MARKET STRUCTURES

Market structure; Degree of competition

Perfect competition

Monopoly

MARKET STRUCTURE

MARKET = a **place** where forces of **demand** and **supply operate**, and where **buyers** and **sellers interact** in order to facilitate an **exchange of goods**.

MARKET STRUCTURE = **organizational** and **competitive characteristics** or other features of the market

Types of market structure:

- **perfect competition**
- **monopoly**
- **monopolistic competititon**
- **oligopoly**

MARKET STRUCTURE

STRUCTURE OF PRESENTATION

- 1. Perfect competition
  - Perfect competition in short-run competition
  - Perfect competition in long-run competition
- 2. Monopoly
  - Monopoly in short-run competition
  - Monopoly in long-run competition

1. Perfect competition (1/7)

PERFECT COMPETITION = the **market price** and **quantity of a product** are **determined** exclusively **by the forces of market** demand and market supply for the product and the firm is a **price taker** (i.e. it can sell any quantity at that price).

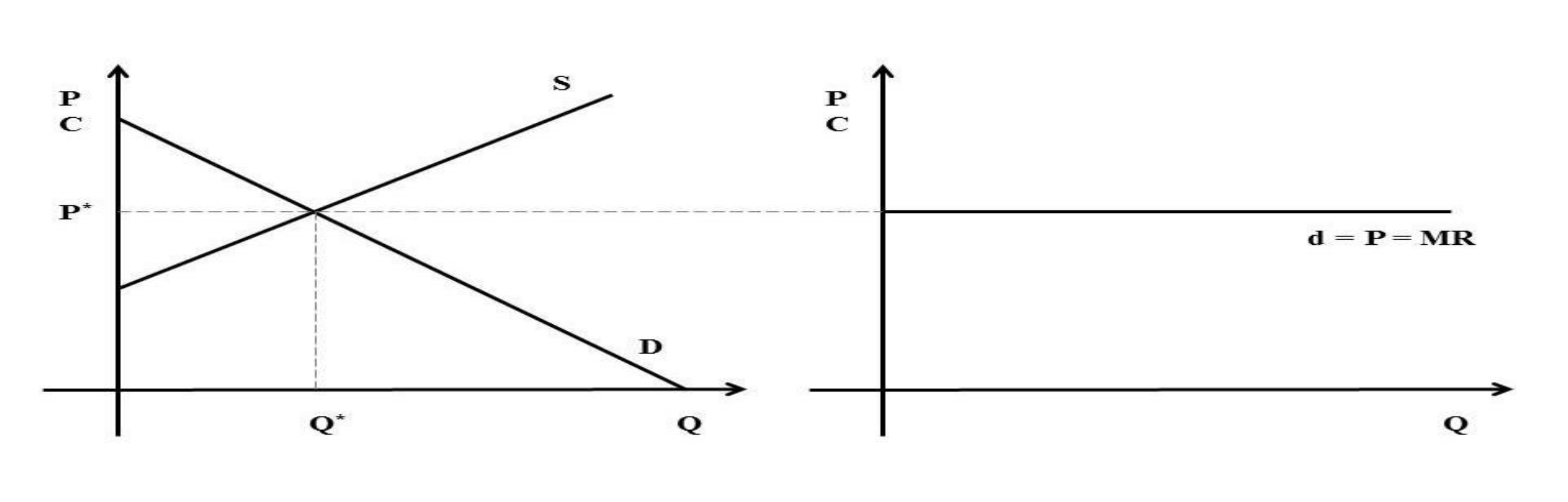
There is a great **number of buyers and sellers** that **are too small** in relation to the market to be able **to affect the price of the product** by their own actions. The **product** of each competitive firm **is homogeneous, identical, or perfectly standardized** (f.e. cereals).

There is also a **perfect mobility of resources**.

Perfect competition, as defined above, never fully existed. The stock market can be considered as a situation closest to the perfect competition.

