

MGM 112

Introduction to Economics

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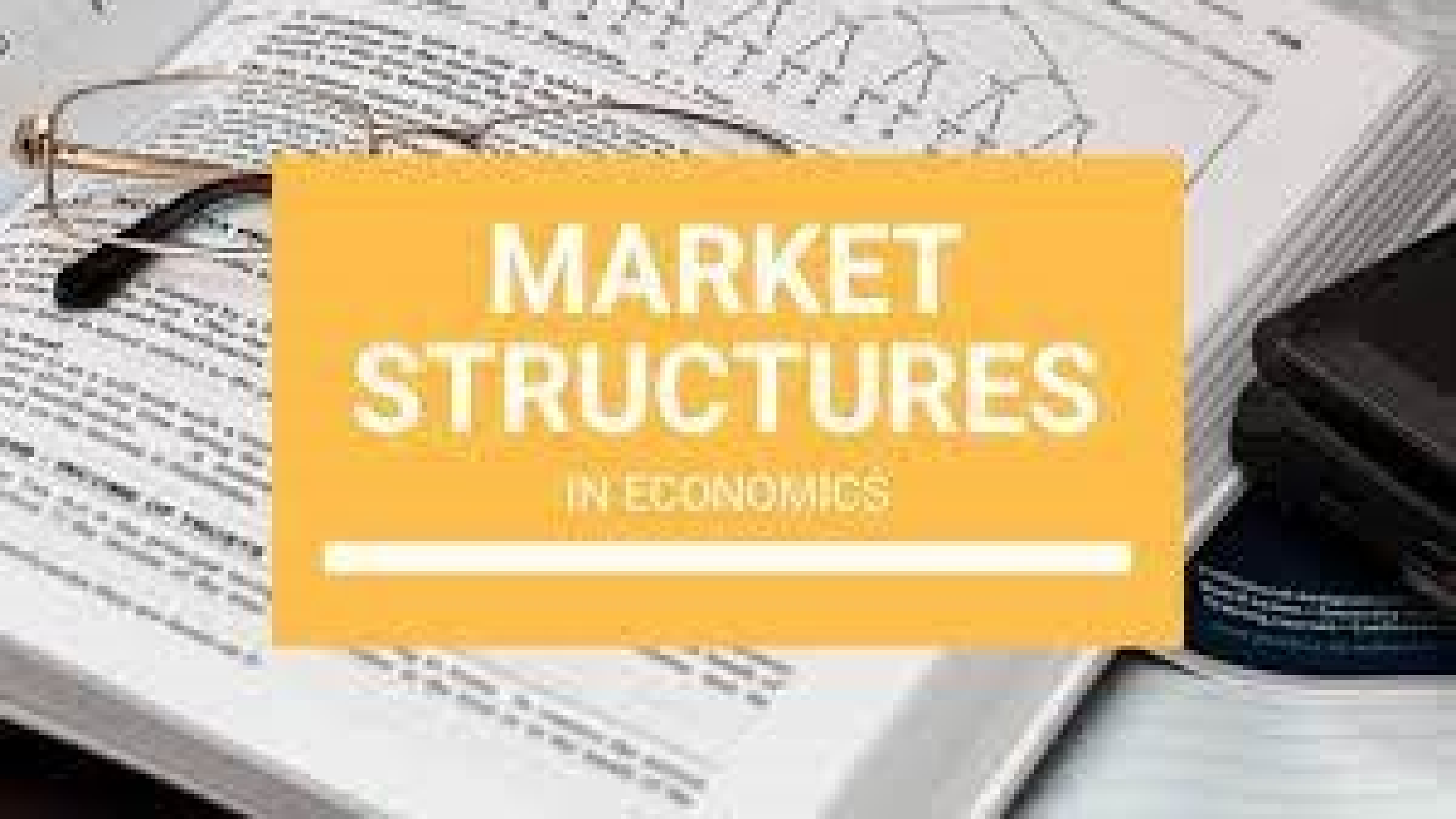


Lecture 8

The Market Structures: Perfect and Imperfect Competition



جامعة الجميع الذكية
EVERYONE'S SMART UNIVERSITY



MARKET STRUCTURES

IN ECONOMICS

Syllabus

I. The Market Structures

II-The market structures based on the number of sellers

III- The market structures based on the number of sellers

IV-Market Structures: Examples in the Real World

I- The Market Structures

I- The Market Structures

- Basically, when we hear the word market, we think of a place where goods are being bought and sold.
- In economics, market is a place where buyers and sellers are exchanging goods and services with the following considerations such as:
 - Types of goods and services being traded
 - The number and size of buyers and sellers in the market
 - The degree to which information can flow freely

I- The Market Structures

- The market structure depends upon the degree of competition prevailing in the market.
- How much is to be produced and at what price is to be sold are the two decisions taken by an individual firm or producer.
- Both of these are affected by the **market structure**.

