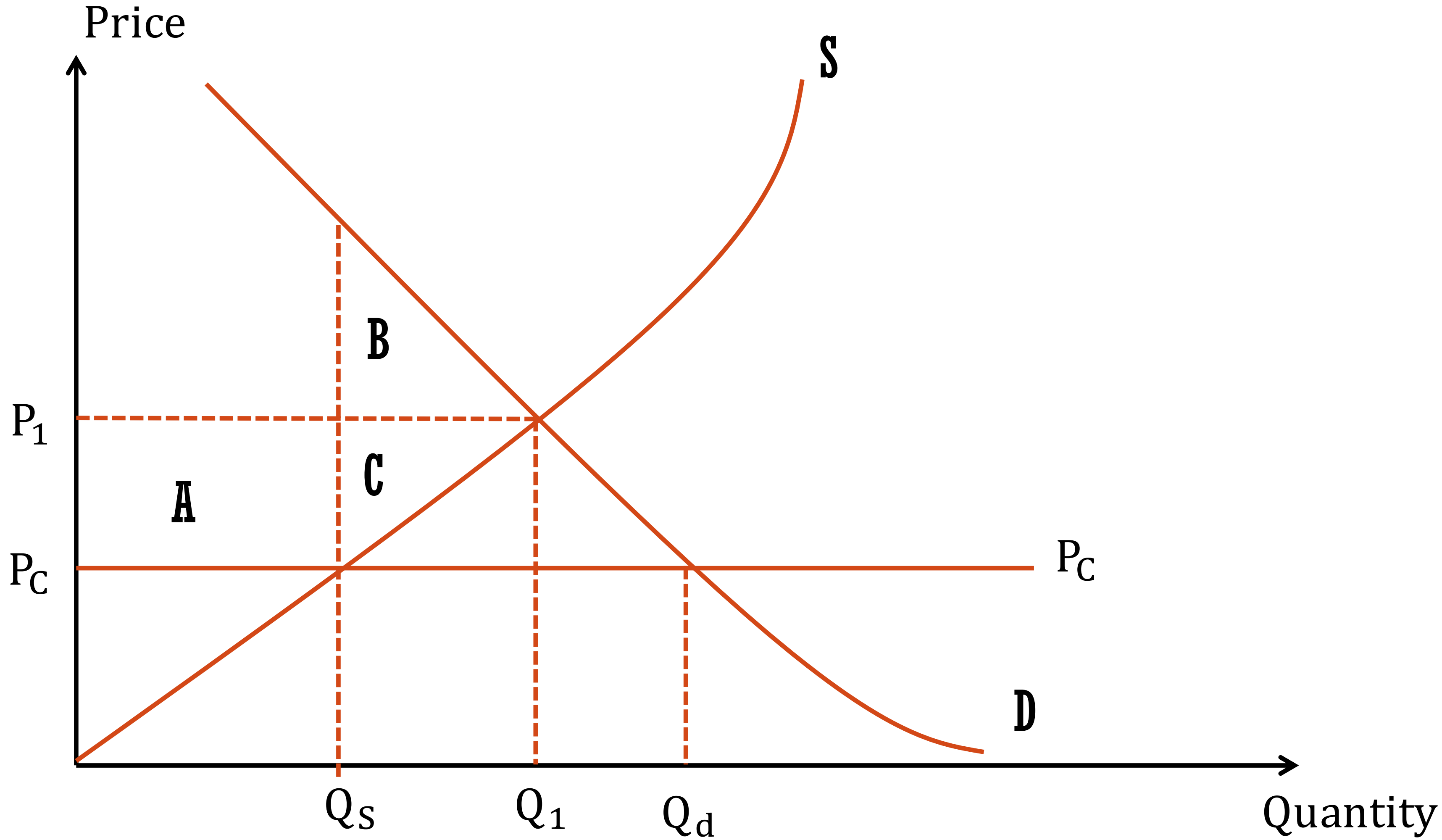
- Taxi market are location specific and so it is not appropriate to look at them at a national level
- In each locality it is likely that the market will comprise of two distinct operations:
  - Hackney carriages
    - One does not need to obtain an operator's license to establish a hackney carriage business but it is necessary to be a licensed hackney carriage driver to use vehicles that have been registered by the local authority for such use
    - Only license a limited number of cabs which are then required to have fare metres fitted and calibrated to the current pricing schedule
  - 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

