Section 5: Perfect and Monopolistic Competition

Market structures
- Perfect competition
- Monopolistic competition
- Oligopolies
- Monopoly

Monopolistic competition

- Many buyer and sellers
- some product differentiation so some price making power
- low barriers of entry
- good information on market conditions
- Non-price competition: branding, quality of goods and services
- firms are profit maximizers

- supernormal profits don't last as new firms enter the market
- as new firms enter, demand curve shifts to the left because demand is spread over more firms
- This erodes the sp profit
- SR position: some sp profit earned
- LR position: normal profit earned

Efficiencies
- Not allocatively efficient: not operating at AR=MC
- Not productively efficient: not on lowest point of AC
- Not dynamically efficient in LR: don't earn supernormal profit in LR

Evaluation
- loss of consumer surplus is not as bad as monopoly
- some variation in goods is what really consumers desire not identical (like perfect comp)
- EOS can be exploited to a greater degree than perfect competition
- dynamic effciency in SR
- Normal profits in LR can be reinvested due to competition

Examples (existence of small firms)
- Clothing
- Taxis
- Fast foods, restaurants, coffee shops
- Tv programs

Perfectly competitive market

- has infinite no. of supplier and consumers
- consumers and suppliers have perfect knowledge of prices, production methods and product details
- identical products= perfect substitutes
- No barriers to entry or exit
- Firms = profit maximizers MC=MR
- Consumers = utility maximizers
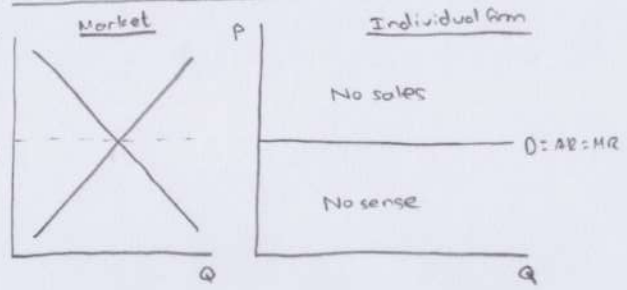- Market prices determined by interaction of demand and supply

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Competitive market process
- price
They compete on:
- better quality
- range of products
- advertising
- promotions

Efficiencies
- Alocatively efficient: MC=AR- price consumer wants
- Productively efficient: lowest point on AC, no EOS because many small firms cannot take full advantage of EOS
- Not dynamically efficient: no supernormal profits to invest
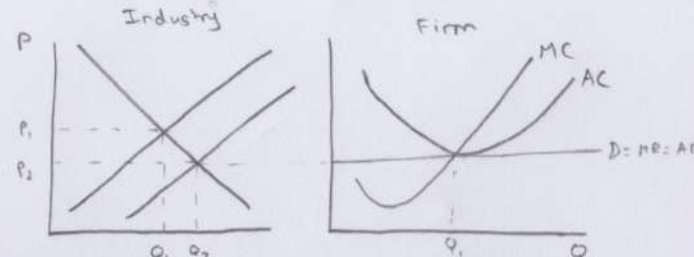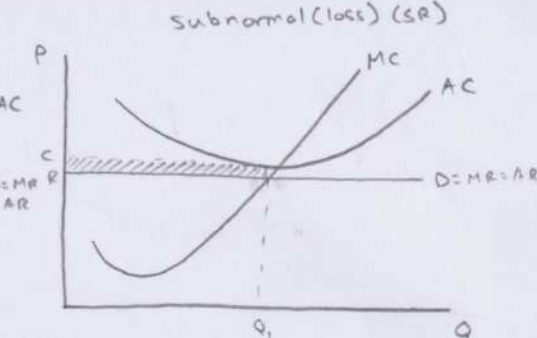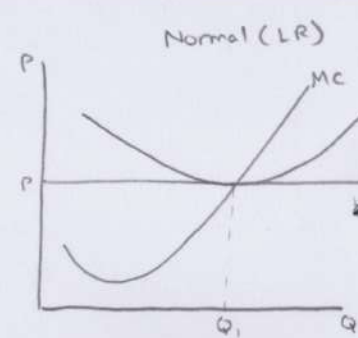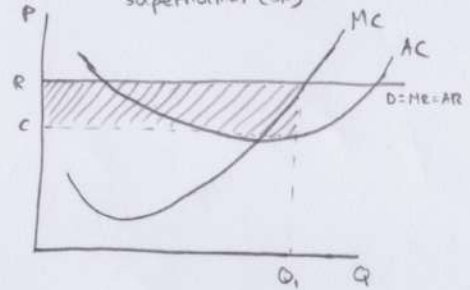- X-efficient: cannot slack

