**Cheap Pearls**

If you are in Shanxiahu (a small Chinese village south of Shanghai), you better not flash your pearls. If you do, you might end up being a laughing stock! Why? Though once highly prized when they were scarce, these freshwater pearls have lost their local luxury appeal due to over production in the last 3 decades.

From a humble beginning, Shanxiahu's pearls have been so improved in size and lustre over the years that they can now compete with the famed Tahitian black pearls! Till even a couple of years back they would sell for a third the price of their Tahitian cousins, today the larger gems from China (10-millimetre-plus diameter) fetch the same price - between $70 and $100 per pearl. They are simply a hit among Asian women, and designers looking for "fancy" gems to please a younger market.

But Shanxiahu's success now appears to pose a threat to the pearl industry as a whole. Pearl traders fear that oversupply from Shanxiahu farmers might cause pearl prices to drop substantially in the future. China has already overtaken Japan in the production of cultured pearls. 1999 figures show that China churned out $170 million of freshwater pearls, compared to $131 million by Japan. Some traders predict, that by the end of the decade China's production will grow to 10,000 tons, from the current 650 tons! Indeed, if it were to happen, cultured pearls might lose their world-wide luxury appeal altogether. Consequences: A fall in demand and decrease in profits for traders.

Goods like pearls (or diamonds) are luxuries exactly because they are scarce and expensive. And consumers derive utility from these goods mainly because of their snob appeal. So by flooding the market, farmers may risk destroying the scarcity value of the good, leading to a fall in demand. When that happens, more volume cannot make up for the decrease in profits.

Competitive overproduction of freshwater pearls by independent producers in Shanxiahu has thus led to atragedy of the commons1. Far from increasing consumer surplus, falling prices reduce both [consumer surplus](http://livingeconomics.org/article.asp?docId=91#note)2 and producer profit. Unlike freshwater pearls, however, the market value of and demand for diamonds have stayed high even amid substantial production increase over the year. The difference lies with their different methods of distribution. De Beers, which owns nearly 60% of the diamond market share, strictly regulates the supply of diamonds in the wholesale market to maintain scarcity. It decides how many will be sold, when, to whom and at what price! Hence, a possible solution for China's pearl farmers may lie in forming a cartel3, which would decide on the quantity of pearls to be released into the market and the price at which they would be released.

Note:

1. Tragedy of the commons occurs when over-exploitation of a limited-capacity resource leads to its total collapse.
2. Consumer surplus is the gap between what buyers are willing to pay and what they actually pay.
3. De Beers has been under pressure from U.S. antitrust enforcement.