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Monopolistic competition

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MONOPOLISTIC COMPETITION

A market form in which there is:

1) Product differentiation.
2) Many firms.
3) Easy entry and exit.

The importance of monopolistic competition is that it seems to explain aspects of many important real world markets.

SOME EXAMPLES

Shoe stores

Pizza parlors

Fast food, in general

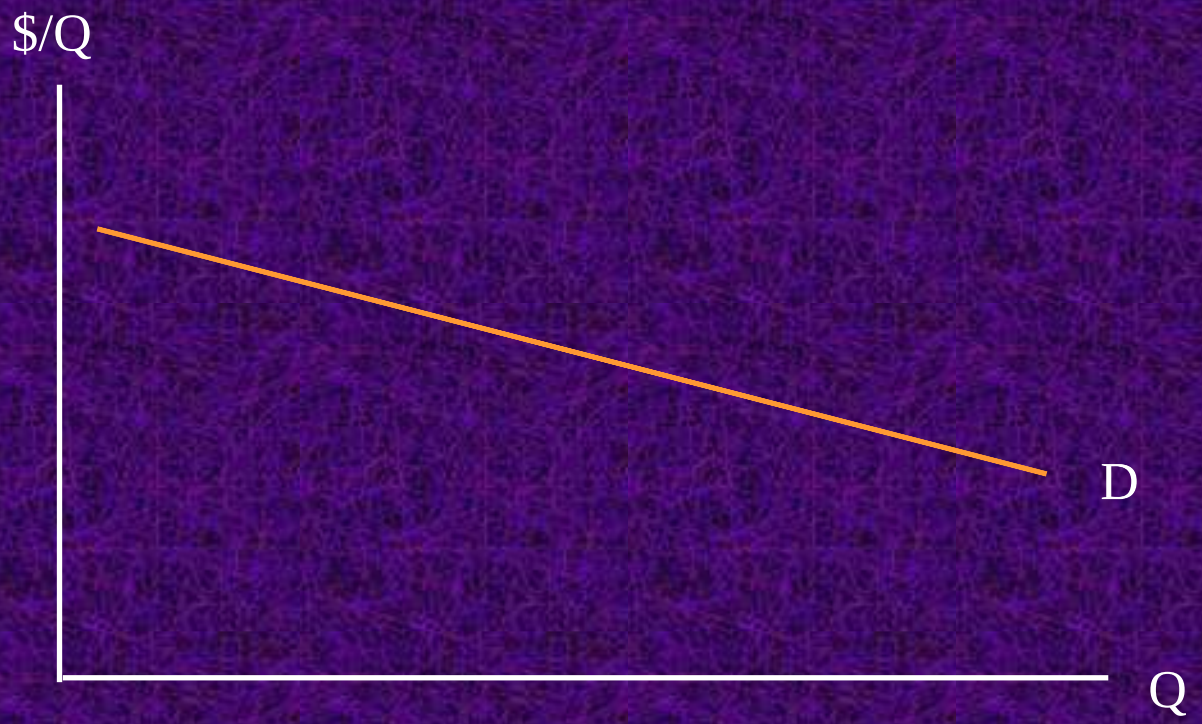
Local moving companies

Hand calculators

PC compatible clones

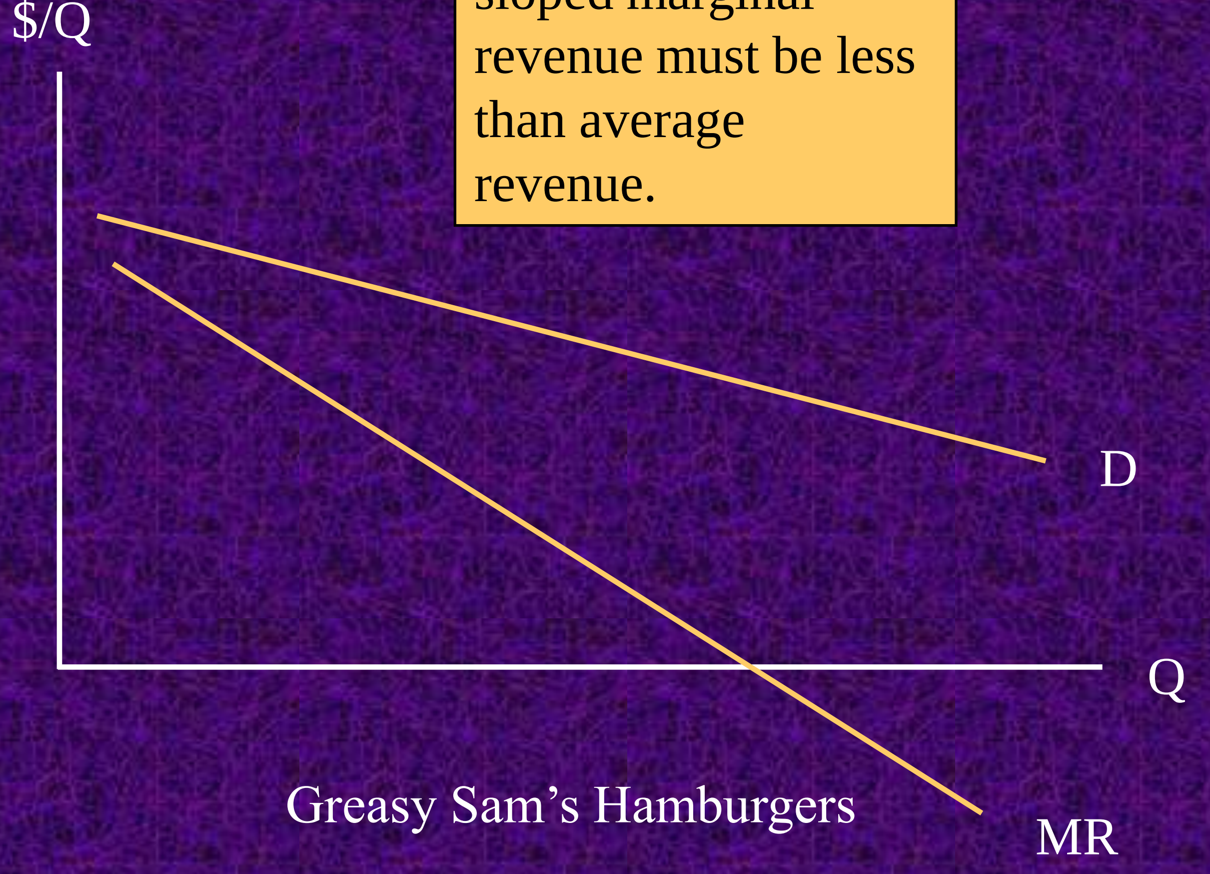
