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Social cost of Monopoly

When an industry is monopolized prices rises above and output falls below the competitive level. Those who continue to buy the product at the higher price suffer a loss, but this loss is exactly offset by the additional revenue that the monopolist obtains by charging the higher price. Other consumers, who are deflected by the higher price to substitute goods suffer a loss. This is the 'deadweight loss' from monopoly, and in conventional analysis only social cost of monopoly. The loss suffered by those who continue to buy the product at the higher cost is regarded merely as a transfer from consumers to owners of the monopoly seller and has not previously been factored into the social cost of monopoly.

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The opportunity to obtain monopoly profit will attract resources and the opportunity cost of those resources are social cost of monopoly too.

Social cost of monopoly.

(1) Normally monopoly output is lower than competitive output. The reserve capacity leads to misallocation of resources.

(2) Monopoly price is higher than competitive price. Lower output and higher cost result in inefficient mix of output. The fall in consumer surplus is larger than monopolist profit, thereby causing a net loss in social welfare.

(3) Monopoly profit is associated with concentration of income and wealth in the hands of the Industrial houses.

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Monopolist rent seeking behaviour consumes resources and adds to social cost, thereby reducing social welfare further.

Social Cost of Monopoly:- This can be measured in terms of market inefficiency and loss of consumer surplus.

Rules for Allocative Efficiency: P = MC.

Monopoly fails to attain allocative efficiency since at equilibrium, P > MC.

Perfectly competitive firms attain allocative efficiency as they operate where P = MC.

Productive Efficiency P = Min - AC.

At monopoly equilibrium P > min - AC.

Competitive firms achieve it in the long run.

Price must equal marginal cost (P = MC) for markets to produce what people want.

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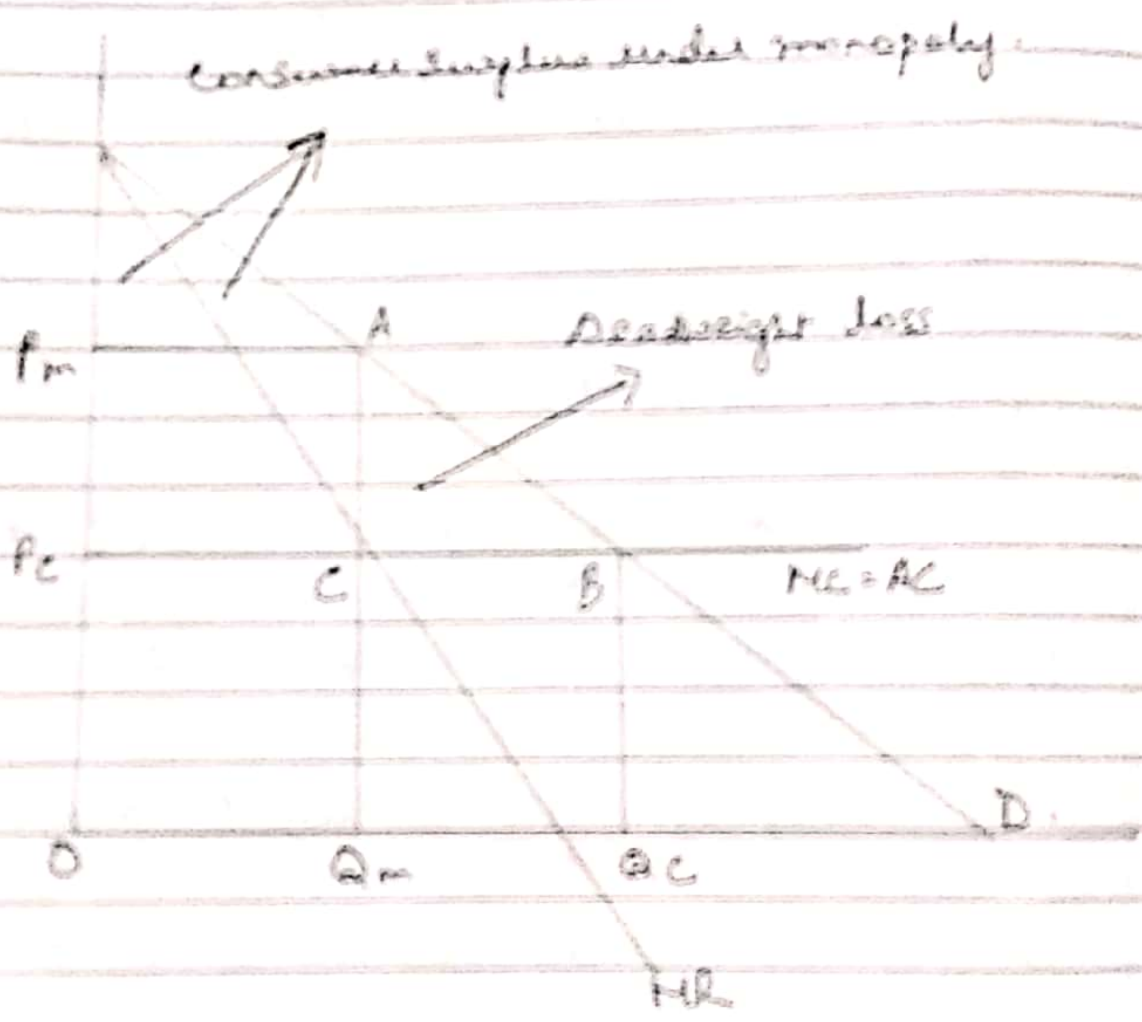
In pure monopoly, price is above marginal cost. At this point the firm is under-producing from societies point of view. In this situation the society will gain if the firm produces more and reduces price. Monopoly leads to inefficient mix of output.



The demand curve in the fig shows

the amounts people are willing to pay at each potential level of output. The demand curve shows the benefits to the consumers of raising output above Qm. MC reflects the marginal cost of the resources needed. The triangle ABC measures the net social gain of moving from Qm to Qc (or the loss that results when monopoly decreases output from Qc to Qm.