I- The Market Structures

- The nature of the commodity determines the market structure: the **commodity** may be either **homogeneous** or identical and **heterogeneous** or differentiated.
- Also, The **number** of **buyers** and **sellers** or few sellers and large buyers or mutual interdependence of buyers and seller also **determine the market structure**.
- From the viewpoint of competition the types of market structures in economics are the following:

❖ **Perfect Competition**

❖ **Imperfect Competition**

II- The Market structures based on the number of sellers

II- The Market structures based on the number of sellers

II-1- Perfect (Pure) Competition

- A market structure where a **large number of buyers and sellers** selling **homogeneous product** and the **price is determined** by the industry.
- English economists believe that there is perfect competition while American economist supports the concept of pure competition.
- **In pure competition**, there is a lack of elements there are certain elements in existence.

II- The Market structures based on the number of sellers

- **Perfect competition** prevails when the demand for the output of each product is perfectly elastic.

*This entails first, that number of sellers is large, so that the output of any other seller is a negligible smaller portion of the total output of the commodity.

*and second, that buyers are all alike in respect of their choice between rival sellers so that the market is perfect.

II- The Market structures based on the number of sellers

Perfect Market is a market situation which consists of a very large number of buyers and sellers offering a homogeneous product. Under such condition, no firm can affect the market price. Price is determined through the market demand and supply of the particular product, since no single buyer or seller has any control over the price.

- Perfect Competition is built on two critical assumptions:
 - The behavior of an individual firm
 - The nature of the industry in which it operates

II- The Market structures based on the number of sellers

- Perfect Competition cannot be found in the real world. For such to exist, the following conditions must be observed and required:
- A large number of sellers
- Selling a homogenous product
- No artificial restrictions placed upon price or quantity
- Easy entry and exit
- All buyers and sellers have perfect knowledge of market conditions and of any changes that occur in the market
- Firms are “**price takers**”

II- The Market structures based on the number of sellers

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- The firm is assumed to be a **price taker**
 - The industry is characterized by **freedom of entry and exit**

II-1-1- Characteristics of perfect competition

- There are very many small firms
- All producers of a good sell the same product
- There are no barriers to enter the market
- All consumers and producers have 'perfect information'
- Firms sell all they produce, but they cannot set a price
- No Transport Cost Absence of Artificial Restrictions

II- The Market structures based on the number of sellers

II-1-2-Short run analysis of perfect competition

- The firm's objective is to produce the level of output that will maximize profit
- Some inputs are variable and therefore fixed costs arise regardless whether the firm is operating or not
- Since the firm is a price taker, it has no control on the price of a product

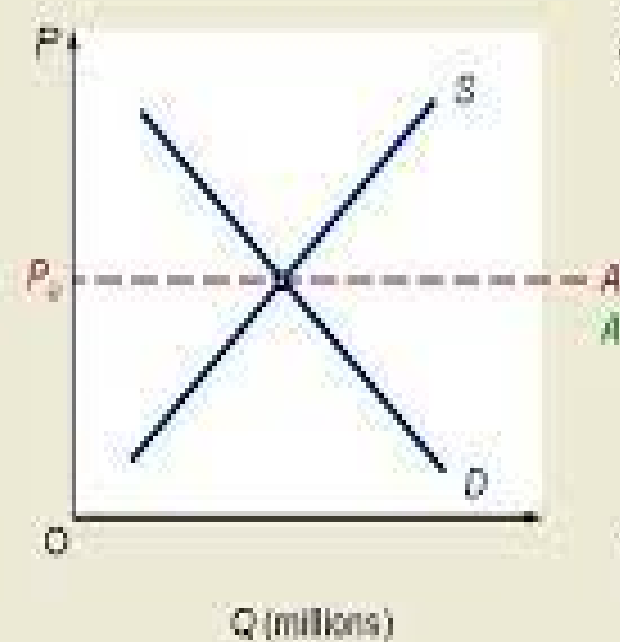
II- The Market structures based on the number of sellers