Others you can think of ...

The demand curve facing a monopolistically competitive firm looks very much like that facing a monopoly, but it is very elastic due to the presence of many close substitutes.



Greasy Sam's Hamburgers

Because the demand curve is negatively sloped marginal revenue must be less than average revenue.



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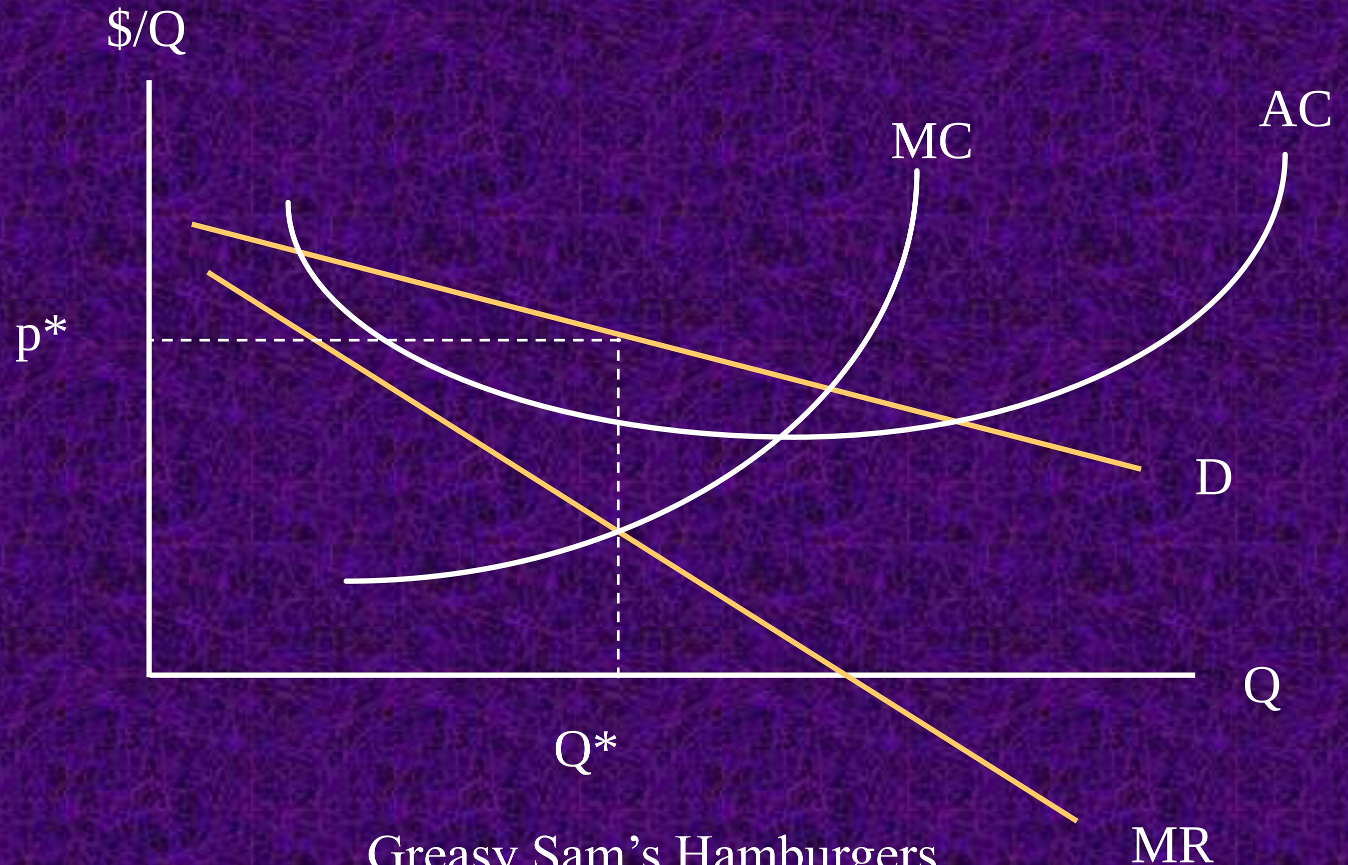
The short-run analysis of the monopolistically competitive firm proceeds exactly as for monopoly, because in the short-run entry and exit are not possible.

