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Monopoly behaviour of the DeBeers Diamond Company

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Diamonds have always been far more than
jewels; they are history twinkling on the skin.
Stefan Kanfer

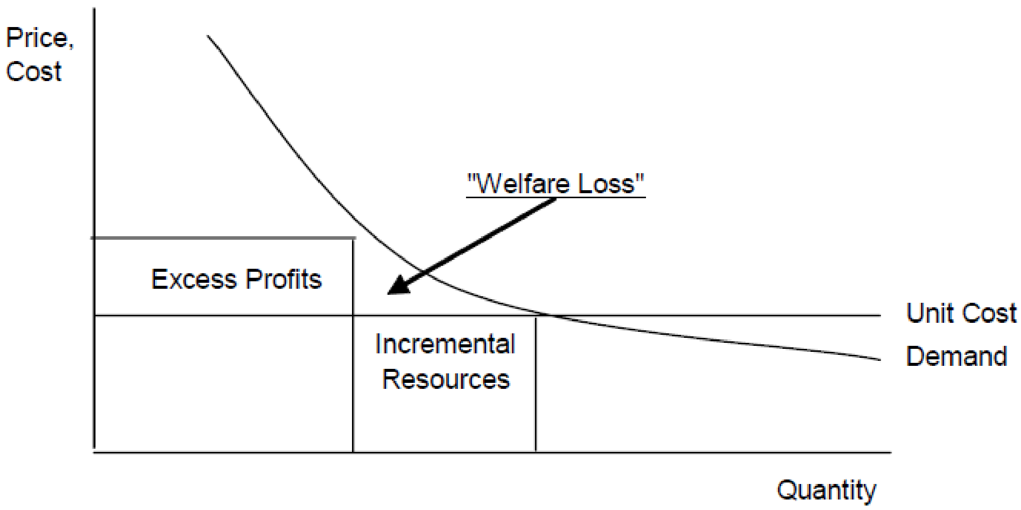
Introduction

Monopoly is the dominating one firm in the market, there is no competitors or no other substitute firms in the market. Monopoly has an ability to set price on his own product. Many researches have been analysed the efficiency of monopoly and its effects to consumer behaviour. The inefficiency of Monopoly is proved by price is above the marginal cost and it causes the shortage of product in the market. Thus, monopolist produces and sells the limited quantity of product and it is below the rank the social efficient level. This coursework has been conducted on the monopoly behaviour of DeBeers Diamond Company. In the Introduction section numerous papers on the efficiency of a monopolistic market have been revived and analysed. In the body part natural barriers to entry, unfair competition of computer software markets, monopoly pricing and social cost of diamond market have been discussed, and in final part how social cost occurs the government intervention to the market have been demonstrated.

Related Literature

Many research papers have been analysed the efficiency of monopoly and some of them found it is efficient and half of them are not agree with them. Numerous arguments have been discussed about social cost of monopoly over years, however Harberger studied the social cost and indicated it as a welfare loss in 1954.

Figure 1



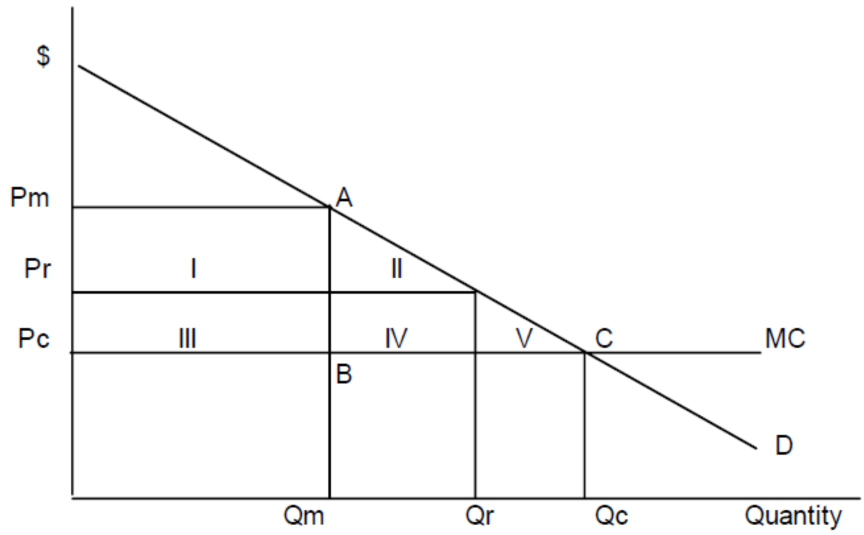
Harberger(1954) analysed the measurement of resource misallocation and welfare loss due to monopoly. He took Epstein's (1934) research as a basic source of data and deemed 1924-1928 years rate of return for each country. The findings was very interesting and he told the followings as a conclusion "all I want to say here is that monopoly does not seem to effecr aggregate welfare very seriously through its effect on resourse allocation(Harberger, 1954,Gumus, 2006).

