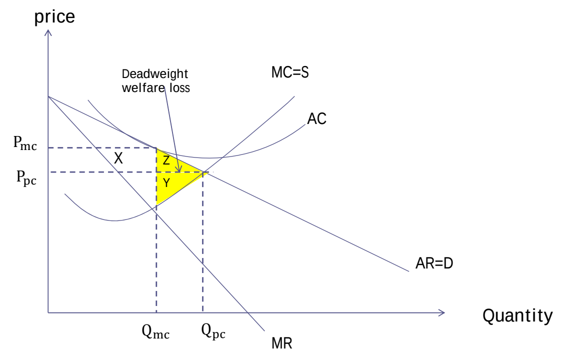
Monopolistic Competition

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

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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

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

- 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

- 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

- 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

- 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

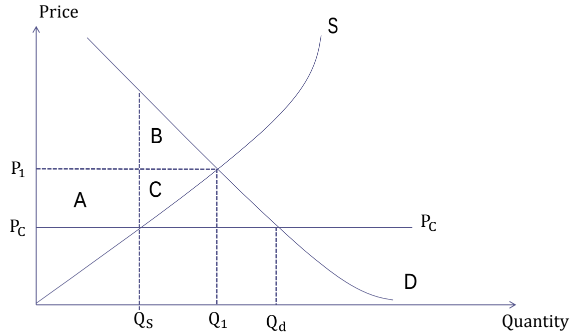
- Hackney carriages
- Private hires

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

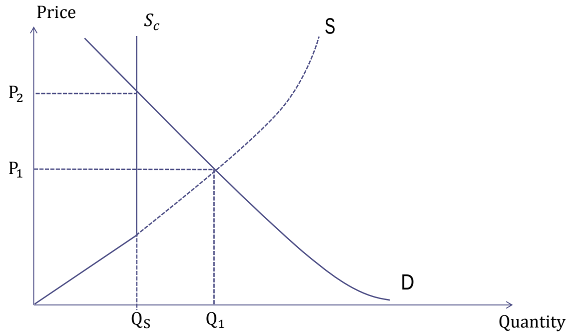
	Tariffs(£)		
	Switch-on	Each 115 meters of part thereof	Each 25 seconds waiting time
Day times: Monday to Saturday (0600 to 2200)	2.20	0.10	0.10
Night-time (2200 to 0600)	2.70	0.10	0.10
Sunday	2.70	0.10	0.10
Bank-holidays	2.70	0.10	0.10
24 and 31 December from 0600 to 2100	5.20	0	0
25 and 26 December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

- 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.