Class: B.Com Part I

Subject : Business Economics and Environment.

Paper : I

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Topic : Price Determination in long-run under Monopoly

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Price Determination in Long-run Under Monopoly:

In monopoly, there is a single seller of a product called monopolist. The monopolist has control over pricing, demand, and supply decision, thus sets prices in a way, so that maximum profit can be earned. The monopolist often charges different prices from different consumer for the same product. This practise of charging different price for identical product is called price for the differentiated product.",

According to Dooley, "Discriminatory monopoly means charging different rates from different customers for the same goods and services."

In the long period, the monopoly price would be higher than the average total unit cost to enable him to earn excess or monopoly profit. In the short period, a monopoly firm may earn super-normal profit, normal profit or even losses, Since there is no possibility of the entry of the new firms into the industry, the monopoly firm could go on earning excess or super-normal profit in the long period.

In long period when firm expands internal and external economies of large scale production arises. The economies of large scale production implies that there are certain benefite which can be derived by a firm only when its scale of output is quite large. These economies reduce cost of output per unit. Increasing return to scale operates when economics of scale are greater than

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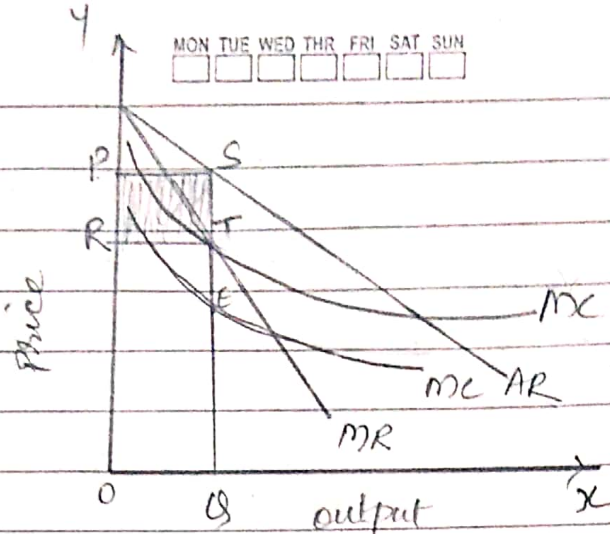
diseconomies of scale and returns to scale decreases when diseconomies are greater than the economies of scale. When economies and diseconomies are in balance, return to scale becomes constant. Benefits of Internal and external economies bring increasing return to scale. Constant returns to scale operates when a firm attained the point of optimum capacity.

As a result, the law of constant returns to scale begins to operate. When a firm goes on expanding its output then ultimately diminishing return to scale will occur. Beyond the point of optimum capacity, economies of scale are replaced by diseconomies of scale which lead to rise in cost per unit of output in constrast to economies which lower the cost of production. In the long-run, with entry blocked the monopolist earns super-normal profit in three stages of returns to scale - Increase returns to scale, constant returns to scale and decreasing return to scale

(i) Increasing Returns to Scale Conditions (or Decreasing Cost conditions).

The monopolist's equilibrium in increasing return to scale (or decreasing cost) when AC and MC both curve fall but MC curve fall but MC curve falls more rapaidly According to the equilibrium conditions, the monopolist is in equilibrium at point E

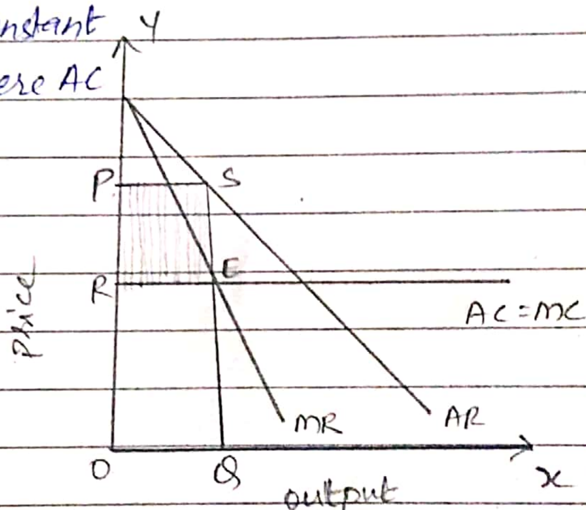
At Equilibrium point E
price per unit = OP or SQ
Cost per unit = OR or TQ
Total output = OQ
profit per unit = OP − OR = PR = ST
Total Profit = Area PRTS.



(ii) Monopolist's equilibrium in constant return to scale condition (or constant cost).

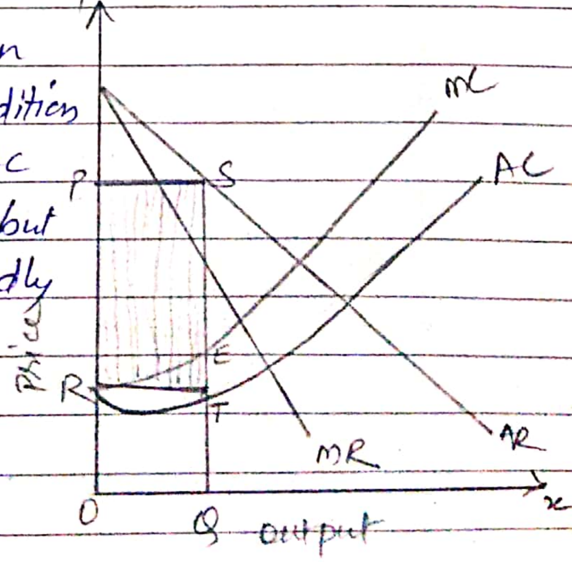
Monopolist's equilibrium in constant return to scale condition. where AC and MC are equal.

At equilibrium point E
price per unit = OP or SQ
Cost per unit = OR or EQ
Total output = OQ
Profit per unit = PR = SE
Total profit = Areas PRES



(iii) Monopolist's Equilibrium in Decreasing Return to Scale (or increasing Cost conditions).

It respresent monopolist's equilibrium in decreasing return to scale or increasing cost condition
Due to decreasing return AC and MC both are increasing but MC is increasing more rapaidly
At equilibrium point E
price per unit = OP or SQ
Cost per unit = OR or TQ
Total Production = OQ
profit per unit = PR or ST
Total profit = Area PRTS



Thus, monopolist earn profit in all cost condition.