7.1 Perfect Competition and Monopoly

Objectives

- Distinguish the features of perfect competition.
- Describe the barriers to entry that can create a monopoly.
- Compare the market structures of monopoly and perfect competition in terms of efficiency.

7.1 Perfect Competition and Monopoly

Key Terms

- market structure
- perfect competition
- commodity
- monopoly
- market power
- barriers to entry

Perfect Competition

- **Market structure**—important features of a market, including the number of buyers and sellers, product uniformity across sellers, ease of entering the market, and forms of competition
- **Perfect competition**—a market structure with many fully informed buyers and sellers of an identical product and ease of entry
- A **commodity** is a product that is identical across producers

Example Markets

- Share of large corporations
- Foreign exchange
- Agricultural products

Market Structure

Market Feature	Questions to Ask
1. Number of buyers and sellers	Are there many, only a few, or just one?
2. Product's uniformity across suppliers	Do firms in the market supply identical products, or are products differentiated across firms?
3. Ease of entry into the market	Can new firms enter easily, or do natural or artificial barriers block them?
4. Forms of competition among firms	Do firms compete based only on prices, or are advertising and product differences also important?

Figure 7.1

Market Price

- The market price is determined by the intersection of the market demand curve and the market supply curve.

Market Equilibrium and a Firm's Curve in Perfect Competition

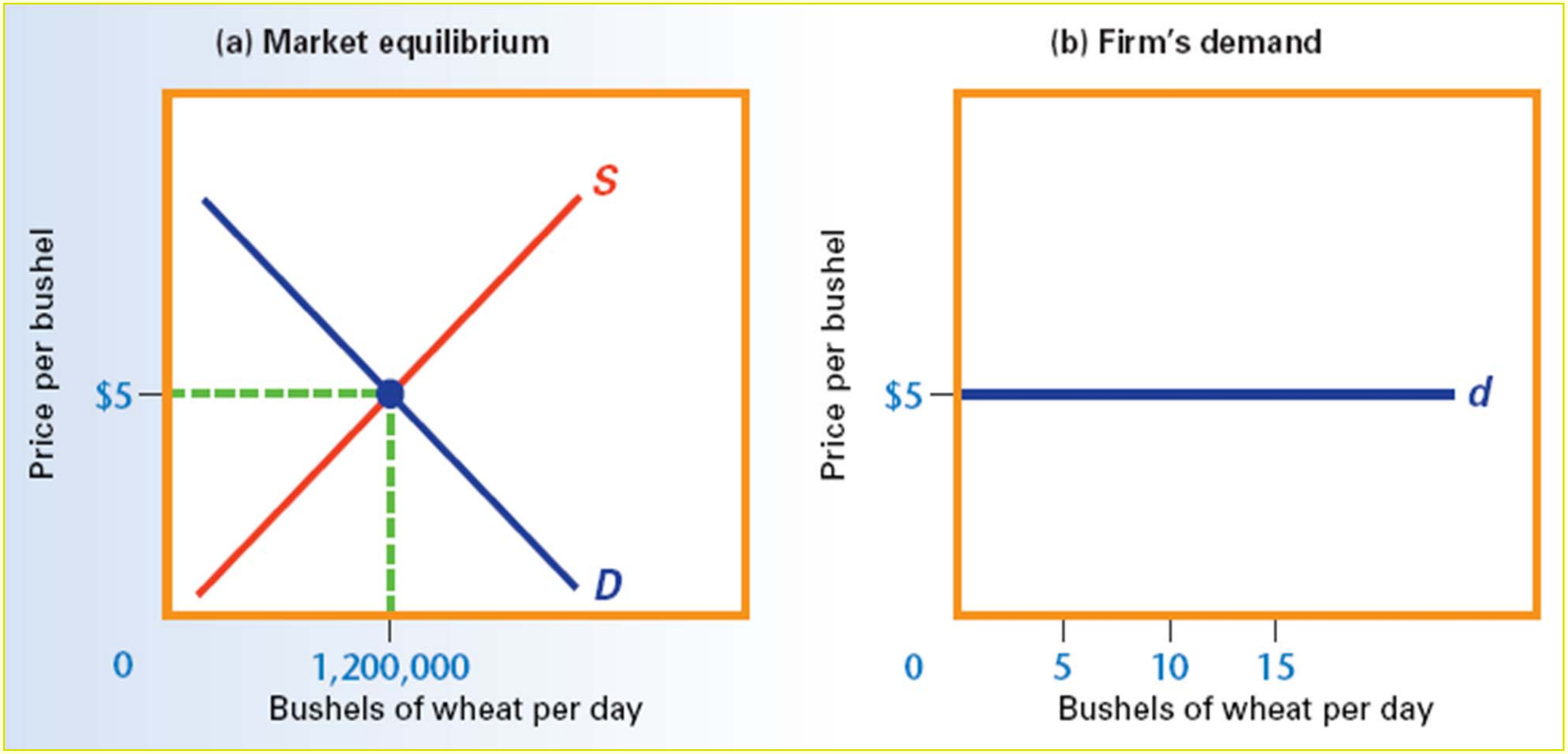

Figure 7.2

Monopoly

- **Monopoly** is the sole supplier of a product with no close substitutes.
- **Market power** is the ability of a firm to raise its price without losing all sales to rivals.

Barriers to Entry

- **Barriers to entry** are restrictions on the entry of new firms into an industry.
- Three types of entry barriers
  - Legal restrictions
  - Economies of scale
  - Control of essential resources

Monopolists May Not Earn a Profit

- Although a monopolist is the sole producer of a good with no close substitution, the demand for that good may not be great enough to keep the firm in business.

True Monopolies Are Rare

- A profitable monopoly attracts competitors and substitutes.
- Examples
  - Railroads—trucking industry
  - Local cable TV providers and local phone services—wireless transmission of long-distance telephone calls
  - U.S. Postal Service—fax machines, e-mail, the Internet, FedEx

Monopoly and Efficiency

- Monopolist are not guaranteed a profit
- Monopolies can lose money
- Monopolies are relatively rare

Monopoly Versus Perfect Competition

- Competition forces firms to be efficient and to supply the product at the lowest possible price.
- A monopoly will charge a higher price than competitive firms.
- With monopoly, consumer surplus shrinks, and is much smaller than consumer surplus with perfect competition.

