Economics Workshop

Topic 8: Imperfect Competition

PART 1

Follow the steps for drawing equilibrium diagrams for monopolistic competition and oligopoly:

1. Draw the demand curve (*D* = *AR*).
    - For monopolistic competition, each firm faces a ______________________ demand curve.
    - For oligopoly, the demand curve will depend on the model used; usually it will be kinked.
2. Draw the marginal revenue curve (*MR*).
    - For both market structures, *MR* is ____.
3. Draw in the usual marginal cost curve (*MC*).
    - For oligopoly, under the kinked demand curve model, it must cut the *MR* curve through the ______________________.
4. Find the profit-maximising output by choosing the output level *Q** where *MC* = *MR*.
    - For oligopoly, under the kinked demand curve model, this will be at the _________________.
5. Find the price (*P**) charged for this level of output. The demand curve (*AR*) tells us the price.
    - For both market structures, the price will depend on _________________________________.
6. Draw the average cost curve (*AC*) so that the marginal cost cuts through the minimum point on the average cost curve. The vertical position of the average cost curve will depend on whether we want to show the firm earning profit or losses.

    In the long run,

    - monopolistically competitive firms will be making _______________, where their demand curves are ______________________to their LRAC indicating no further incentive could be gained for new firms.
    - Oligopolists are likely to be making ______________________.
7. Find the average cost of making *Q**. Mark it on the diagram AC*
8. Find the level of profit. If price exceeds average cost, then the firm is making profit per unit of ______________________. Total profit is ____.

PART 2 (QUESTIONS WILL BE A COMBINATION OF TOPIC 7 & 8)

1. Explain why under **perfect competition** the price charged to customers is equal to the marginal cost? Draw a diagram representing the long-run equilibrium under perfect competition.

2. Explain how the following factors affects the degree of market power and competition enjoyed by the firm:
   (a) Number of firms in the industry
   (b) Freedom of entry into the industry
   (c) Nature of product
   (d) Degree of control the firm has over the price (shape of demand curve)
   (e) Producers and consumers knowledge to the market

3. What is the key feature which distinguishes monopolistic competition from perfect competition?
   a. Unrestricted entry
   b. Unique product
   c. Elastic demand curve
   d. Degree of control the firm has over the price

4. What is the key feature which distinguishes oligopoly from monopoly?
   a. Restricted entry
   b. Unique product
   c. Inelastic demand curve
   d. Perfect knowledge

5. Clams Pty Ltd and Nest Pty Ltd operate in a duopolistic market. Each company has fixed costs of $0.5m and variable costs of $1 per unit. The product is sold for $1.50 per unit. They are considering the amount they should spend on advertising, $1m or $4m. If:
   - Each spends the low amount on advertising (i.e. $1m each), the total market of 10m units will be shared equally between them.
   - Each spend a higher amount on advertising (i.e. $4m each), the total market of 20m units will be shared between them.
   - One firm spends a low amount and the other a high amount, the total market of 15m units will be shared in the ratio 1:4 respectively.

   (a) Complete the payoff table below to show the profit received by each company for each combination of strategies

		Nest Pty Ltd	
		High	Low
Clams Pty Ltd	High		
	Low		

   (b) State the maximin and the maximax strategies for each firm and explain whether a dominant strategy exists for Clams Ltd or Nest Ltd
   (c) Discuss the outcome