1. Perfect competition (2/7)

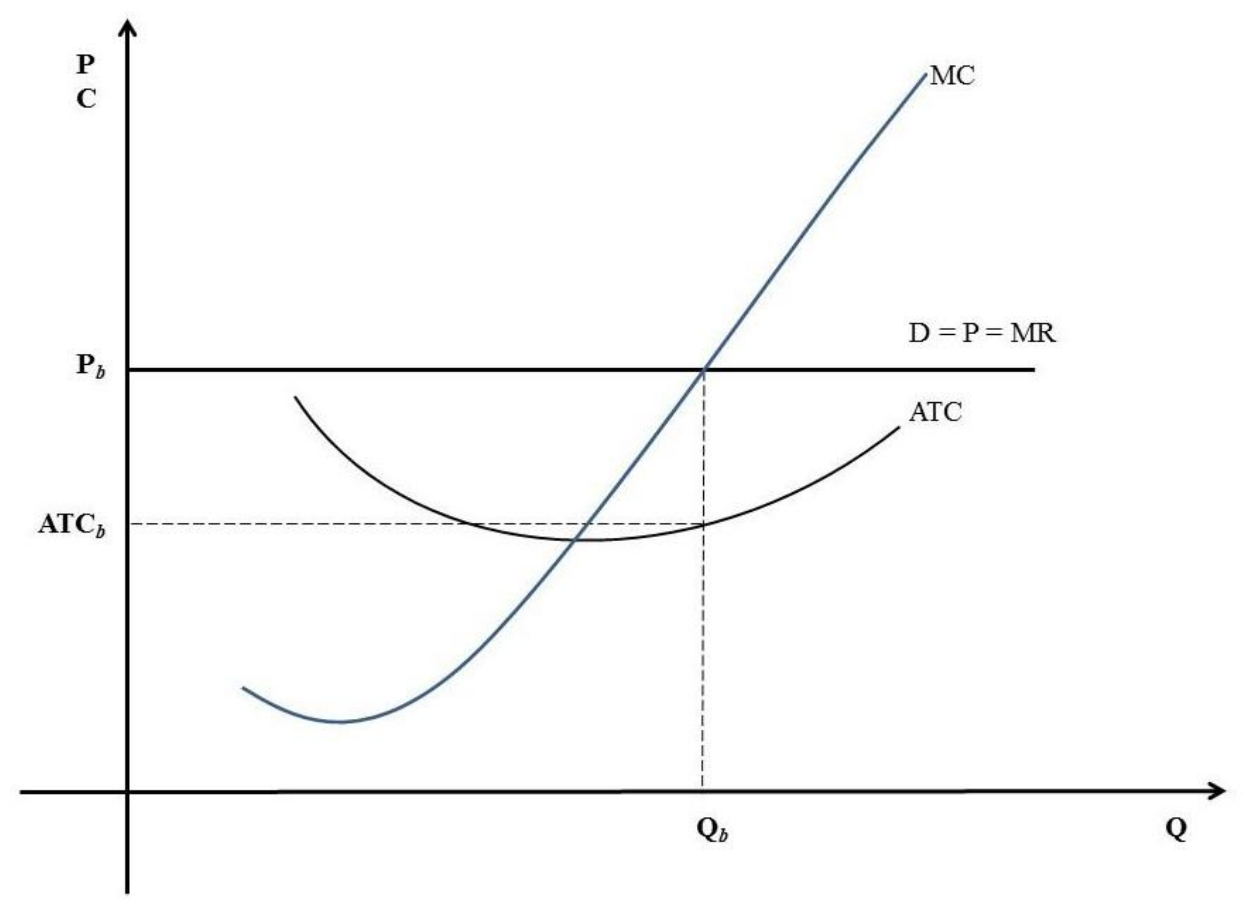
PRICE DETERMINATION UNDER PERFECT COMPETITION



The **product price** is **constant**, the change in the total revenue per unit change in output, that means the **change in marginal revenue (*MR*)** is also **constant** and is **equal to the product price**.

