CHAPTER 7
Market Structure

7.1 Perfect Competition and Monopoly
7.2 Monopolistic Competition and Oligopoly
7.3 Antitrust, Economic Regulation, and Competition
CHAPTER 7

Market Structure

- What does a bushel of wheat have in common with a share of Microsoft stock?
- What’s so perfect about perfect competition?
- Why don’t most monopolies last?
- Why are some panty hose sold in egg-shaped cartons?
- Why was OPEC created?
- Is the U.S. economy more competitive now than it used to be?
LESSON 7.1

Perfect Competition and Monopoly

- 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.
LESSON 7.1

Perfect Competition and Monopoly

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

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

a) Market equilibrium

b) Firm’s demand

- Price per bushel
- $5
- 0, 1,200,000 Bushels of wheat per day
- 0, 5, 10, 15 Bushels of wheat per day

CONTEMPORARY ECONOMICS: LESSON 7.1
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

- 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

- Not guaranteed a profit
- Can lose money
- 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.
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
Monopoly, Perfect Competitor, and Consumer Surplus
Objectives

LESSON 7.2  
Monopolistic Competition and Oligopoly

▸ Identify the features of monopolistic competition.

▸ Identify the features of oligopoly, and analyze firm behavior when these firms cooperate and when they compete.
LESSON 7.2
Monopolistic Competition and Oligopoly

- monopolistic competition
- oligopoly
- cartel
Monopolistic Competition

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

- Can enter or leave the market with ease
- 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.
- Markets for cigarettes, computers, airline fares, long-distance phone service
Comparison of Market Structures

<table>
<thead>
<tr>
<th></th>
<th>Perfect Competition</th>
<th>Monopolistic Competition</th>
<th>Oligopoly</th>
<th>Monopoly</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of firms</strong></td>
<td>most</td>
<td>many</td>
<td>few</td>
<td>one</td>
</tr>
<tr>
<td><strong>Control over price</strong></td>
<td>none</td>
<td>limited</td>
<td>some</td>
<td>complete</td>
</tr>
<tr>
<td><strong>Product differences</strong></td>
<td>none</td>
<td>some</td>
<td>none or some</td>
<td>none</td>
</tr>
<tr>
<td><strong>Barriers to entry</strong></td>
<td>none</td>
<td>low</td>
<td>substantial</td>
<td>insurmountable</td>
</tr>
<tr>
<td><strong>Examples</strong></td>
<td>wheat, shares of stock</td>
<td>convenience stores, books</td>
<td>automobiles, cigarettes</td>
<td>local electricity and phone service</td>
</tr>
</tbody>
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LESSON 7.3

Antitrust, Economic Regulation, and Competition

- Explain the goal of U.S. antitrust laws.
- Distinguish between the two views of government regulation.
- Discuss why U.S. markets have grown more competitive in recent decades.
LESSON 7.3
Antitrust, Economic Regulation, and Competition

- antitrust activity
- merger
- deregulation
U.S. Antitrust Activity

- Promote the market structure that will lead to greater competition
- Reduce anticompetitive behavior
Antitrust Laws

- Sherman Antitrust Act of 1890
- Clayton Act of 1914
- Federal Trade Commission (FTC) Act of 1914
Mergers and Antitrust

- A **merger** is the combination of two or more firms to form a single firm.
- Horizontal mergers involve firms in the same market.
- Nonhorizontal mergers include all other types of mergers.
Flexible Merger Policy

- New government approach allows big companies to merge if the combination is more efficient or more competitive with other big firms in the market.
Regulation of Natural Monopolies

- The regulation of natural monopolies tries to control price, output, the entry of new firms, and the quality of service in the industry in which monopoly appears inevitable or even desirable.
Two Views of Government Regulation

- Regulation in the public interest
  - Regulation promotes social welfare by reducing the price and increasing the output when a market is served most efficiently by one or just a few firms.

- Regulation in the special interest
  - Well-organized producer groups expect to profit from government regulation by persuading public officials to impose restrictions that these groups find attractive.
Competitive Trends in the U.S. Economy

- Antitrust activity
- Deregulation
- International trade
- Technological change