Monopoly, Perfect Competitor, and Consumer Surplus

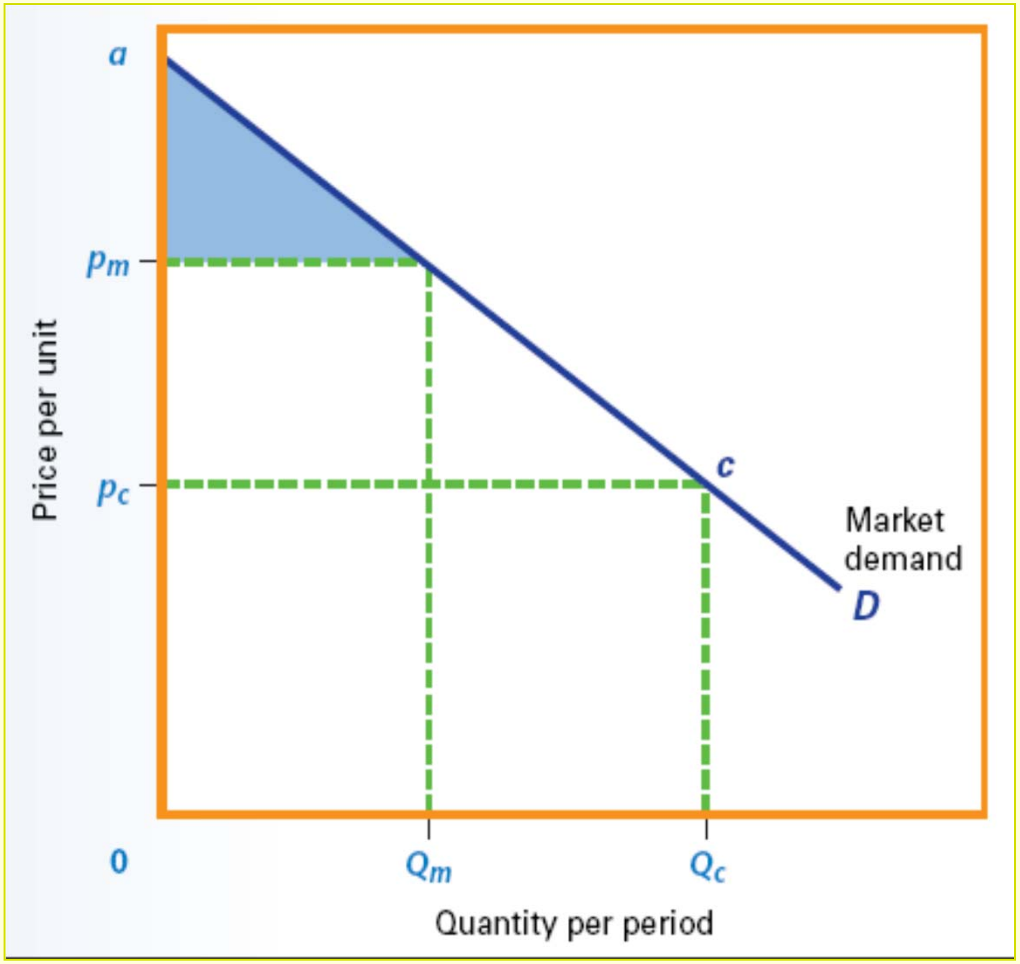

Figure 7.4

Other Problems with Monopoly

- Resources wasted securing monopoly privilege
- Monopolies may grow inefficient

Monopoly Might Not Be So Bad

- Economies of scale
- Government regulation
- Keeping prices low to avoid regulation
- Keeping prices low to avoid competition

7.2 Monopolistic Competition and Oligopoly

Objectives

- Identify the features of monopolistic competition.
- Identify the features of oligopoly, and analyze firm behavior when these firms cooperate and when they compete.

7.2 Monopolistic Competition and Oligopoly

Key Terms

- monopolistic competition
- oligopoly
- cartel

Monopolistic Competition

- **Monopolistic competition** is a market structure with low entry barriers and many firms selling products differentiated enough that each firm's demand curve slopes downward.
- Monopolistic competition contains elements of both monopoly and competition.

Market Characteristics

- Firms can, in the long run, enter or leave the market with ease.
- There are enough sellers that they behave competitively.

Product Differentiation

- Physical differences
- Location
- Services
- Product image

Costs of Product Differentiation

- Advertising
- Promotional expenses

Excess Capacity

- *Excess capacity* means that a firm could lower its average cost by selling more.

Oligopoly

- **Oligopoly** is a market dominated by just a few firms.
- Oligopolistic industries include the markets for steel, oil, automobiles, breakfast cereals, and tobacco.

Barriers to Entry

- Economies of scale
- The high cost of entry
- Product differentiation costs

When Oligopolists Collude

- Collusion is an agreement among firms in the industry to divide the market and fix the price.
- A **cartel** is a group of firms that agree to act as a single monopolist to increase the market price and maximize the group's profits.
- Colluding firms usually produce less, charge higher prices, earn more profit, and try to block the entry of new firms.
- Collusion and cartels are illegal in the United States.

When Oligopolists Compete

- Oligopolists may compete so fiercely that price wars erupt.
- Examples
  - Cigarettes
  - Computers
  - Airline fares
  - Long-distance phone service

Comparison of Market Structures

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Number of firms	most	many	few	one
Control over price	none	limited	some	complete
Product differences	none	some	none or some	none
Barriers to entry	none	low	substantial	insurmountable
Examples	wheat, shares of stock	convenience and book stores	automobiles, oil	local phone and electricity service

Figure 7.5