1. Perfect competition (3/7)

PERFECT COMPETITION IN SHORT-RUN ANALYSIS

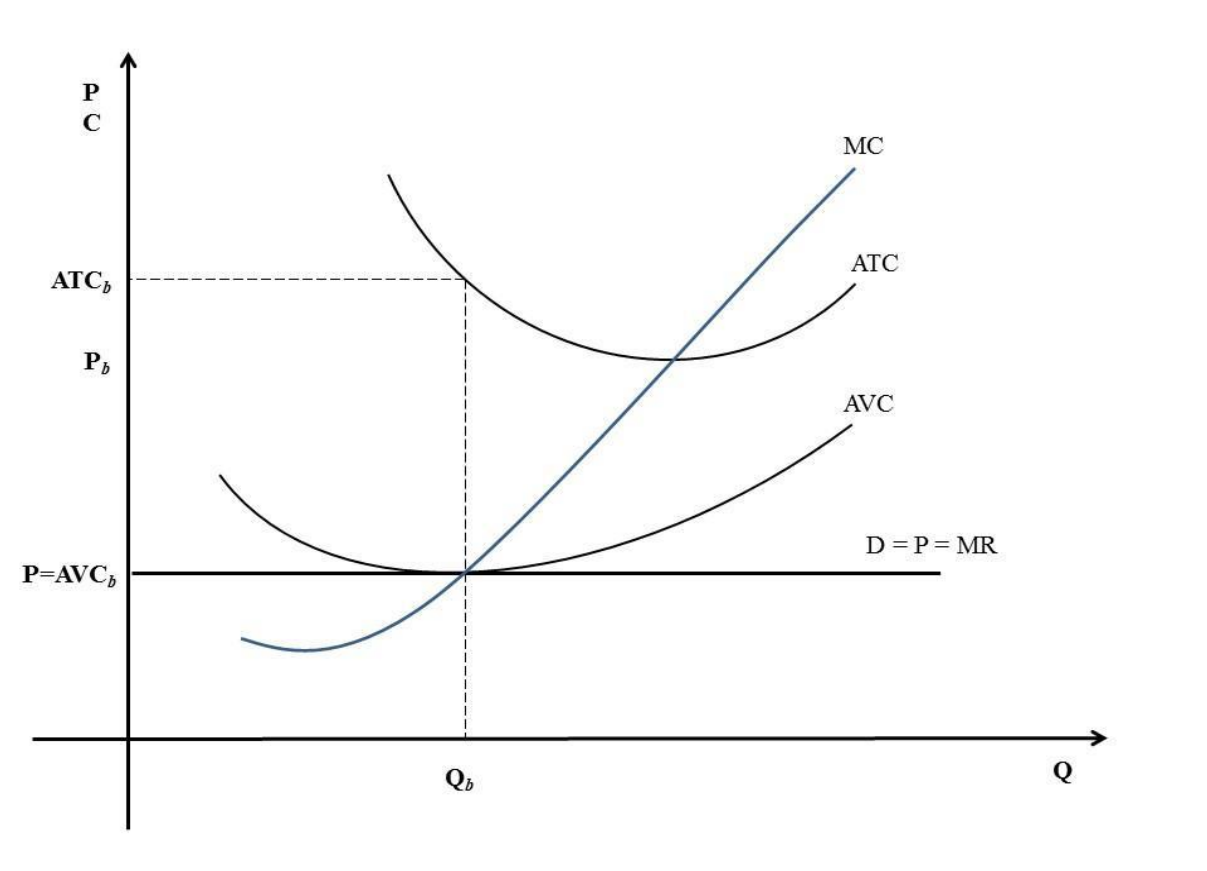


The best level of output in the short run is the one at which the firm maximizes profits or minimizes losses.