II-1-3- Short run equilibrium under perfect competition

Efficiency of short run equilibrium

- In an exchange economy, a [competitive equilibrium](#) is [Pareto efficient](#).
- In a competitive equilibrium **$p = C \text{ marg}$** in short run so no firm can sell an extra unit at a price that covers its short run marginal cost.
- Short run marginal cost is the market value of the variable inputs needed to produce the extra unit of output, so in an equilibrium it is not possible to sell another unit at a price that covers the market value of the inputs needed to produce that unit.

Short-run equilibrium of
under perfect c



(a) Industry

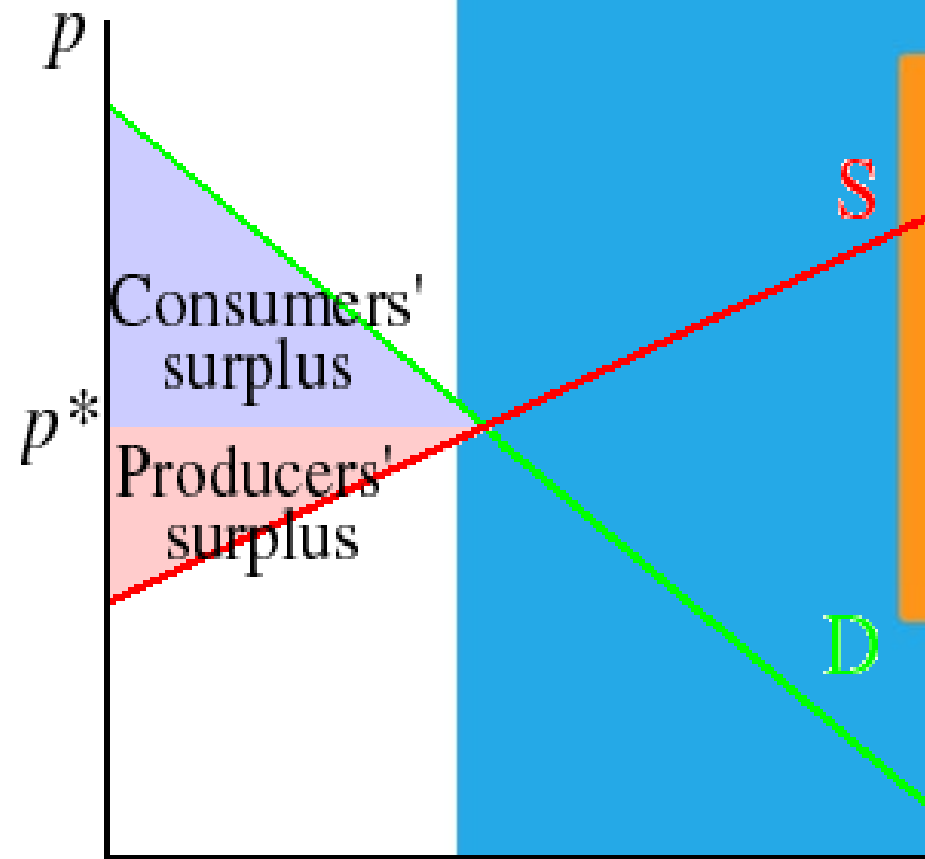
II- The Market structures based on the number of sellers

II-1-4- Long run analysis of perfect competition

- All inputs and costs of production are variable
- The firm can build most appropriate scale of plant to produce the optimum level of output.
- A rough measure of the **consumers' gains** from trade is the area under the demand curve and above the price, indicated by the light purple area in the figure below: this area is called the **consumers' surplus**.
- A measure of the **gain to the producers** is the difference between their revenue and their variable cost (since fixed cost is fixed!); this measure is called the **producers' surplus**.

II- The Market structures based on the number of sellers

- The total variable cost is the area under the supply function (which is the marginal cost function) up to the equilibrium output; so **the producers' surplus** is equal to the **area between the supply function and the price**, indicated by the pink area in the following figure.
- The sum of **consumers' surplus and producers' surplus** is a measure of the **total gains from trade in equilibrium**. As you can see, it is **maximized in a competitive equilibrium**.