Gumus(2006) studied Harberger's triangle and interpreted it as ABC triangle(see the Figure 3).

Herberger(2006) concluded that the social cost influenced only by resource allocation and its danger to economy not so significant. If the monopoly produces at the competitive level and the price is above competitive level, the loss to society will happen, if the consumers accept the price (Qc–Qm)

The below ABC figure was designated as a social cost of monopoly and PmABC area is excess profit which is a transfer from consumers to monopolist (Herberger,2006,Gumus, 2006).

Figure 2.



Varian also stated that a monopoly company is not Pareto efficient. In competitive market designated a Pareto efficient output, thus the price of consumer wants to pay and the price of consume must pay is always the same. Pareto efficient is an economic situation if there is no way to make any person better off without hurting anybody else (Varian, 2010). Contrasting to competitive market, a monopolistic company production is less and it causes to inefficiency of Pareto (Varian, 2010).

Leontieff (1946) founded that a monopoly is not efficient or Pareto optimal. If there is not possibility to find a substitute to Wage and Labour, a labour contract is considered as efficient. If a contract is not efficient, for conserving a different W/L compounding is strong distinction, the rate of satisfaction can be higher for one or both parties (Leontieff,1946)

Monopoly operates at an inefficient level of output since it restricts output to a point where consumers are willing to pay more for extra output than its cost to manufacture it. The monopoly does not want to produce this extra output, thus it would lead to decrease the price that it would be able to get for all of its output (Varian, 2010).

Monopolist's goal is to maximize its profit. In order to optimize profit he calculates the extra unit of manufacturing will give a profit. Here are the formula: MP=MR-MC. The monopolist gets concave profit function so it reached its peak and it stops producing. MR=MC is the best option for maximizing profit(Varian, 2010).

The government's giving a permission to one firm to be a monopoly it is called natural monopoly. It brings great profit to both government and consumers. For example, UzRailways Company Uzbekistan adds its contribution to government development gets consumers' satisfaction at the same time. Another example of natural monopoly is USA Network Solutions company which supports the database of all .com, .net, and .org Internet addresses, because such data need to be centralized and comprehensive (Pindyck&Rubinfeld,2015).The copyright and patents are servicing to government to create natural monopoly. With creating a new type of drug the firm gaining the patent and over many years, the government support the firm not entering other entrant to market. The advantage of government patents and copyrights is improved incentive for creative activity (Pindyck&Rubinfeld, 2015)

Monopoly has less elastic demand curve. The firm's elasticity of demand is determined by three factors:

1. The market demand elasticity. The potential for monopoly power is limited by the elasticity of market demand.
2. The market firms quantity. If there are many firms, no one can change the price notably.

3. The firms ‘cooperation. The negotiation of firms will help to control price in the market. No one can raise or decrease the price (Pindyck&Rubinfeld, 2015).

The Example of market elasticity of demand has been explained in Soft Drinks Company. According to the studies market elasticity of demand is -0.8 and -1.0and it means that if *all* soft drink producers increased the prices of all of their brands by 1 percent, the quantity of soft drinks demanded would fall by 0.8 to 1.0 percent (Pindyck & Rubinfeld, 2015).

Monopolistic power effects the price to exceed marginal cost, so the price is higher than the quantities manufactured. That is not Pareto efficient; the firms get profit but the consumer get harm (Pindick & Rubinfeld, 2015)

According to findings of Gumus some factors effect to the relative size of social cost of monopoly:

- ✓ Behaviour of regulating authority
- ✓ Relative size of rent protecting activities
- ✓ Relative size of rent defending activities
- ✓ Degree of economic development of the economy
- ✓ Degree of differentiation of price from marginal cost
- ✓ Relative size of monopolized industry in the economy
- ✓ Price elasticity of demand in the monopoly industries
- ✓ Relative size of consumer surplus defending activities (cited from Gumus, 2006).

On experimental grounds, the evaluated social expenses of imposing business model has been viewed as low because of specialized and estimation troubles to snatch every single pertinent factor in to the investigations (Gumus, 2006).

In the figure below the social cost of monopoly is analysed: because of monopoly increases, the price from competitive market price deadweight loss was occurred and this

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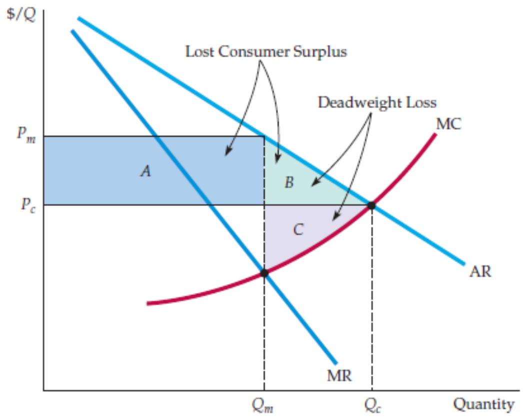
leads to consumer product shortage for monopolist the resource surplus. Consumers lose A+B and producer gains A-C. The Deadweight loss is B+C (Pindyck&Rubinfeld, 2015).