$$P = MR = MC$$

1. Perfect competition (4/7)

PERFECT COMPETITION IN SHORT-RUN ANALYSIS



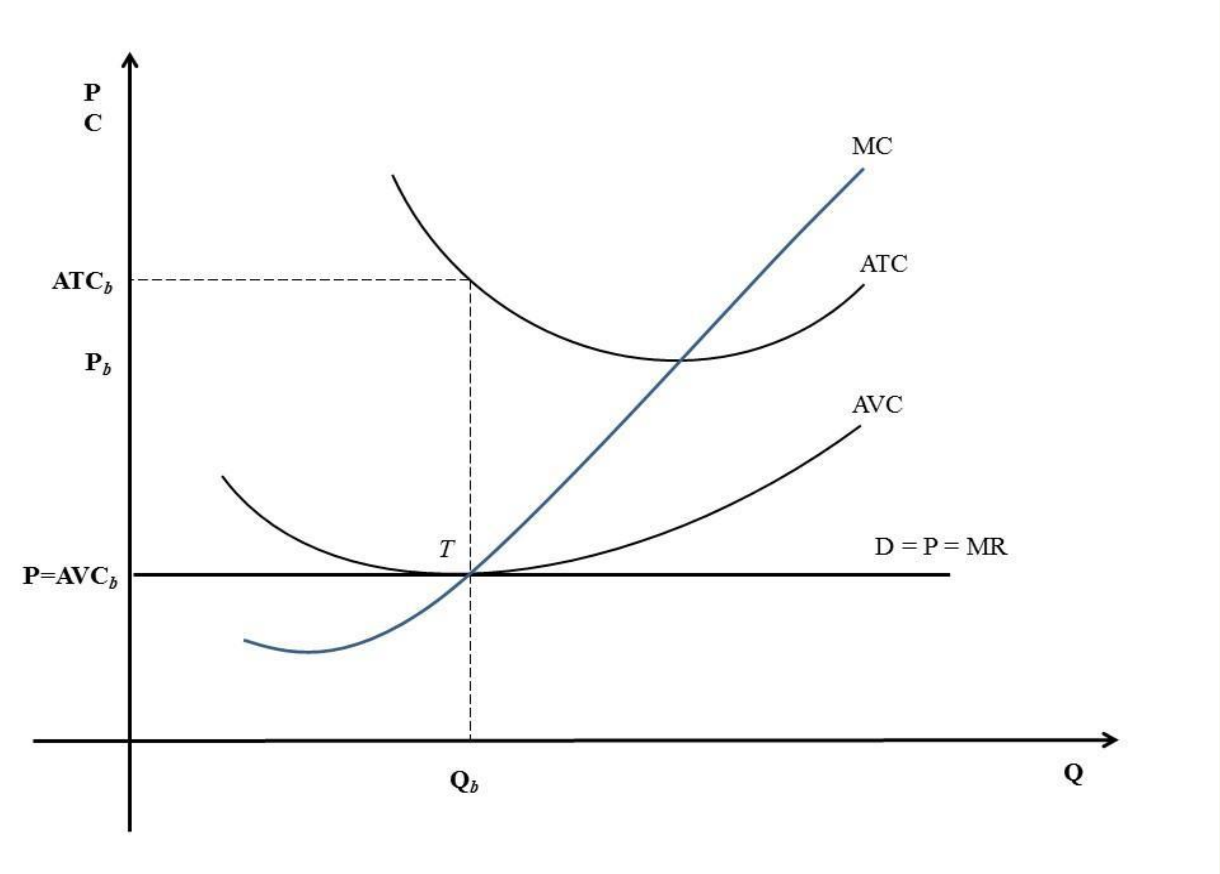
It is possible to incur losses and still be in business.

The requirement is that the **market price of the product is higher than the average variable costs (*AVC*)** of the firm.

The firm minimizes its losses by continuing to produce its best level of output.