With the the cost curves shown below, the firm can maximize profits by choosing output where MC = MR.



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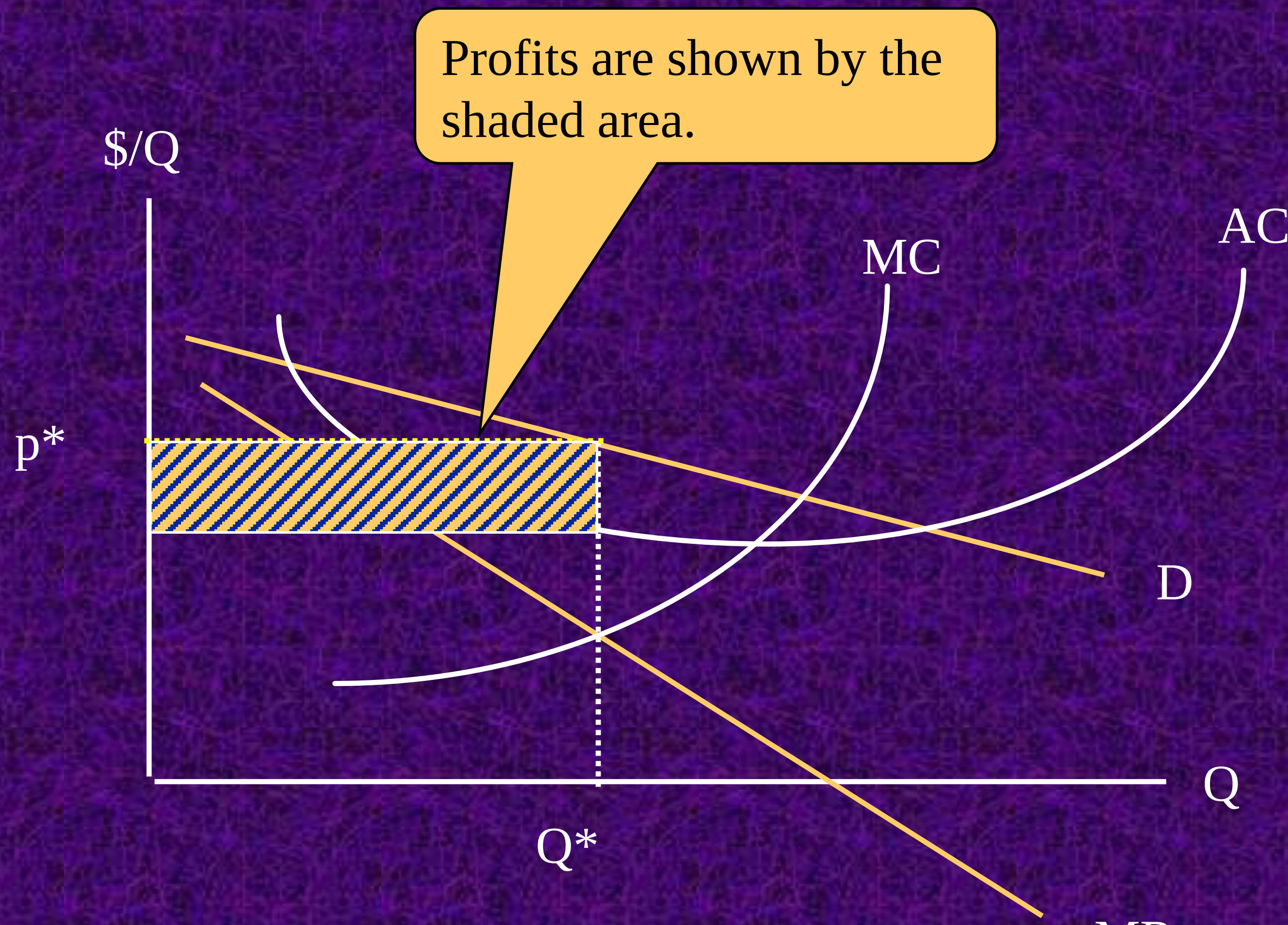

