# Section 9: Quality Competition

In MSE, the market structure of perfect or pure competition (price-taking) and perfect monopoly are regarded as two extremes. There are also two kinds of situations between these two extremes, one closer to perfect monopoly is oligopoly, and the other closer to perfect competition is monopolistic competition. There are limited numbers of producers in the market of oligopoly including duopoly (only two producers in the market). There are many producers in the market of monopolistic competition, but they supplied slightly different products, so they can charge slightly different prices.

However, according to the correct definition of monopoly or price-searching, the number of producers in the market does not matter, so the above distinction is meaningless. The entry threshold is the key. In a market with a higher threshold, producers (no matter one, two or a few) in it can have a wider range to search the price most favorable for them. Or else, they can only search the price in a narrower range, and can only charge a price a little higher than their competitors.

What is more, if the entry threshold is caused by information cost rather than technology or entry control by government, the number of producers in the market will be even more than that in the market of so-called perfect competition (price-taking), and there is also fierce bargaining, which will be discussed in the next lecture.

As mentioned in the previous lecture, the market structure of price-taking is very rare in reality, because it appears only when some rigor conditions are satisfied, including no difference in quality and type. In MSE, it is generally believed that a large number of products in reality differ in quality and type, thus turning the so-called perfect competition into the so-called monopolistic competition.

With different quality, producers have already faced different demand curves, so they can search price. However, products of different quality are highly substitutable to each other. Once the price difference exceeds the extent of the quality difference, there will be a large number of competitors, so the range for producers to search prices is very limited.

Similarly, with different types (such as different colors or designs), producers have also faced different demand curves, so they can search price. However, products of different type are highly substitutable to each other, so the range for producers to search prices is very limited.

For example, in China, there are all kinds of lanterns sold online. There are different materials (such as paper, cloth and yarn), and different degree of solid and beauty, so the prices are correspondingly different. Prices are different due to different quality, or strictly speaking, different costs. Generally, the bigger the lantern is, the more expensive it is. Usually the lanterns with only different colors will be not different priced, but white lanterns are a few cents cheaper than those of other colors, because in China white lanterns are only needed in funeral. In other words, there is a wider demand for colored lanterns than white ones, so there is wider range for their producers to search price.

The more popular types can be regarded as higher quality, so the difference in types can also be included in the difference in quality. Because different quality leads to different price, if government imposes price control, producers cannot compete in price, which does not mean there is on competition any longer, but price competition turns to quality competition.

For example, if the rent of a house is controlled lower than the equilibrium determined by the market, the landlord will reduce the quality of the house by poor maintenance or being not equipped with furniture and electrical appliances.

However, if the price is regulated above the equilibrium determined by the market, producers will improve the quality. A typical example is the “Sandwich War” that broke out in the aviation industry of US in the 1970s when there was quite serious regulation. Airlines which want to run a new route had to apply approval from the government department which had not approved such applications for many years. Although the government approval constituted the entry threshold, there was still competition in the aviation industry. The government even directly regulated the price of air ticket, and did not allow airlines to offer discount. However, this regulation could only restrict price competition, not quality competition. In order to get a higher attendance rate, major airlines tried their best to attract customers by providing high-quality airline meals. The government further imposed a strict rule that airline meals could only provide sandwiches, in an attempt to restrict competition, but airlines still competed to provide luxurious sandwiches.

Some may ask: isn’t it good that price control leads to a rise in product quality? However, consumers do not necessarily think that the higher the product quality is, the better! Take the price control in aviation industry of US as an example. If consumers could choose, they would rather have cheaper air tickets than luxurious airline meals. In fact, when the aviation industry was deregulated in the 1980s, low-cost airlines entered the market in large numbers and offered very cheap tickets at the cost of not providing airlines meals at all! These low-cost airlines quickly gained a considerable market share, which clearly shows that many consumers think that cheap air tickets without airlines meals are much better than the expensive ones with high-quality airline meals.

What consumers need is not high-quality product, but the product with appropriate price and quality. It is no good for Government to impose administrative intervention forcing producers to improve quality.