1. Perfect competition (5/7)

PERFECT COMPETITION IN SHORT-RUN ANALYSIS

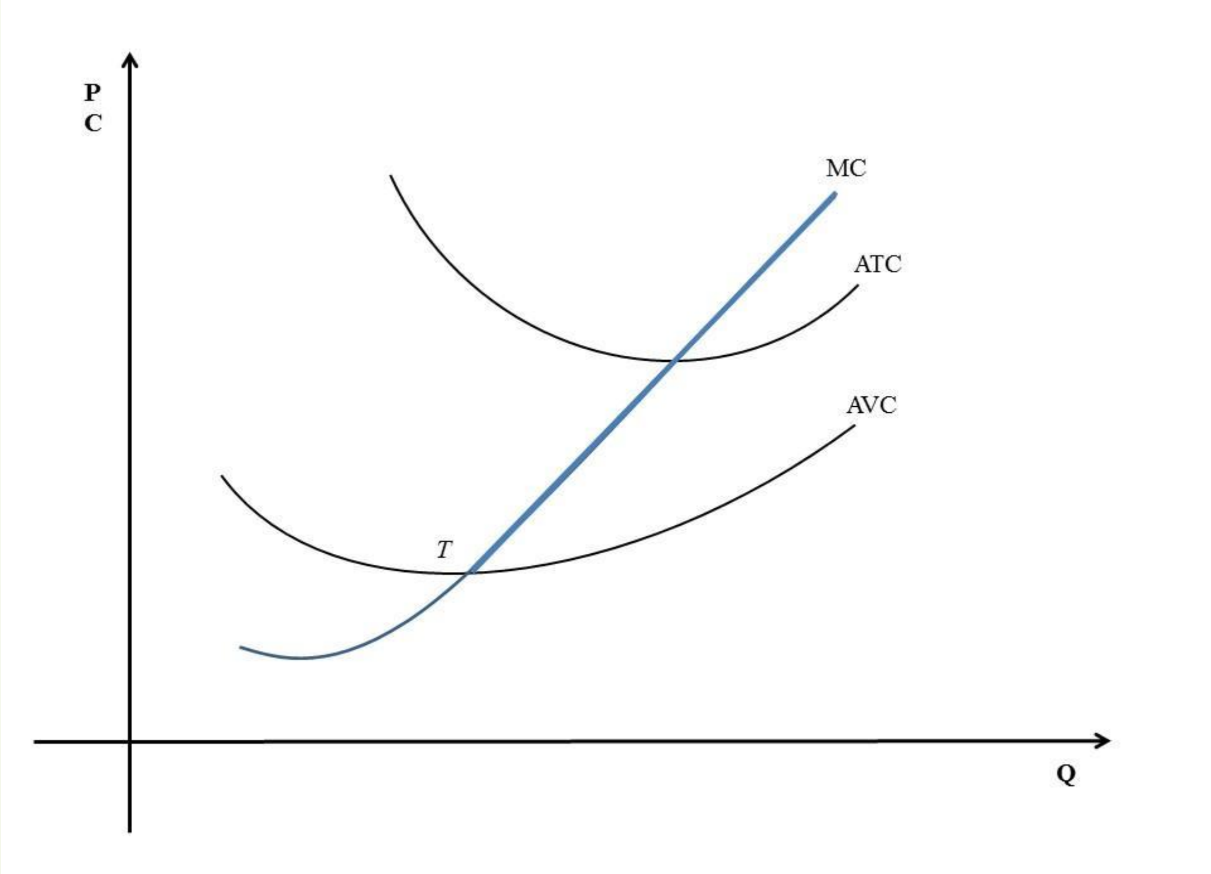


P = AVC

The **total losses** of the firm would be **equal to** its **total fixed costs** whether it produced or not. Thus, point ***T*** is the **shut-down point** of the firm.