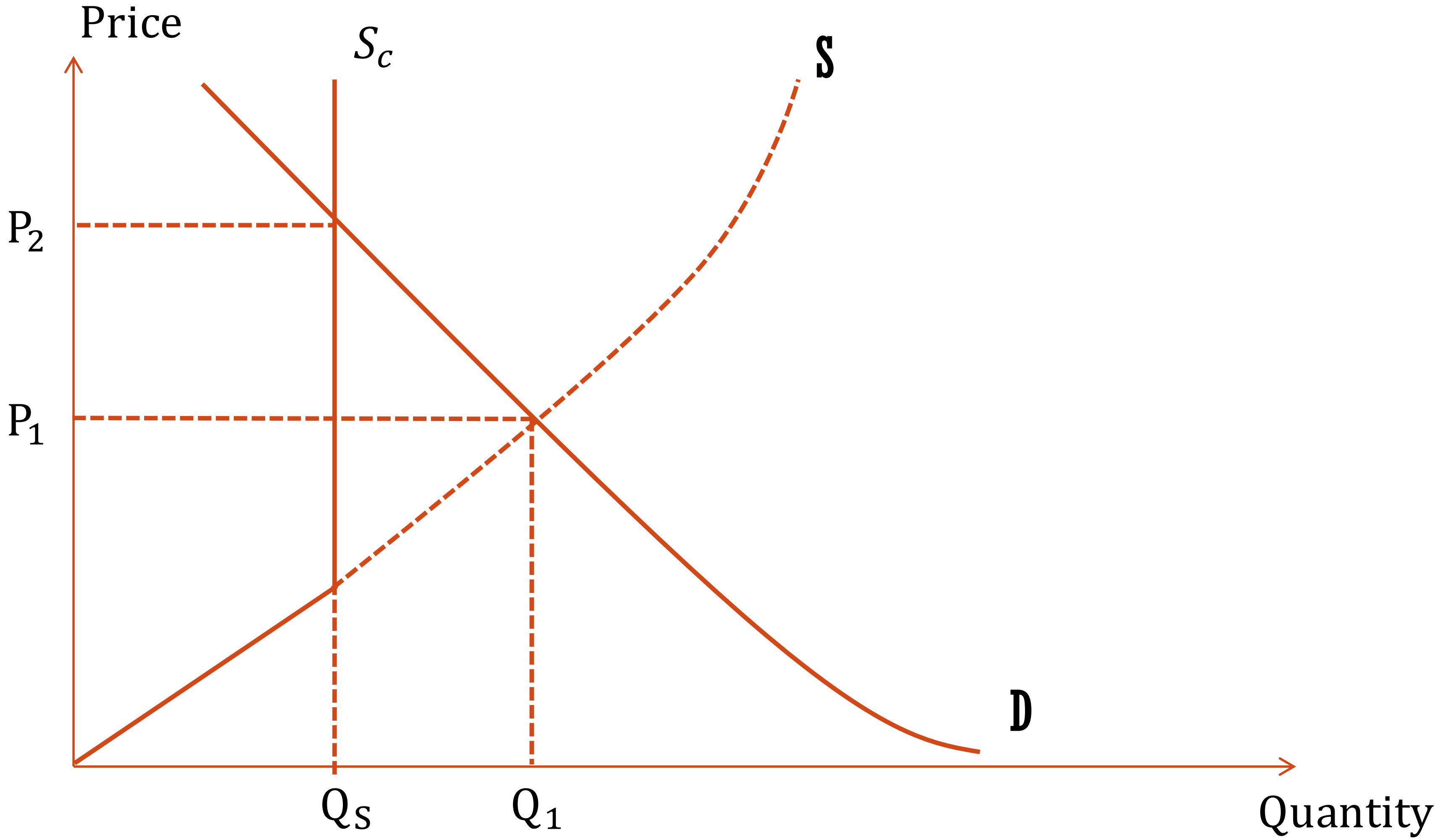


PRICE CEILINGS

- There is a deadweight welfare loss, society is also worse off and is no longer Pareto efficient

- Councils are willing to accept this result to provide passengers with the increase in consumer surplus

THE IMPOSITION OF A SUPPLY CONSTRAINT



- As the Council is only willing to license a set number of vehicles the hackney carriage market is also subject to a supply constraint, which is shown by the vertical section of the supply curve

- This would reduce the welfare of consumers to a level below that in the free market, which strengthens the reason for the Council imposing a price ceiling as well

- If the price ceiling is set correctly, the quantity supplied will automatically fall to the desired level of Q2

- The problem is that it is not practically feasible for policy makers to perfectly estimate how quantity supplied will respond to an enforced change in price- they cannot perfectly construct the supply curve in the market

- Simply relying on a price ceiling would leave the resulting quantity supplied in the market to an element of change and so it is necessary to impose both forms of intervention in order to be certain of the outcomes

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

- 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.