Class: B.Com Part I

Subject: Business Economics and Environment.

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Unit: IV

Topic: Monopoly and Price Discrimination

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Monopoly and Price Discrimination:

According to Prof. Braff, "Under pure monopoly there is a single seller in the market. The monopolist's demand is market demand. The monopolist is a price maker. Pure monopoly suggests a number substitute solution".

According to Stigler, "Price discrimination is the sale of various products at prices which are not proportional to their marginal cost.".

Price Determination in Short-run under Monopoly:

In a short period, a monopolist operates in situations of super-normal profit, normal profits or even in loss. The monopoly price may be greater than, equal to or less than the monopoly price is greater than average cost the firm earns monopoly profits. If it is equal to average costs; it earns normal profit. The monopoly firms will continue to operate in the short period even if the price does not fully cover its average costs. But the price should not fall below the average variable costs. It is not necessary that a monopoly firm always makes profit. There is no guarantee that a monopoly firm will always make profits in the short period

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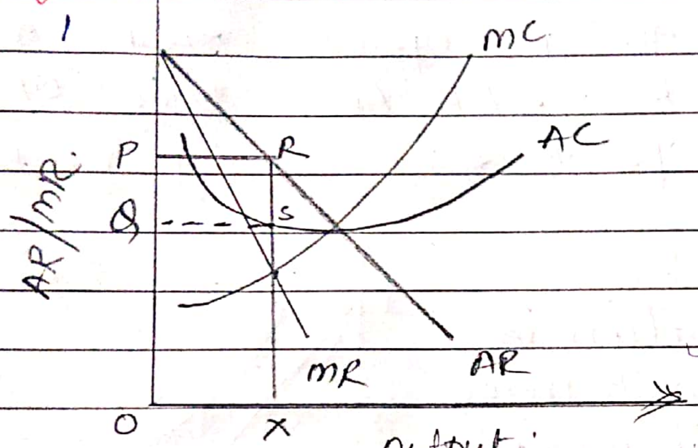
In fact whether a monopoly firm makes profit or loss in the short run depends on its revenue and cost conditions. The equilibrium of the monopoly firm in the short period has been represented here diagrammatically.

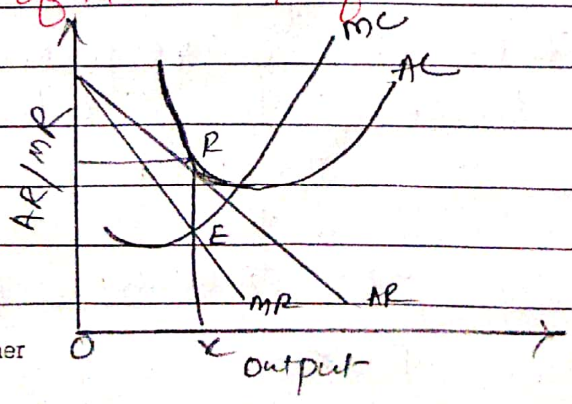
(i) Profit Situation:



Monopoly short period profit.

In the figure AR curve is the demand curve of a monopoly firm is in equilibrium at point E where equilibrium conditions are satisfied. At this point MR = MC. RX (or OP) is the monopoly price charge by the firm SX (or OQ) is the total unit cost. The area PRSQ represents the monopoly profit at OX output. Price = OP, output = OX Total profit = Profit per unit X Output Area PQRS.

(ii) Situation of Normal Profit:



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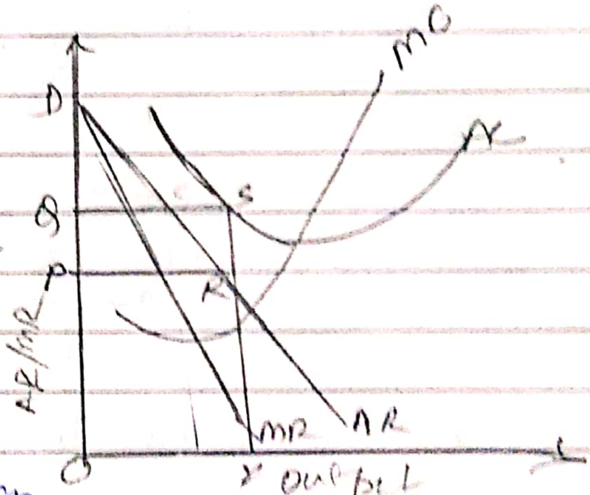
The short run equilibrium of the monopolist is shown when he earns only normal profits It is zero profit situation. The equality of MC and MR curve at point E determines OX output which is sold at OP price. Since AC curve is tangent to the AR curve at this level of output the monopolist earns normal profit. At point R, AR = AC, price = OP, Output = OX / Monopolist earns only normal profits.

(iii) Situation loss :-



As per the situation in which the monopolist incurs losses. The equilibrium point E is determined by the equation MC = MR. But monopoly price OP, as fixed by demand condition does not cover the short run average costs of production. If the price covers the average variable cost, the firm will continue its operation even though the price does not cover the average total unit cost fully. In the figure RX is the price per unit and average cost per unit is SX. The firm suffer a loss of SR per unit. The total loss is represented by the area PRSQ. If however, the price fall below the average variable cost, the monopoly firm will cease operation even in the short period.

Price OP = OP, Output = OX Total loss = Loss per unit X Total output

Area PQRS.