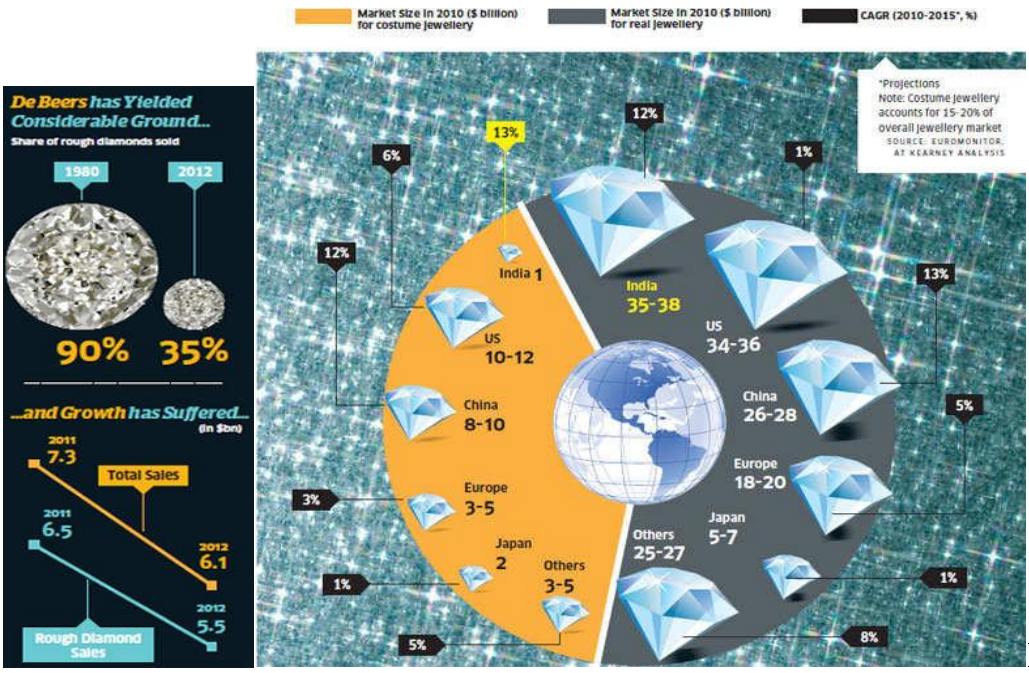
Figure 3



The market of Diamonds

Before 1866 the diamond have rare but when massive discoveries were found in South Africa and the rock was on the verge of losing its value. Cecil Rhode stepped firstly and founded DeBeers Corporation, the objective was combining the mines and confining inventory, keeping up the fiction that precious stones were rare and had inalienable worth. International Corporation DeBeers is specialised in diamond investigation, jewel mining, diamond retail, diamond exchanging and mechanical jewel fabricating segments. The organization is as of now dynamic in open-pit, huge scale alluvial, waterfront and remote ocean mining. It manufactures in 35 different countries and mining happens in Botswana, Namibia, South Africa, Canada and Australia. Until 2000 year, it gained 85% of diamond market and saved its monopolistic power. Nowadays it supports 35% of world diamond market by its international sight holder and auction sales businesses.

Table 1



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Source from taken the site://economictimes.indiatimes.com/articleshow/19154196.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

Natural barriers to entry

Barriers to entry changes a firm to monopoly. If there is high restrictions to enter the monopolist remains the unique, and manages the prices over its unique product. There are three main factors of barrier to entry:

- A key resource is owned by a single firm.
- The government gives a single firm the exclusive right to produce some good or service.
- The costs of production make a single producer more efficient than a large number of producers (Pindyck&Rubinfeld, 2015).

For the new entrants there are some factors to occur difficulties such as patent, copyright, ownership of resources, government license and high starting cost. Contrasting with competitive market, there is no completion in monopoly and it has definitely power on market. Legal, technological, and market forces discourage or prevent potential competitors from entering a monopolistic market (Greenlaw&Shapiro, 2011).

Table 2

Barrier to Entry	Government Role?	Example
Natural monopoly	Government often responds with regulation (or ownership)	Water and electric companies
Control of a physical resource	No	DeBeers for diamonds
Legal monopoly	Yes	Post office, past regulation of airlines and trucking
Patent, trademark, and copyright	Yes, through protection of intellectual property	New drugs or software
Intimidating potential competitors	Somewhat	Predatory pricing; well-known brand names

Source is taken from:Greenlaw, S.,&Shapiro, D. *Principles of economics 2e*. 2nd ed. OpenStax2011., pp.246-250.