II- The Market structures based on the number of sellers

- **Does Perfect Competition Exist in the Real World?**

Perfect competition is an imaginary an unrealistic market structure and it is called a Myth because of the following reasons:

- | | |
|---|---|
| 1. Lack of a Large number of Buyers and Sellers | 6. Absence of Perfect Mobility of Factors of Production |
| 2. Restrictions on Entry and Exit of Firms | 7. Presence of Transport Cost |
| 3. Existence of Artificial Restrictions | 8. Existence of Non-Price Competition |
| 4. Lack of Homogenous Product | 9. Price Differences |
| 5. No Perfect Knowledge of Market Condition | |

II- The Market structures based on the number of sellers

II-2-Imperfect market

- In economic theory, imperfect competition is a type of market structure showing some but not all features of competitive markets.
- The Forms of imperfect competition include:
 - Monopolistic
 - Monopoly
 - Oligopoly
- monopsony
- oligopsony

Competition

II- The Market structures based on the number of sellers

- On the basis of definitions of Imperfect competition we can say that the following are the salient **features of imperfect competition**:

1.A small number of buyers and sellers.

2.Ignorance or laziness of buyers and sellers.

3.Product differentiation.

4.The difference in prices.

5.Non-price competition or advertisement and sales promotion.

6.Highly transport costs.

7.Other factors prevailing in the market namely Trademark, the behavior of sellers, credit facility, home delivery and repair services, guarantee, samples, etc..

II- The Market structures based on the number of sellers

II-2-1- Monopoly

- It's a situation where there is only **one seller** of goods or services.
- **A pure monopolist**, therefore, is a firm producing a product which has **no effective substitutes** through the products of any other form effective in the sense that even though the monopolist may be making abnormal profits, other firms cannot encroach on these profits by producing substitute commodities which might and entice purchases away from the product of the monopolist.
- Thus, a Monopoly market structure is that where there is a single seller of a commodity having full control over its supply and there is no close substitute.

a-Key Features of Monopoly Market Structure

- There is only one producer or seller of goods and only one provider of services in the market.
- New firms find extreme difficulty in entering the market. The existing monopolist is considered giant in its field or industry
- There are no available substitute goods or services so that it is considered unique.
- It controls the total supply of raw materials in the industry and has no control over price.
- It owns a patent or copyright.
- Its operations are under economies of scale

II- The Market structures based on the number of sellers

b-Classifications of Monopoly:

Monopolies are classified according to circumstances they arise from, that is, cost structure of the industry, possibly the result of law, or by other means.

Natural Monopoly:

It is a market situation where is a single firm can supply the entire market due to the fundamental cost structure of the industry.

Legal Monopoly:

It is sometimes called as de jure monopoly, a form of monopoly which the government grants to a private individual or firm over the product or services.

Coercive Monopoly:

It is a form of monopoly whose existence as the sole producer and distributor of goods and services is by means of coercion (legal or illegal), so that most of the time it violates the principle of free market just to avoid competition.

II- The Market structures based on the number of sellers

c-Short run analysis of Monopoly

- A monopolist is considered a **price maker**, since he is the **sole seller** of a product that has no close substitute in the market.

d-Long run analysis of Monopoly

- In the long-run, all inputs and costs are variable, and the monopolist can make his optimal scale of plant to make the best level of output.

II- The Market structures based on the number of sellers

II-2-2- Oligopoly

- Oligopoly is also known as **the competition among law**.
- Oligopoly, in which a market is run by a small number of firms that together control the majority of the market share.

➤ Features of Oligopoly Market Structure:

1.Importance of Advertising and 2-Selling Cost 2.Interdependence 3.Group Behaviour 4.A Small Number of Sellers 5. Strong Composition	6. Homogeneous Product 7. Heterogeneous Oligopoly 8. Barriers to Entry of Firms 9. Lack of Uniformity 10. Price War 11. Demand Curve
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a-Classification of Oligopoly

Pure or Perfect Oligopoly	Imperfect or Differentiated Oligopoly	Collusive Oligopoly	Non-collusive Oligopoly
If the firms produce homogeneous products.	If the firms produce differentiated products.	If the firms cooperate with each other in determining price or output or both	If firms in an oligopoly market compete with each other

II- The Market structures based on the number of sellers

b-Types of organisation of Oligopoly:

- **Cartel** is a formal agreement among oligopolists to set-up a monopoly price, allocate output, and share profit among members.
- **Collusion** is a formal or an informal agreement among oligopolists to adopt policies that will restrict or reduce the level of competition in the market.

