

Market Structure:-

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Models of Market Structure

Objectives:

To explain the formal models of market structure used in economic analysis.

Perfect competition; Monopoly; Oligopoly;
Monopolistic Competition

To explain how price is determined in these models.



Formal Textbook Models

- Economic analysis identifies four types of market structure
- PERFECT COMPETITION
- MONOPOLY
- OLIGOPOLY
- MONOPOLISTIC COMPETITION
- The basis for the STRUCTURE-CONDUCT-PERFORMANCE approach to industrial organization.
 - Structure determines prices and profitability



What Is the Structure of These Different Types of Industry? What is the Result of that Structure?

- **Perfect Competition**

- Large No of Small Firms, (i.e.No Economies of Scale), Identical Products, Free Entry to the Industry, Perfect Knowledge of market Opportunities

- see the diagrams, pp.198-200

- **SHORT RUN**

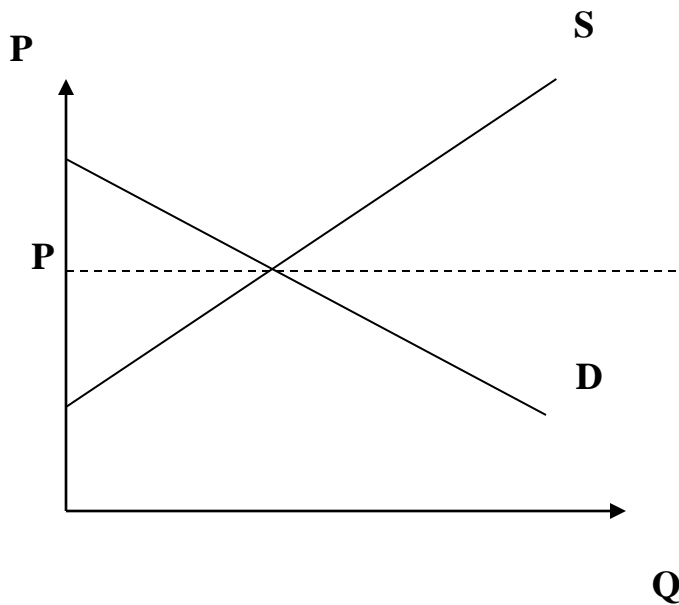
- price is determined at industry level by supply and demand
- each firm has a horizontal demand curve at the market price
- demand and marginal revenue curve are the same
- $MR = P = MC$

- **LONG RUN**

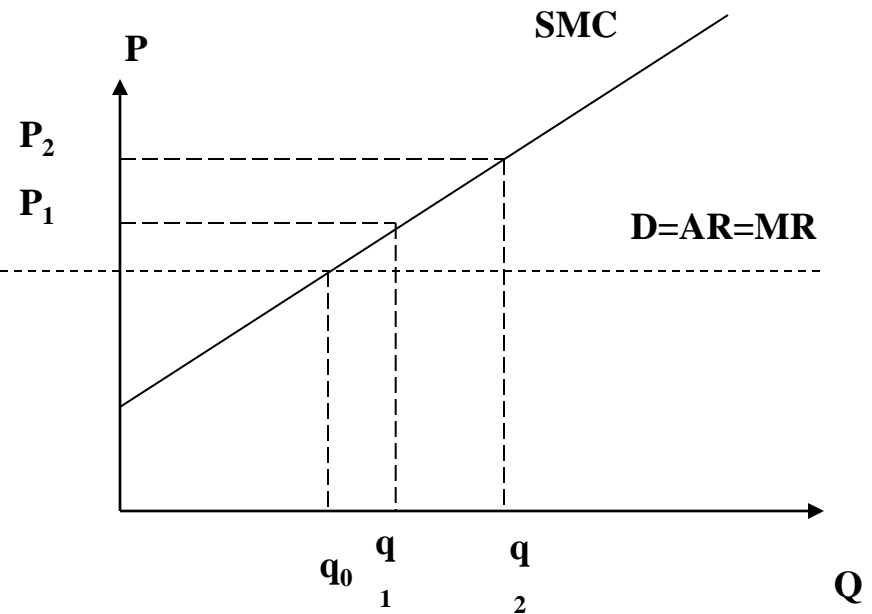
- entry takes place, shifting supply curve to the right and price down
- super-normal profits are competed away, $P = \text{minimum LAC}$