1. Perfect competition (6/7)

SHORT RUN SUPPLY CURVE OF THE PERFECTLY COMPETITIVE FIRM

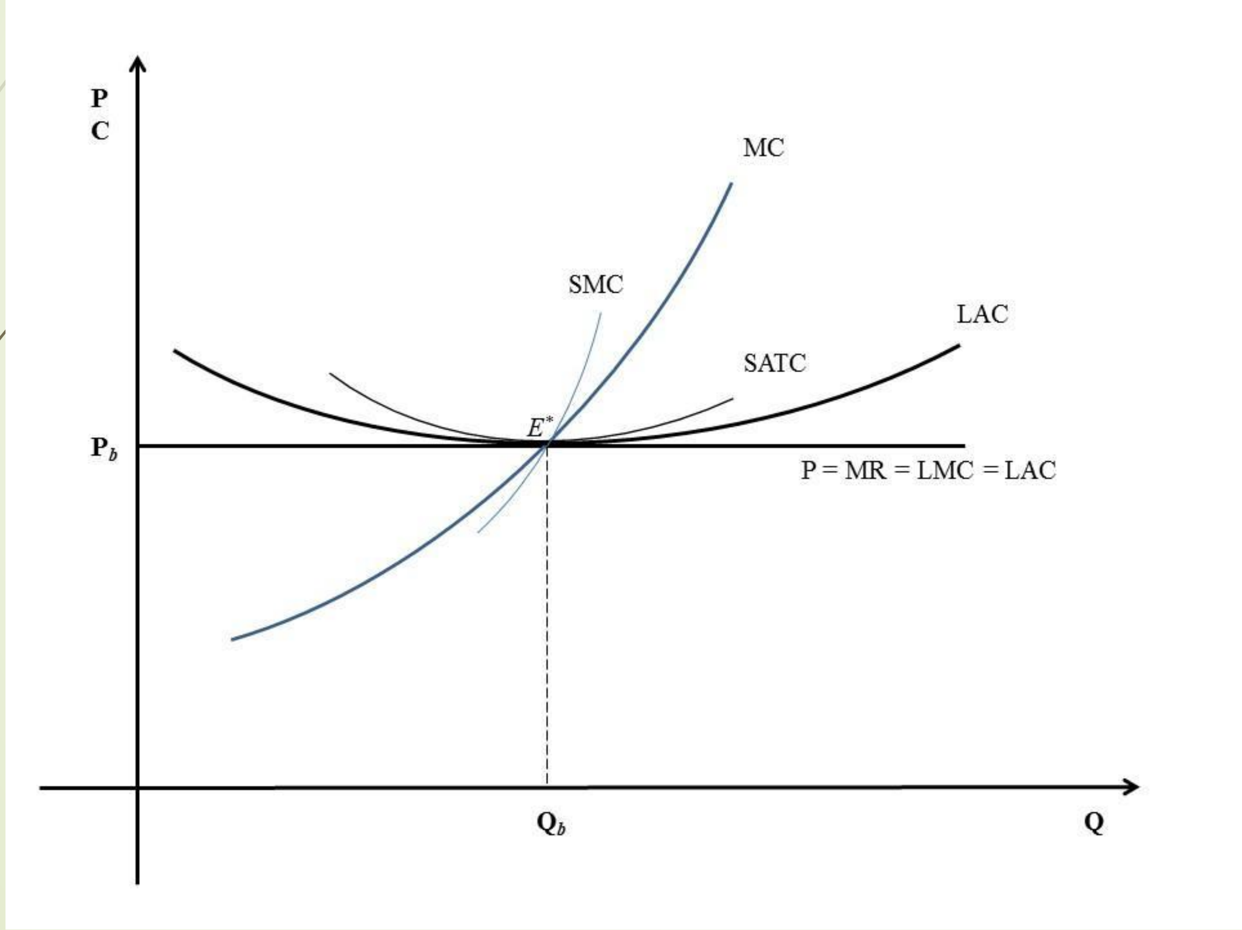


The **shape of the market supply** is the **same as firm's supply**, but the **quantity scale of the market supply is larger**.

At the point where *D* and *S* cross, we then have the equilibrium price, which is given to the firm.

1. Perfect competition (7/7)

LONG RUN SUPPLY CURVE OF THE PERFECTLY COMPETITIVE FIRM



All inputs and costs of production are variable.

E* = P = MR = LMC**= **lowest LAC
All firms produce at the lowest point on their long-run average cost (*LAC*) curve.