II- The Market structures based on the number of sellers

c- The Duopoly

- A market where there are two sellers or producers of a product is called do a **Duopoly**: it's a **special case of Oligopoly**.
- They have a complete hold over the supply of that product. A **product** of both the sellers is **Homogeneous** and the prices are also the **same**.
- Both the **firms** are **interdependent** and they try to keep the **same price**.

II- The Market structures based on the number of sellers

- If a seller of the commodity lowers the price then the other seller is forced to reduce its price because customers will prefer to purchase the [cheaper commodity](#).
- Both the sellers have to think about the possible impact when they are taking independent decisions relating to price and prediction.
- **In order to maximize the profits of each**, they may form an association or can share the market and can charge high prices for the customers.

It will lead to the exploitation of the customers.

II- The Market structures based on the number of sellers

II-2-3- Monopolistic competition

- Market situation in which there are many sellers producing highly differentiated products.
- Monopolistic competition is also perfect competition plus product differentiation.
- Product differentiation gives each monopolistic competitor some market power, since each competitor can raise price slightly without losing all its customers.

II- The Market structures based on the number of sellers

a-Characteristics of Monopolistic Concurrence:

- A large number of buyers and sellers in a given market act independently.
- There is a limited control of price because of product differentiation. [?] Sellers offer differentiated products or similar but not identical products.
- New firms can enter the market easily. However, there is a greater competition in the sense that new firms have to offer better features of their products.
- Economic rivalry centers not only upon price but also upon product variation and product promotion.

II- The Market structures based on the number of sellers

- **Thus**, Monopolistic competition is a market situation in which there are many sellers of a particular product, but the product of each seller is in some way differentiated in the minds of consumers from the product of every other seller.

Monopolistic competition is the market structure in which there is co-existence of competition and Monopoly to some degree.

