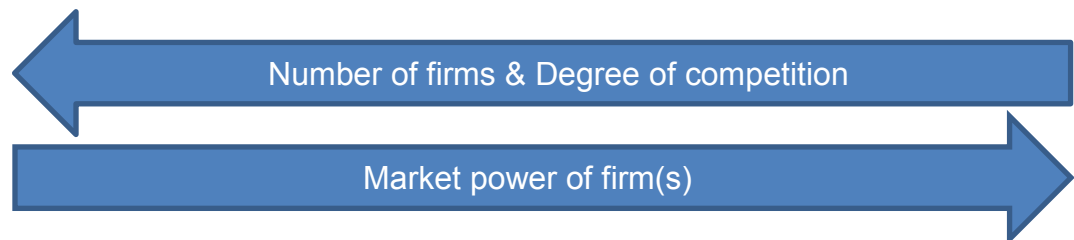




## Microeconomics: Different Types of Market Competition

Free markets can be classified based on the degree of competition a firm face in them. Degree of competition increases as the number of firms in the market increases. Contrary to the degree of competition, a firm's market power decreases as the number of firms in the market increases.

There are 4 types of market competition:



| Types                      | Perfect Competition          | Monopolistic Competition     | Oligopoly            | Monopoly                 |
|----------------------------|------------------------------|------------------------------|----------------------|--------------------------|
| Examples                   | Flour<br>Milk                | Restaurants<br>Novels        | Smart Phones<br>Cars | Tap water<br>Electricity |
| Goal                       | Maximize profits   $MC = MR$ |                              |                      |                          |
| Short run economic profits | Yes                          |                              |                      |                          |
| Long run economic profits  | No                           | No                           | Yes                  | Yes                      |
| Price taker                | Yes   $P = MC$               | No   $P > MC$                |                      |                          |
| Welfare-maximizing output  | Yes                          | No                           |                      |                          |
| # of firms                 | Many                         | Many                         | Few                  | One                      |
| Product                    | Effectively the same         | Similar with differentiation | Effectively the same | N/A                      |
| Barriers to entry          | No                           |                              | Yes                  |                          |

*P: Price*

*MC: Marginal Cost*

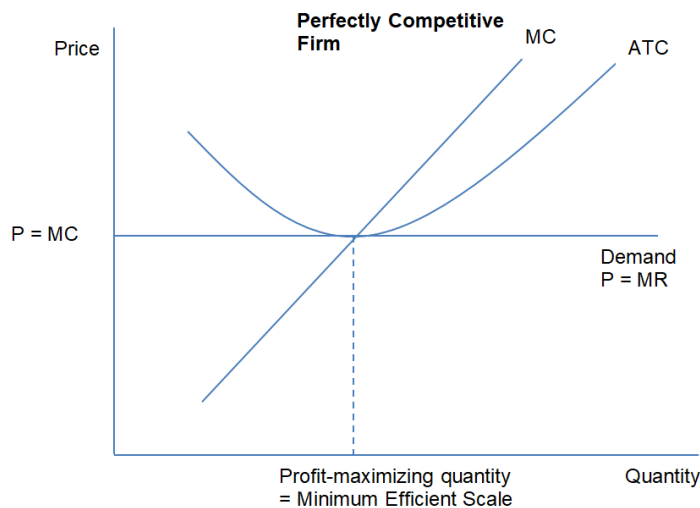
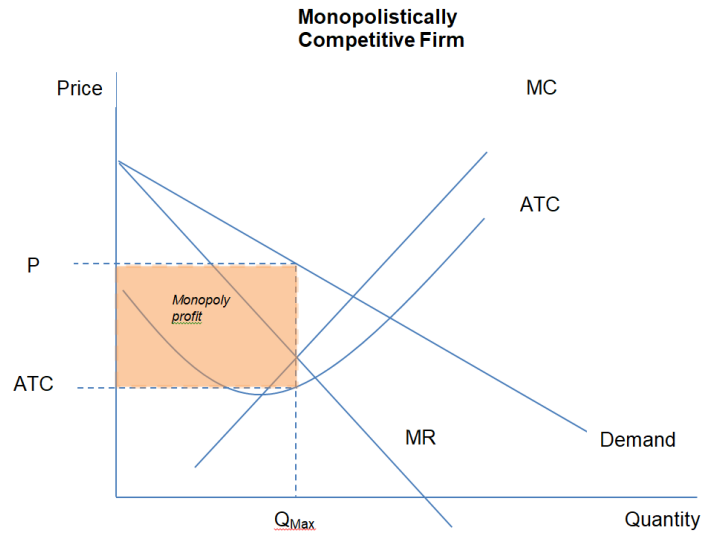
*MR: Marginal Revenue*

The given monopoly examples are natural monopolies because a second firm will need to build the whole pipeline/power-grid to provide the same good and is not cost efficient to do so. However, monopolies can also be artificially made (i.e. ICBC, De Beers until the start of the 21<sup>st</sup> century).



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From the above graphs, we observe that a monopoly is able to choose to produce the quantity and set the price that will maximize profit, contrary to a perfectly competitive firm, who is a price taker and has to produce the quantity where its  $MC = P$  in order to maximize profit. We also observe that a monopoly can achieve economic profit (profit after direct and opportunity cost) while a perfectly competitive firm can only realize nominal profit (profit after direct but before opportunity cost).

Additionally, we observe that a perfectly competitive firm's profit-maximizing quantity is equal to the Minimum Efficient Scale (MES), which is the optimal level of output for a firm and minimizes long-run average total cost. On the other hand, a monopoly will produce the profit maximizing, instead of the most cost efficient, quantity.



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## Practice Problems

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1. Which type of market competition has the highest degree of competition?
  - a) Perfect Competition
  - b) Monopolistic Competition
  - c) Oligopoly
  - d) Monopoly
2. Which type of market competition represents the vast majority of firms?
  - a) Perfect Competition
  - b) Monopolistic Competition
  - c) Oligopoly
  - d) Monopoly
3. Why would perfectly competitive firms continue to operate if they cannot make any economic profit in the long run?
  - a) Some business owners do not have a business degree, and they don't know what they are doing
  - b) They are making nominal profits over their direct costs, which could be the best option/opportunity for them
  - c) Economic theories are just theories and are not applicable in real life
  - d) They hope to capture the whole market and become a monopoly one day
4. Do firms in a monopolistic competition market have pricing power?
  - a) Yes, they have absolute power to price their products
  - b) Yes, they have some power to price their products
  - c) No, they have absolutely no power to price their products
  - d) It depends. Some do, some do not.
5. What are some characteristics of a monopoly?
  - a) They can make sustainable economic profits in the long run.
  - b) The quantity of good they choose to produce will maximize their expected revenue.
  - c) They are always profitable.
  - d) All of the above.

## Solutions

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1. a
2. b
3. b
4. b
5. a