Zero economic profits means that the **total revenues of the firm just cover all costs**.

2. Monopoly (1/3)

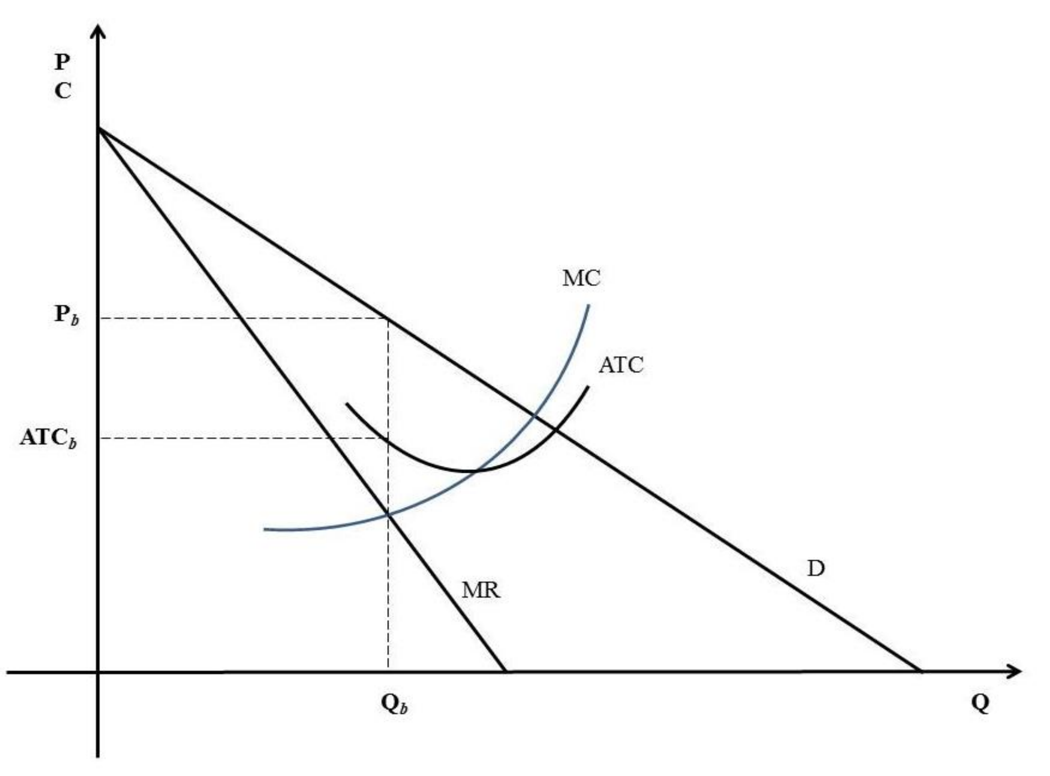
MONOPOLY: the **form of market organization in which a single firm sells a product for which there are no close substitutes**. The monopolist represents the market (opposite from perfect competition). Monopolist is a **price-maker.**

Basic reasons that can give rise to monopoly:

1. **control the entire supply of raw materials** required to produce the product.
2. **own a patent or copyright** which precludes other firms from using a particular production process or producing the same product
3. **natural monopoly = only one firm supplies the entire market**. Only one firm operates, but government regulates prices.
4. **government franchise** = firm is set up as the sole producer and distributor of a product or service but is subjected to governmental regulation (licenses for liquor stores, taxis, broadcasting).

