

Market Structures Part I

A market is never saturated with a good product,
but it is very quickly saturated with a bad one.

Henry Ford



Know the terminology!

This presentation applies a number of terms you learned in previous units to market structures.



If you did not take the time to understand those terms when they were first introduced, it's important that you do so now.



What is a market?

When most people think of a **market**, they think of a physical place, like their neighborhood supermarket, complete with shoppers & shelves stocked with a wide range of goods.

In economics, however, a market is not a physical location. Where you have buyers & sellers of a specific product or service, you have a market.



Market: Mechanism of Exchange

In a market, firms offer their good or service with an eye towards offering a lower price or a better product or service than their competitors. Consumers vote with their dollars, purchasing the product or service they want from the firm offering the best price and quality.

If a firm raises its price without offering a significantly better product or service, consumers are free to take their business to a competing firm.



An Invisible Hand

Adam Smith was an early advocate of a market economy as preferable to one based on government central planning.

Smith contended that consumers and firms interact in a market system as if they were guided by "an invisible hand" that leads to optimal results which benefit society as a whole.



Competition

- Competition spurs all firms in a market to offer competitive pricing or a clearly superior product.
- Competition leads to
 - lower prices
 - better quality
 - efficiency



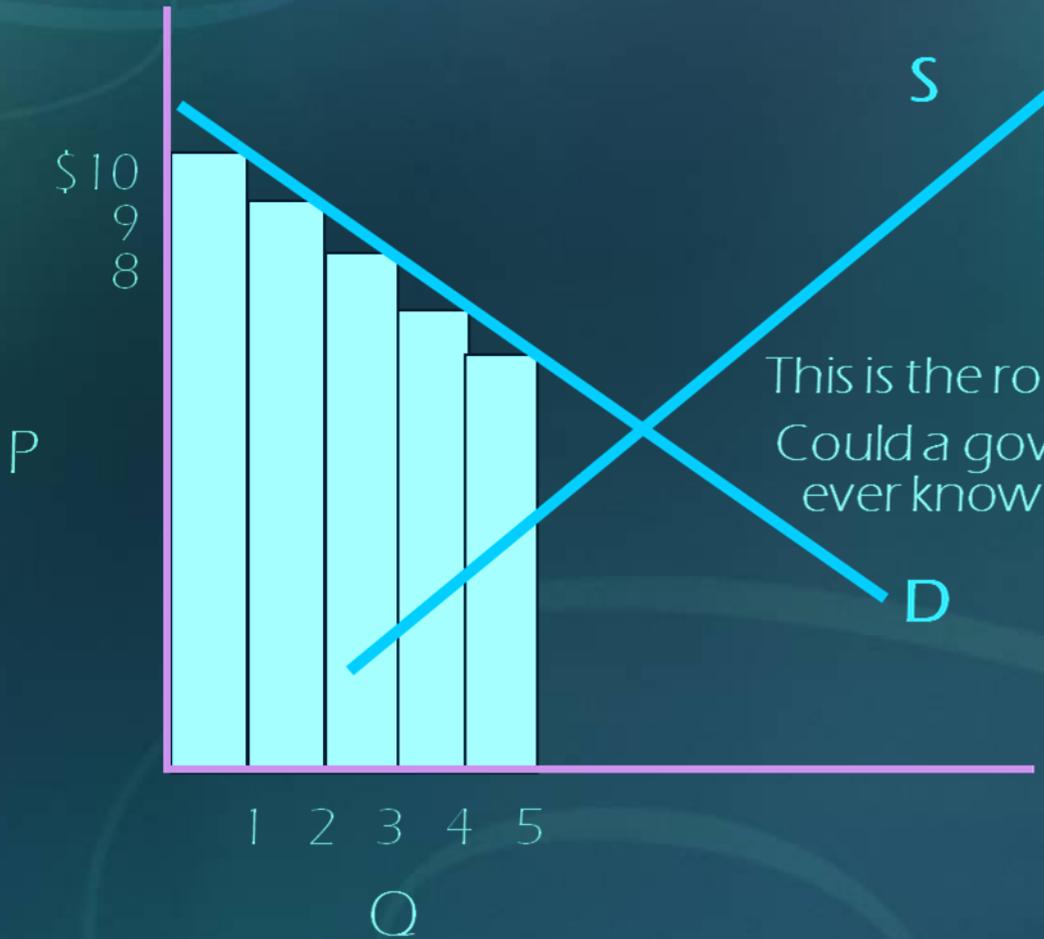
Efficiency

- The size of the pie for society is maximized.
 - This occurs at the market equilibrium.
 - Why?