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Shut down points
- firms must still be able to cover the variable costs
- any revnue generated above the firms VC, will be used to pay FC.
- will only shut down if AVC>AR

Examples
- ebay (large number of buyer and seller, low barriers of entry, easy comparison

How price is set in perfect comp

Market

P, P₁, Q

Individual firm

No sales
$0 = AR = MR$
No sense

P, Q

Types of profits shown on graphs

Supernormal (SR)

P, MC, AC, R, C, $D = MR = AR$, Q_1, Q

Normal (LR)

P, MC, AC, $D = MR = AR$, Q_1, Q

Subnormal (loss) (SR)

P, MC, AC, C, R, $D = MR = AR$, Q_1, Q

Industry

P, P_1, P_2, Q_1, Q_2

Firm

P, MC, AC, $D = MR = AR$, Q_1, Q

- In PC supernormal profits are competed away instantly because as soon as supernormal profits are made suppliers enter the market making S_1 shift to S_2 until normal profit is made

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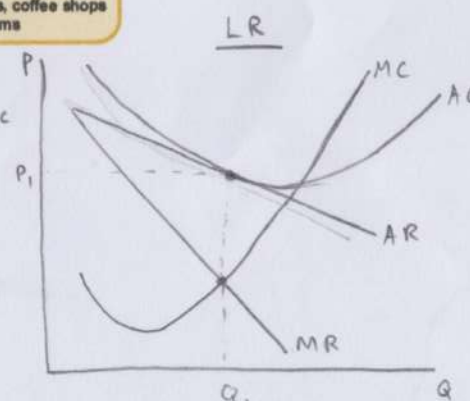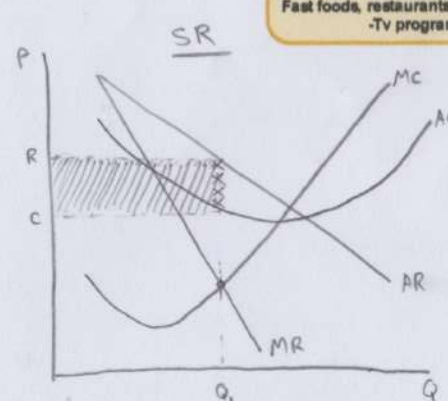
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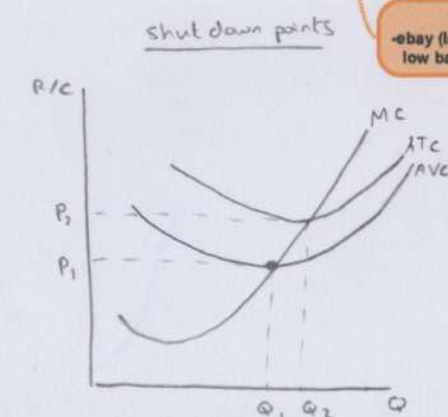 - Market prices determined by interaction of demand and supply

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SR

P, MC, AC, R, C, AR, MR, Q_1, Q

LR

P, MC, AC, P_1, AR, MR, Q_1, Q

shut down points

R/C, MC, ATC, AVC, P_2, P_1, Q_1, Q_2, Q

- In LR if price are below P_2 firm will shut down (losses are unsustainable)

- In SR if prices between P_1 and P_2 firm should continue to produce

- If prices fall below P_1 firm exit as VC is not being covered

- AC > AR - continue to produce

- AVC > AR - shut down point