II- The Market structures based on the number of sellers

MARKET STRUCTURES

Market Structures

Perfect Competition

Large number of buyers and sellers

Homogeneous Product

Perfect substitutes available

Free entry and exit

Perfect knowledge and information

No advertising or product innovation

Monopolistic Competition

Many sellers

Differentiated product

Close substitutes available

Relatively free entry and exit

Non-price competition in the form of advertising and product innovation

Oligopoly

Few sellers

Homogeneous or differentiated product

Interdependent decision-making

Substitutes may or may not be available

Very difficult entry and exit

Strategic pricing, output decisions and marketing efforts

Monopoly

Single producer and seller

No close substitutes available

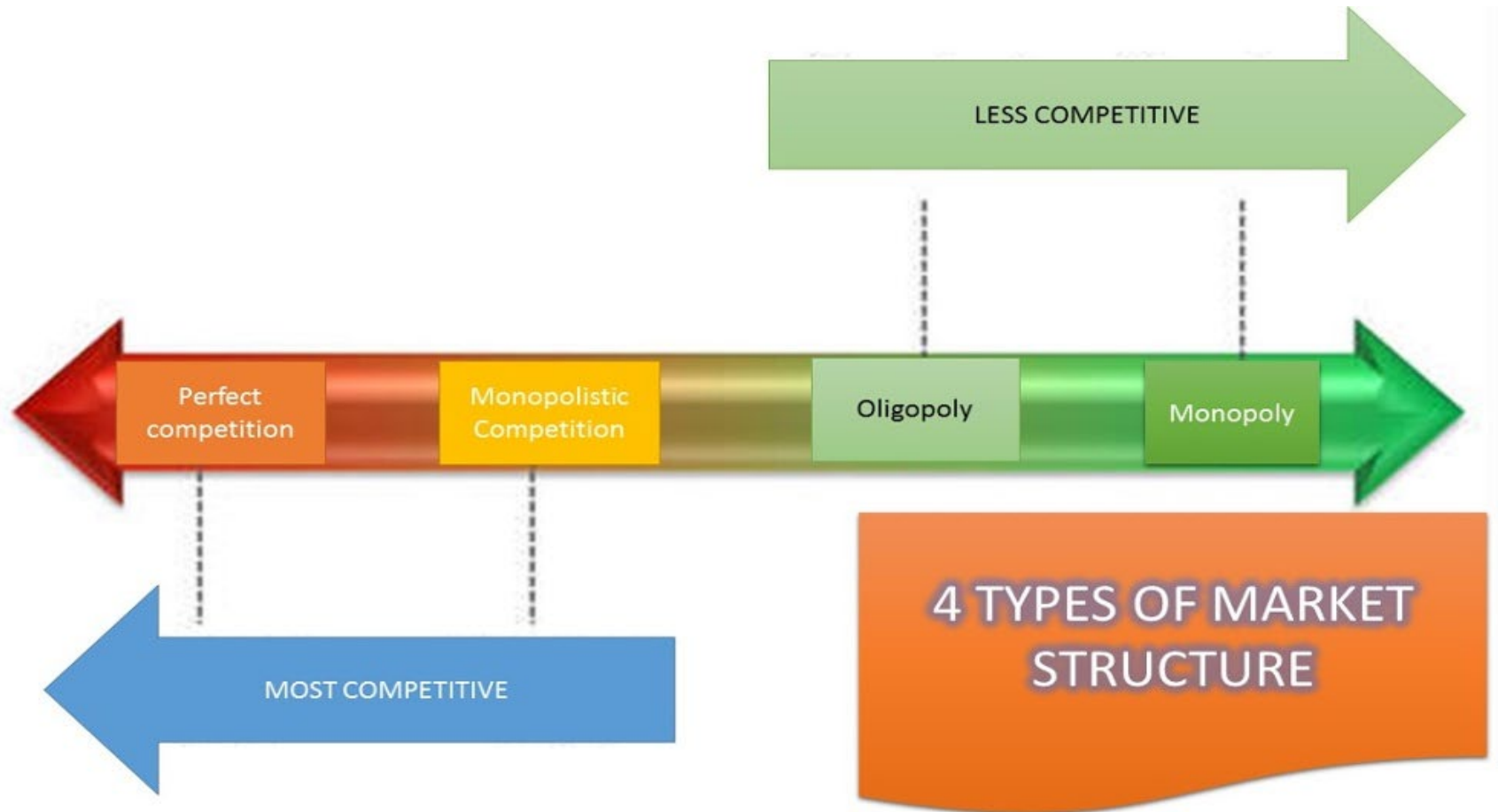
Impossible entry (pure monopoly), or may face threat of potential entrants (contestable monopoly)

Usually regulated public utilities (natural monopolies that produce essential goods)

Lecture 8

- Thus, there are **two extremes of market structure**:
 - * On the one hand, we have perfect competition or pure competition and
 - * monopoly on the other hand.
- Between these two extremes we have imperfect competition consisting of monopolistic competition, oligopoly (and duopoly).

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III- The Market structures based on the number of buyers

III- The Market structures based on the number of buyers

- Market structure is also based on the number of buyers. It may be of the following types:

III-1- Perfect Competition

A market with a **large number of buyers and sellers** and very similar products, .

III-2- Monopsony

- A market where there is a single bar of a commodity or service is called Monopsony.

III- The Market structures based on the number of buyers

III-3- Oligopsony

- A market structure in which there are **few buyers** of a product the market is called Oligopsony.
- These buyers can influence the price in the market by an agreement of association.
- A special case of Oligopsony is **Duopsony**.

A market where there are two buyers of a commodity or product is called **Duopsony market**.

IV-Market Structures: Examples in the Real World

Competition

Burger King, McDonald's, and Wendy's are examples of competition. They all sell similar products and try to advertise their differences from the other. They also all have value menus in hopes to attract people to their restaurant and increase profits.



IV-Market Structures: Examples in the Real World

Monopoly



Back in the late 1800s and the early 1900s when railroads were first being built, the owners of the companies building these railroads also owned the steel companies and the coal companies; all of the things needed to make these railroads successful.

Monopolistic Competition

Car companies are an example of monopolistic competition. There are many sellers and many buyers. They all have similar products, cars, but they all make different types of cars.



IV-Market Structures: Examples in the Real World

Oligopoly

The Coca-Cola logo, featuring the brand name in its iconic red script with a white outline.

Coca-Cola and Pepsi are examples of an oligopoly. They sell similar but slightly different products and there are very few sellers. For example, Coke and Pepsi are both cola's, but have slightly different flavors.