Perfect Competition: Short Run

■ Industry



Firm



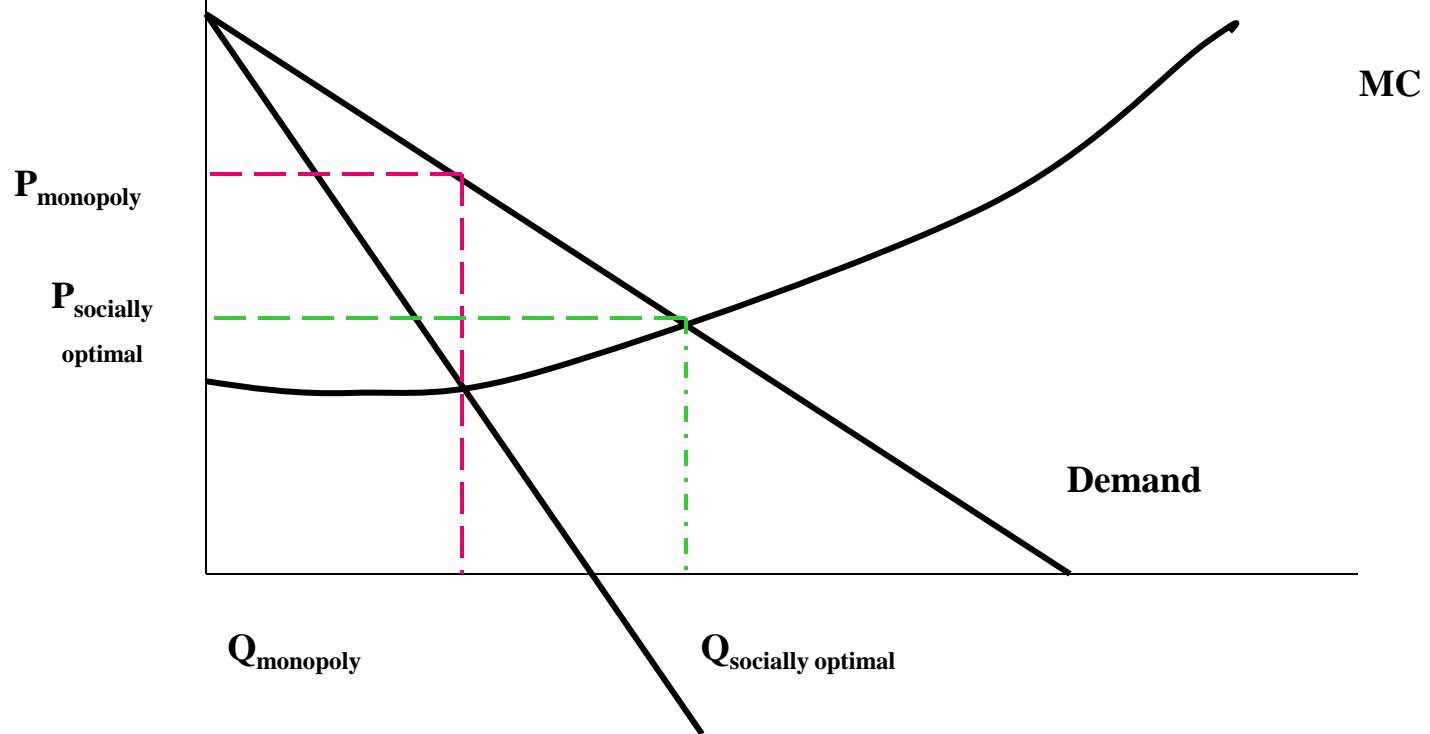


Monopoly

- One firm, no entry is possible - 'pure monopoly'
- Firm's demand-curve is industry's demand curve
- Price $>$ Marginal Cost - economic inefficiency. Super-profits can be made in the long run. The firm does not necessarily use the plant which gives lowest cost
- Most countries have some kind of anti-monopoly policy
 - note that the economic rationale for monopoly policy is $P > MC$ not $P > AC$
 - the problem is inefficiency not inequity

Monopoly

- A monopolist produces less and charges a higher price, relative to the socially optimal





Monopolistic Competition

- Many firms, free entry, differentiated products
- Downward-sloping demand-curves
- In the long-run $\text{Price} = \text{Average Cost}$. Firms have plants which are too small to take full advantage of scale economies. (But there is only an equilibrium in this market structure if heroic and perhaps contradictory assumptions made)
 - when new firms enter, they take customers in equal proportions from all old firms
 - all firms have same cost and demand curves, while producing different products
 - will new firms not imitate successful old ones?
- Kreps only introduces it because it is in the introductory texts
- Krugman cites it as the ‘analytical workhorse’ for innovative analyses

Oligopoly

- Competition amongst the Few
- Key feature is *interdependence and rivalry*
- Small number of firms (2 = duopoly)
- Condition of Entry may vary
- Product differentiation may vary
- Possible outcomes include:
 - co-operation and collusion - the monopoly price
 - price war - the perfectly competitive price
- The modern approach to oligopoly is through game theory

Oligopoly: Pre-Game Theory Ideas

- What determines whether collusion takes place or not?
 - How well-informed are rivals about each other?
 - Trade association increases probability of collusion
 - Published prices increase it
 - Slow technical progress
 - Small number of firms
 - Limited product differentiation
- The kinky demand-curve model:p.213