2. Monopoly (2/3)

<u>MONOPOLY IN SHORT-RUN ANALYSIS</u>: the market demand curve of the product **is negatively sloped** = the **monopolist can sell more units of the product only by lowering price.**



P = a – bQ

a = the vertical or price intercept

–*b* = the slope of the demand curve

$$TR = PQ = (a - bQ)Q = aQ - bQ^2$$

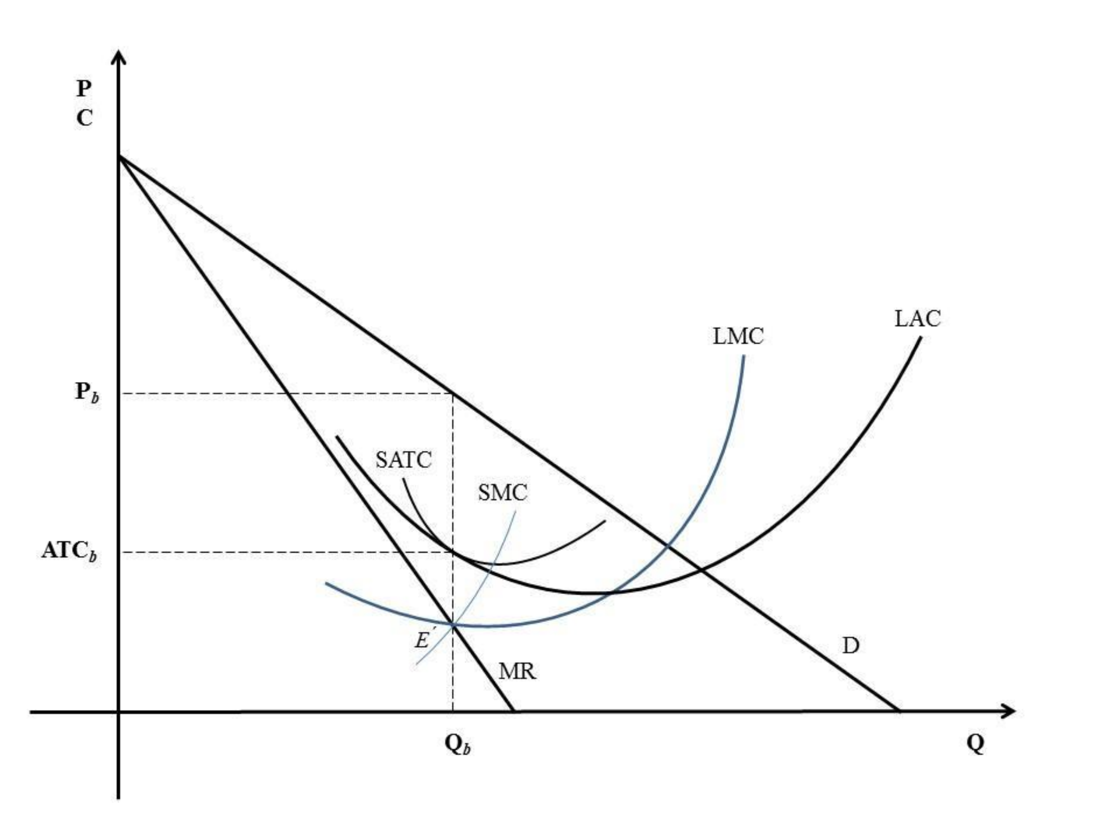
$$MR = \frac{\Delta TR}{\Delta Q} = \frac{\Delta(aQ - bQ^2)}{\Delta Q} = a - 2bQ$$

The largest profit represents the area of rectangle $Q_b(P_b - ATC_b)$.

There is no unique relationship between *P* and Q under monopoly.

2. Monopoly (3/3)

<u>MONOPOLY IN LONG-RUN ANALYSIS</u>: input and costs of production are variable.
LAC = a **cost curve** in the long run.
MR = LMC = the best level of output of the monopolist



Optimum scale: *SATC = LAC*
Long run profit: $Q_b(P_b - ATC_b)$

The market is blocked, the **monopolist** will continue to **earn** these profits in the long run **as long as the demand it faces and its cost curves remain unchanged.**

When the monopolist is in long-run equilibrium (point *E´*), it is also and necessarily in short-run equilibrium (i.e., *MR* = *SMC*), but the reverse is not true.

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Next lesson

- MARKET STRUCTURES

  Monopolistic competition

  Oligopoly

THANK YOU FOR YOUR ATTENTION!