SUMMARY

A

N

Y

E

Classification of markets

PLACE

LOCAL

NATIONAL

INTERNATIONAL

TIME

Very Short Period

Short Period

Long Period

Very Long Period

COMPETITION

IMPERFECT COMPETITION

MONOPOLY

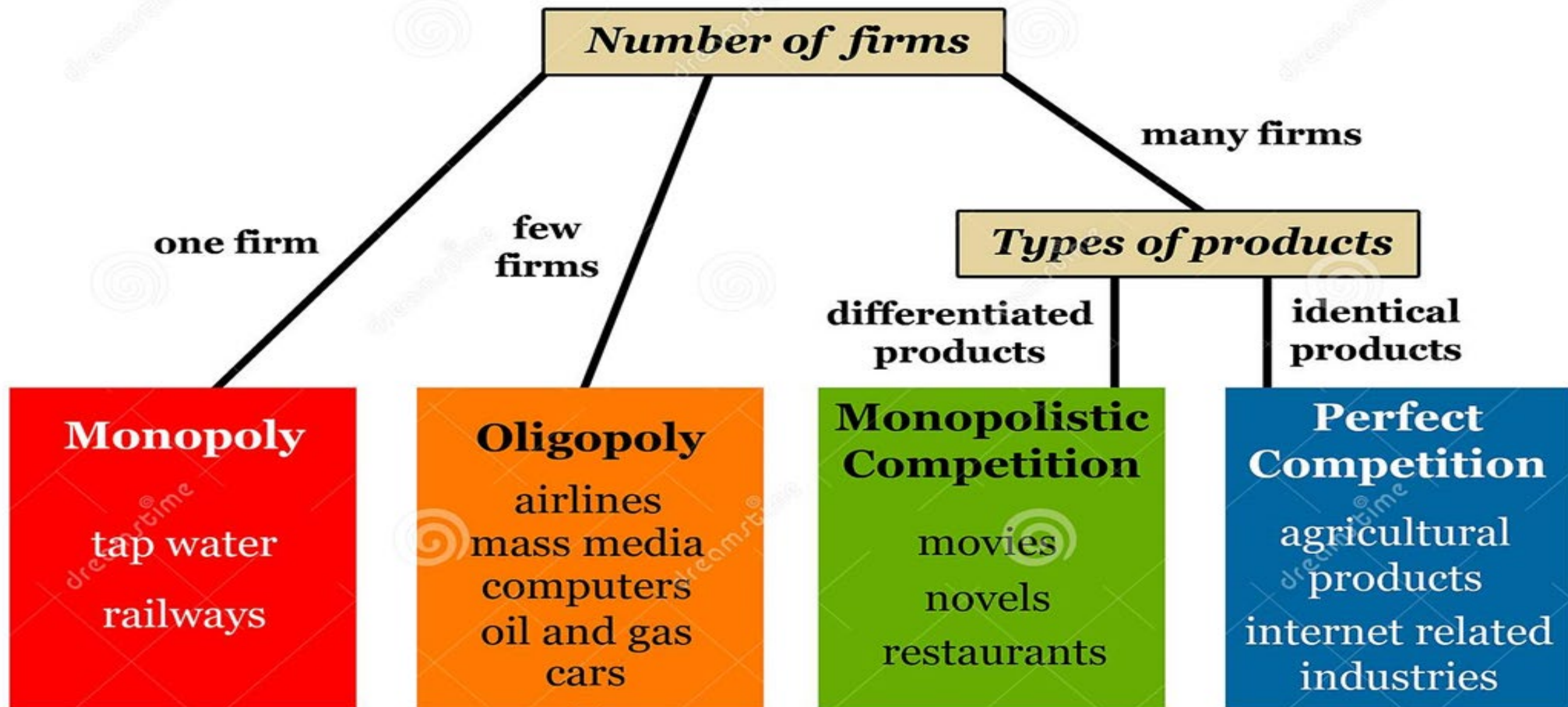
DUOPOLY

MONOPOLISTIC
COMPETITION

OLIGOPOLY

PERFECT COMPETITION

The four types of Market Structure



Quick Reference to Basic Market Structures

Market Structure	Seller Entry Barriers	Seller Number	Buyer Entry Barriers	Buyer Number
Perfect Competition	No	Many	No	Many
Monopolistic competition	No	Many	No	Many
Oligopoly	Yes	Few	No	Many
Oligopsony	No	Many	Yes	Few
Monopoly	Yes	One	No	Many
Monopsony	No	Many	Yes	One



THANK YOU