Comparing Market Structures

AP Microeconomics | Unit 4 | perfect competition, monopolistic competition, oligopoly, monopoly

1. The whole unit in one table

	Perfect competition	Monopolistic competition	Oligopoly	Monopoly
number of firms	many	many	a few	one
product	identical	differentiated	either	unique
barriers to entry	none	low	high	very high
firm's demand curve	horizontal	downward	downward	downward
price and MR	$P = MR$	$P > MR$	$P > MR$	$P > MR$
long-run economic profit	zero	zero	possible	possible
price and MC	$P = MC$	$P > MC$	$P > MC$	$P > MC$
at minimum ATC (long run)	yes	no	no	no
efficient	**yes**	no	no	no

2. The demand curve each firm sees

Price taker or price maker

A **perfectly competitive** firm is a *price taker*: its demand curve is horizontal at the market price, so $P = MR$.
The **other three** are *price makers*: demand slopes down, so to sell more the firm must lower its price, and $MR < P$.
Every firm, in every structure, produces where $\boldsymbol{MR = MC}$.

3. Who keeps a profit in the long run

In the short run any firm can earn a profit or take a loss. In the long run it depends on **entry**:

- free or easy entry (perfect competition, monopolistic competition): profit attracts new firms until economic profit is **zero**;
- high barriers (oligopoly, monopoly): economic profit **can** last. It is possible, not guaranteed.

4. Who is efficient, and how to spot each one

Only perfect competition gives $P = MC$ (allocative efficiency) and production at minimum ATC (productive efficiency). In the other three $P > MC$: too little is produced and there is a deadweight loss. Monopolistic competition also has *excess capacity*.

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Clues in the question

- identical product, price taker, $P = MR$ → **perfect competition**
- many firms, differentiated product, easy entry → **monopolistic competition**
- a few firms, a payoff matrix, rivals react → **oligopoly**
- one seller, no close substitutes → **monopoly**

5. Monopoly vs competition, antitrust, concentration

Same demand and cost. $D: P = 12 - Q$, $MC = \$4$. Competition: $P = MC$, 8 units at \$4, $CS = \frac{1}{2}(8)(8) = \$32$. Monopoly: $MR = MC$, 4 units at \$8, $CS = \frac{1}{2}(4)(4) = \$8$, profit $(8-4)(4) = \$16$, $DWL = \frac{1}{2}(4)(4) = \$8$: less output, a higher price, $P > MC$, a smaller consumer surplus.

Antitrust policy limits market power. Blocking a merger of the largest sellers keeps prices lower for buyers; blocking a merger of the largest buyers of an input protects suppliers from below-competitive prices. A *conduct* remedy changes behavior (punishing price-fixing); a *structural* remedy changes the number or size of firms (blocking a merger, breaking up a monopoly).

Four-firm concentration ratio CR_4: the share of industry sales made by the four largest firms, e.g. $\frac{150+100+60+40}{500} = 70\%$. Near 100% suggests oligopoly or monopoly. When new firms enter (a patent expires), the ratio falls.

Where students lose points

1. Mixing up monopoly and monopolistic competition.
2. Giving a monopolistically competitive firm long-run profit.
3. Drawing a horizontal demand curve for anything but perfect competition.
4. Saying only a monopoly has MR below price: every price maker does.
5. Saying zero profit means efficient.

Now practise it

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