Comparing Market Structures – Please submit your completed assignment when finished.

1. **Consider the similarities and differences between perfect competition and monopoly. Identify the similarities and differences that are most important in your opinion. In a well-developed paragraph, discuss two similarities and two differences between perfect competition and monopoly that you feel are most noteworthy.**
   Perfect competition and monopoly are similar in two ways. For instance, they are both extreme market structures. Additionally, both market structures face the same cost and production functions, and shutdown decisions are motivated just the same in each market structure. The two contrast greatly, however. In perfect competition, there are many firms who share the market, with no one firm possessing market control. In a monopoly market structure, on the other hand, there is one firm that dictates prices and supply of goods. Another important difference between the two is that in perfect competition, equilibrium is possible only where Marginal Revenue and Marginal Cost are equal, and price, given that demand is perfectly elastic, is equal to AR which is equal to Marginal Revenue. In monopoly, however, equilibrium still occurs at the intersection of MR and MC, but price is generally set above Marginal Cost so the monopoly firm may earn a positive profit.
2. **Consider the similarities and differences between perfect competition and monopolistic competition. Identify the similarities and differences that are most important in your opinion. In a well-developed paragraph, discuss two similarities and two differences between perfect competition and monopolistic competition that you feel are most noteworthy.**
   Perfect competition and monopolistic competition are far more closely related than perfect competition and regular monopoly are. Two key similarities are that there are a large number of firms and there is freedom of entry and exit for these firms. This is what distinguishes monopolistic competition from standard monopoly and makes it much more related to perfect competition. In perfect competition, the large number of firms are all essentially the same (producing the same product, making zero profit in the long run, et cetera), and all have easy entry and exit to the market in the long run, entering and exiting based upon the existing of profit or loss. Monopolistic competition is similar, in that there are many firms that are all competing with one another, and these firms may freely enter and exit as they see fit due to incentive or disincentive in the long run. Unlike perfect competition, however, firms competing in monopolistic competition can engage in product differentiation and variation, a form of non-price competition, and attempt to draw consumers away from other firms on those grounds. Additionally, firms in monopolistic competition typically charge a price higher than marginal cost, which creates deadweight loss and provides profit for the firm. This does not occur in perfect competition, as under perfect competition, demand is perfectly elastic (it is only elastic in monopolistic competition) and price is always set to AR = MR where MR intersects MC. As such, under perfect competition, there is no deadweight loss.
3. **Consider the similarities and differences between monopoly and monopolistic competition. Identify the similarities and differences that are most important in your opinion. In a well-developed paragraph, discuss two similarities and two differences between monopoly and monopolistic competition that you feel are most noteworthy.**
   Monopoly and monopolistic competition are also closely related. Two similarities are that in both, firms are price-makers and there is excess capacity. In monopoly, a single firm is able to set its price above marginal cost with a desire to make a profit, disregarding allocative efficiency and instead seeking the most profitable price. Similarly, all firms in monopolistic competition

seek to do the same to the best of their ability while considering the existence and behavior fo the competing firms. As such, there is excess capacity. Also, deadweight loss occurs in both, as price is not set at the equilibrium, and consumer and producer surplus are not each maximized. One critical difference is that monopolistic competition, while it does experience deadweight loss just like a monopoly market structure, sees a much less severe level of deadweight loss. Another key difference, besides the fact that there are multiple firms in monopolistic competition capable of freely entering and exiting the market and only one firm in a monopoly, is that the very nature of these many competing firms leads to competition in terms of prices as well as non-price competition, such as product differentiation. A monopoly does not have to experience this, as the single firm in that market bars entry to competitors and is able to set prices and product design and output as it sees fit. For monopolistic competition, it is much more important to consider these factors so firms may compete with one another and earn a profit.

Short Answer Questions:

4. Why is deadweight loss less severe in monopolistic competition compared to monopoly? **Unlike a monopoly, in a monopolistic competition market structure, even though producers will try to set prices above marginal costs, the competition that firms experience from all the other firms in the market necessitates prices to be lower, thereby decreasing deadweight loss compared to a normal monopoly.**
5. **Collusion** is when a small group of firms band together to set prices and/or restrict quantity to create monopoly power. This would typically be seen in which market structure? **Oligopolistic Markets have few competitors and may see collusion, either explicit or tacit, or the formation of cartels to artificially set prices higher/reduce output to earn greater profits at the expense of the consumer.**
6. Why is demand less elastic in monopolistic competition than perfect competition? What impact does this have on price? **In perfect competition, demand is perfectly elastic for individual firms, because there is no product differentiation or product variation. All firms are price-takers and have no price making ability, and therefore, all firms are essentially the same in the good or service they provide. In monopolistic competition, however, demand is less elastic, but still elastic, because competing firms now have the price making ability of product differentiation and variation. Firms are now price searchers or price makers. Therefore, price goes up some as firms utilize their abilities and seek to make a positive profit, creating some deadweight loss in the process.**
7. What is the link between product differentiation and non-price competition? How does advertising (or branding) influence the elasticity of demand for a monopolistic competitor? How is this beneficial to monopolistic competitors? **Product differentiation is a form of non-price competition in which firms attempt to set their products apart on the basis of design, features, workmanship, quality, and other factors. Essentially, it is a form of non-price competition wherein firms attempt to appeal to consumers by offering versions of products perceived to be superior to competing firms. Advertising and branding are a critical part of this, creating an image for the firm or product in question, intended to make the product choice more desirable to consumers. In so doing, it should affect elasticity of demand by reducing elasticity, as price becomes less of a consideration for the consumer and the brand,**

image, or quality/features of the product become a greater consideration. This benefits monopolistic competitors because it means they can charge a higher price for their variant of the product or direct more consumers to their firm instead of competitors, both helping to result in positive profit.

8. Although monopolistic competition produces inefficiency and deadweight loss, consumers still benefit from this type of market structure. Why might consumers prefer monopolistic competition to perfect competition? **Unlike perfect competition, even though there is inefficiency, deadweight loss, and perhaps higher prices, there is more choice for the consumers. Different firms offer slightly different and more varied products/services, as well as items that appeal to certain segments of consumers. Greater choice is something consumers generally enjoy.**

Scenarios: Read the descriptions provided. Analyze each description and identify the market structure that best characterizes the structure the business operates in. Explain your reasoning.

9. Oh So Fresh Deodorants: Oh So Fresh Deodorants produces a variety of deodorants and antiperspirants. In the market for deodorant, there is a great deal of competition. Oh So Fresh Deodorants spends a great deal of money of advertising in order to influence consumer demand. Its "brand power" has become strong enough that Oh So Fresh is able to sell its product for a price higher than many of its competitors. **Monopolistic Competition. There are many firms that are competing in this market, and Oh So Fresh Deodorants engages in non-price competition through advertising. These are features of Monopolistic Competition.**

10. Old McDonald's Farm Fresh Foods sells its goods at the local farmers' market, along with a very large number of other farmers. Old McDonald's goods are just like the other farmers' goods and he is unable to set the price of his goods higher than the prevailing rate at the farmers' market. **Perfect Competition. Old McDonald is the same as every other firm in this market, and no firm has the ability to be a price maker. They are all price takers. These are characteristics of Perfect Competition.**

11. Intra-city Internet provides internet access to all local residents in the local area. The company is earning a positive economic profit. Other firms have considered entering the industry, but the upfront costs associated with providing internet service are extremely high. As a result, Intra-City Internet is able to continue earning economic profits into the long run. **Monopoly. IntraCity Internet is the sole firm operating in this market, and the barriers to entry for other firms is high. It is a price-making firm and earns a positive economic profit, so price exceeds marginal cost. These are characteristics of a Monopoly.**

12. Energy Up is a large energy drink producer with distribution centers located around the country. It has significant competition from several other energy drink producers. In order to gain a greater portion of the market and positively impact profits, Energy Up has considered various pricing strategies. Energy Up had to remain mindful of how other firms might price and react to their pricing strategies. **Oligopolistic. Even though there are other firms in this market, it is not a significant number (re: several). Additionally, Energy Up had to pay attention to the behavior of rival firms that control significant portions of this market as it moved ahead to**

implement pricing strategies to positively impact its profits and its market share. These are traits of an Oligopolistic market structure.

Graphing:

13. Draw the graph of a monopolistically competitive firm in long run equilibrium. Label the profit maximizing level of output Qmc and the price the firm will charge Pmc. Next label the allocatively efficient level of output Qa and the corresponding price Pa. How is the market negatively impacted by monopolistic competition? Shade in the loss to society on the graph.
14. Draw side by side graphs of a monopolistically competitive market and a firm operating in that market earning short run losses.
    a. What must be true in order for this firm to be operating while incurring a loss?
    b. How will the market graph adjust in the long run due to the short run losses?
    c. What will happen to demand at the representative firm? What impact will this have on the economic profit earned by the firm?
    d. Using your graphs, show the process that will result in the firm earning zero economic profit.
    e. How does this long run equilibrium compare to that of a perfectly competitive firm?