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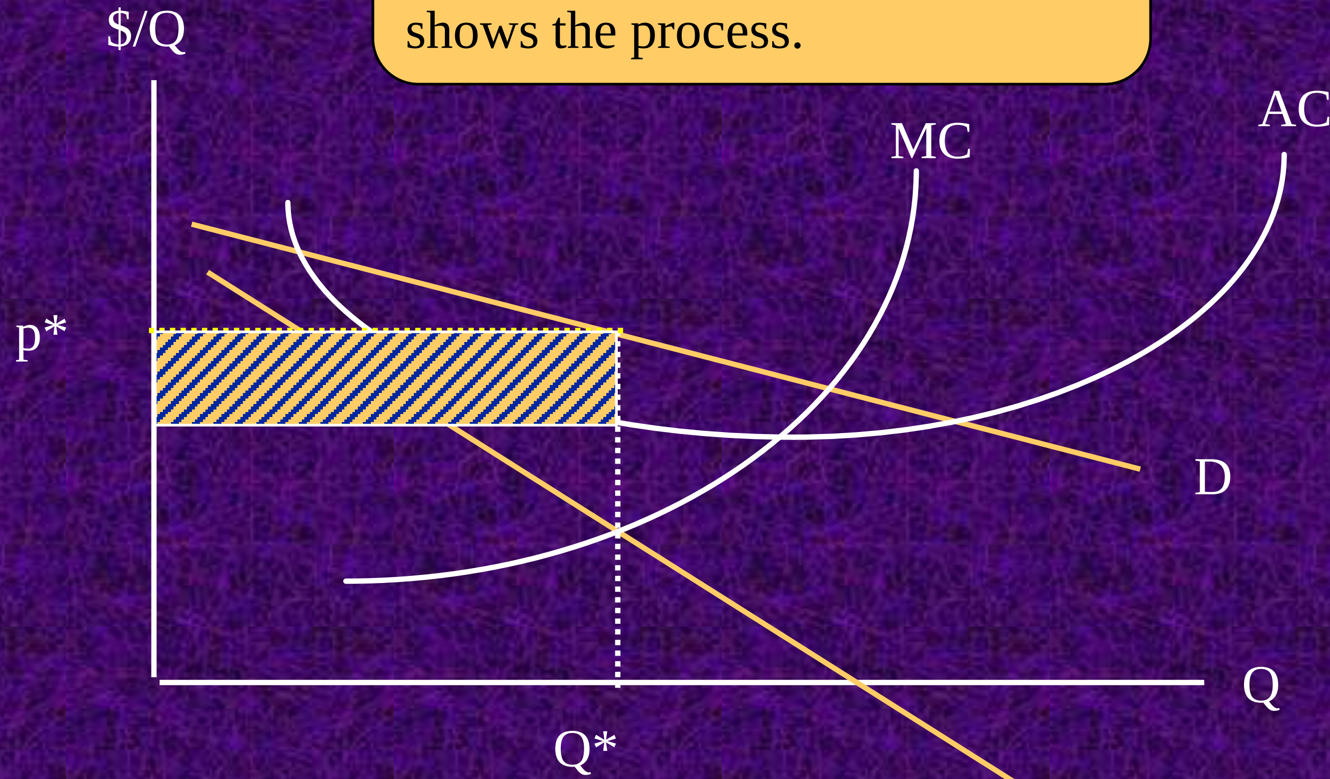
What happens in the long-run, as firms can enter or leave?

The following hidden slide shows the process.



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Hidden slide

Do monopolistically competitive firms operate in society’s interest? Do they produce outputs and sell at prices which maximize surplus? Are the firms economically efficient?

SUMMARY OF MONOPOLISTIC COMPETITION

1) In the short-run firms choose price and output by setting MC = MR.
2) In the long-run entry of new firms assures that profit will be zero.
3) Some economic inefficiency exists because in equilibrium price is higher than marginal cost.