Unfair competition

The substitute products for diamond can be emeralds, rubies and sapphires due to consumers ‘view. Therefore, if DeBeers increase price the consumers can switch the product. However, other stones differ significantly from diamond and this gives power to DeBeers to influence over the price. The company tried to absorb into consumers mind by advertising its product by slogan “Diamond is forever”. This slogan is applied to all diamonds not only DeBeers and it a sign of DeBeers’s monopolistic power (Mankish, 2008).

Government antitrust policy

DeBeers multicorporation has been called to U.S Department of Justice Court in 1994, accusation was criminal price fixing of industrial diamonds (Andrew, 2006). Although the company refused to answer for 10 years. In 2000 The Kimberley Process, an international certification scheme for diamonds, was established due to countries and industry representatives adopted it (ibid). Members of the jewel business, agents of significant precious stone creating countries, and the universal network set the activity moving to annihilate the utilization of precious stones to back wars(ibid). De Beers later consented to agree to Kimberley Process guidelines restricting which precious stones the organization would be allowed to buy (ibid).

In inspecting these occasions, it shows up the Kimberley Process has had a definitive impact of prompting De Beers to adjust a portion of its corporate practices (Andrew, 2006). This Note investigates De Beers' reaction to the charges gave by the U.S. and furthermore dissects how De Beers reacted to the making of the Kimberley Process. This Note in this manner looks at the adequacy of improved self regulation conspires in actuating worldwide partnerships to modify strategic policies, especially when those organizations work on a worldwide scale (Andrew, 2006).

Monopoly Pricing Strategy

Devastated countries are accordingly blocked the chance to charge continues from precious stone deals which could some way or another be used to construct foundation and accommodate residents' fundamental needs (Andrew, 2006). Additionally, the close out of contention jewels has been ascribed to fear based oppressor associations most outstandingly. Some have arranged De Beers as a worldwide cartel, as it positively displays a large number of the qualities of one. Actually, De Beers' tight power over precious stone market power provides enticing proof of its likeness to a cartel (Andrew, 2006).

Social costs of public policy

De Beers controls the world's jewel supply by purchasing the vast majority of the world's harsh precious stones and amassing them in its London distribution centre. The enterprise at that point offers just enough precious stones to fulfil need when the demand increases (Andrew, 2006). De Beers expands the cost. De Beers further tries to confine jewel deals by selling just a predetermined number of precious stones to favoured clients through a procedure covered in mystery and known as "selling sights.” Through this procedure, De Beers chooses purchasers, restricts the amount it will offer to each, decides the precious stones' quality, and sets the cost (Andrew, 2006). The purchasers may either acknowledge or decay the whole gathering of precious stones they are offered. DeBeers does not allow arrangement, and by and by, no purchaser cannot. De Beers' effect available is likewise apparent through its overwhelming contribution in jewel promoting through the CSO (ibid). The organization's accentuation on showcasing is inescapable to the point that it has significantly affected the overall interest for precious stones as adornments The CSO spends generally $200 million every year on jewel marketing and is liable for the renowned publicizing effort, "a jewel is everlastingly," one of the best advertising mottos ever.

Government intervention to the market of Diamonds

In 1994, the U.S. Branch of Justice again gave charges against De Beers, asserting that the company had gone into a criminal scheme in the mid 1990's with General Electric Co (Andrew, 2006). These organizations controlling 80% of the world market for modern jewels (ibid). Understandings among contenders to fix costs, rig offers, or apportion clients and regions. Despite the fact that the Kimberley Process has been planned for diminishing the contention precious stone exchange, it has had the additional and unintended impact of relaxing De Beers' hold on the jewel business (ibid). The precious stone industry's reliance on its item's picture without a doubt initiated De Beers to adjust itself to U.S and worldwide exchange, antitrust laws, and human rights destinations (Andrew, 2006).

Conclusion

For increasing country economy, the government braces and secures monopolists despite of social cost of market(Pindyck&Rubinfeld, 2015). Practically all creating nations will in general control the businesses that produce basic products, specifically power, water supply, and a few pieces of agribusiness. Governments do as such by making imposing business models and securing them through tax breaks and sponsorships. Through keeping costs lower, for lower and middle class individuals, government need to use these approaches particularly in creating nations. On the other hand, government secures a few ventures to accomplish long haul objective of upper hand in worldwide market by leaving social damage of more significant expenses as negative externality(Varian, 2010).

It is recommended that specific businesses need insurance from government against rivalry to keep costs low, while some kind of ventures need to open ways to contenders to achieve previously mentioned target.

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