Chart: Central Planning vs. Decentralized Markets



This is the role of decentralized markets.
Could a government planning agency
ever know the most efficient values?



Chart: The Efficiency of Markets

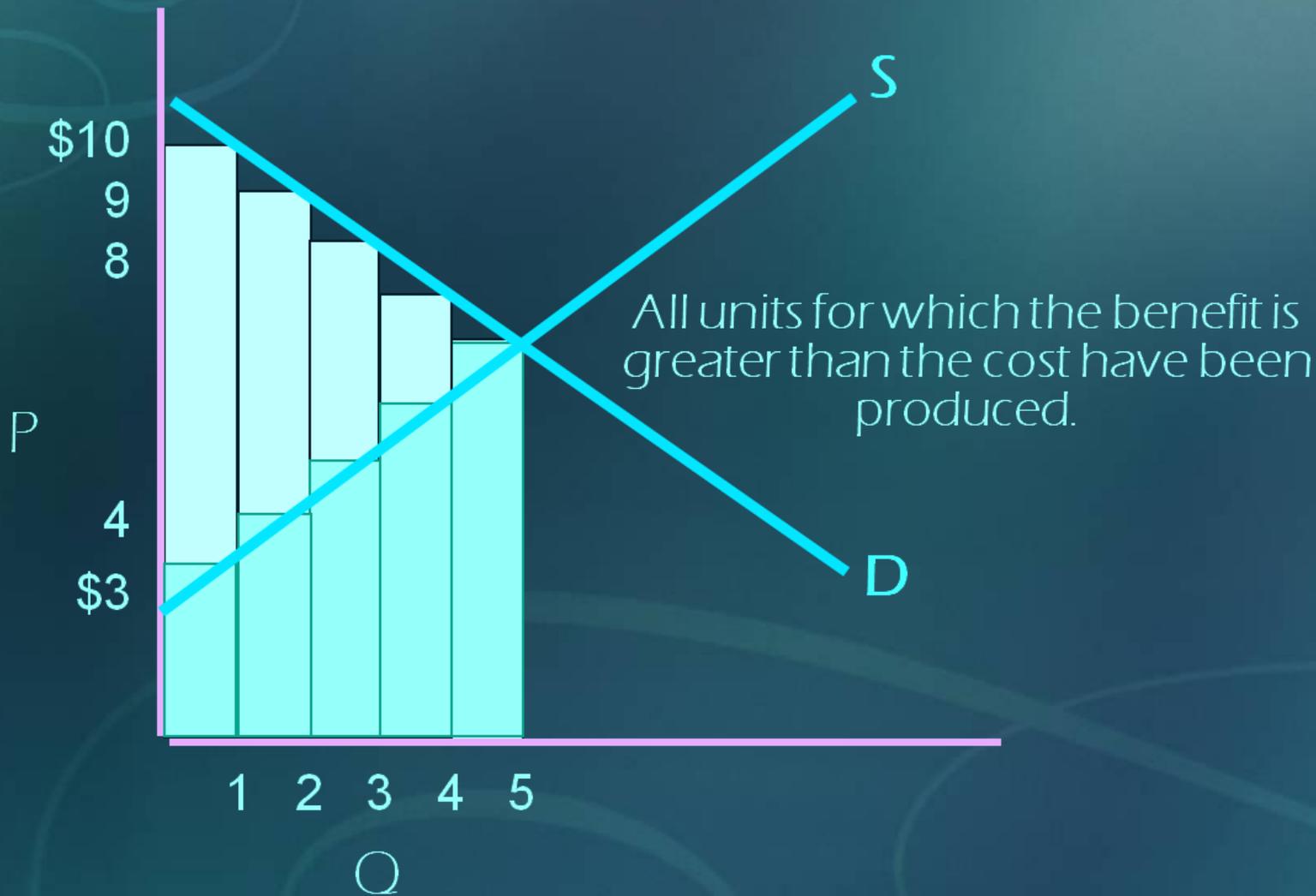




Chart: MC Must Be $<$ MB

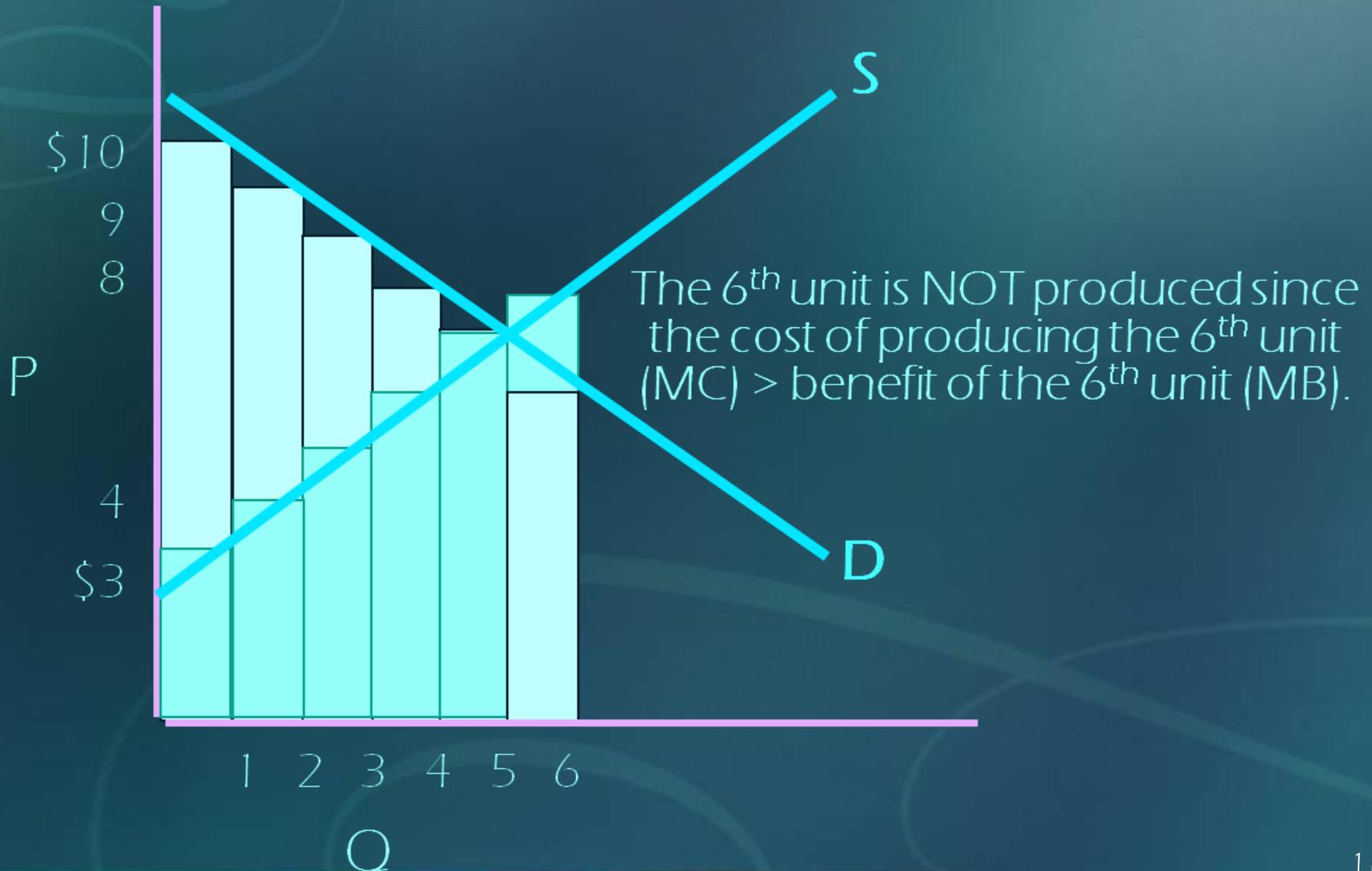




Chart: The Inefficiency of Central Planning

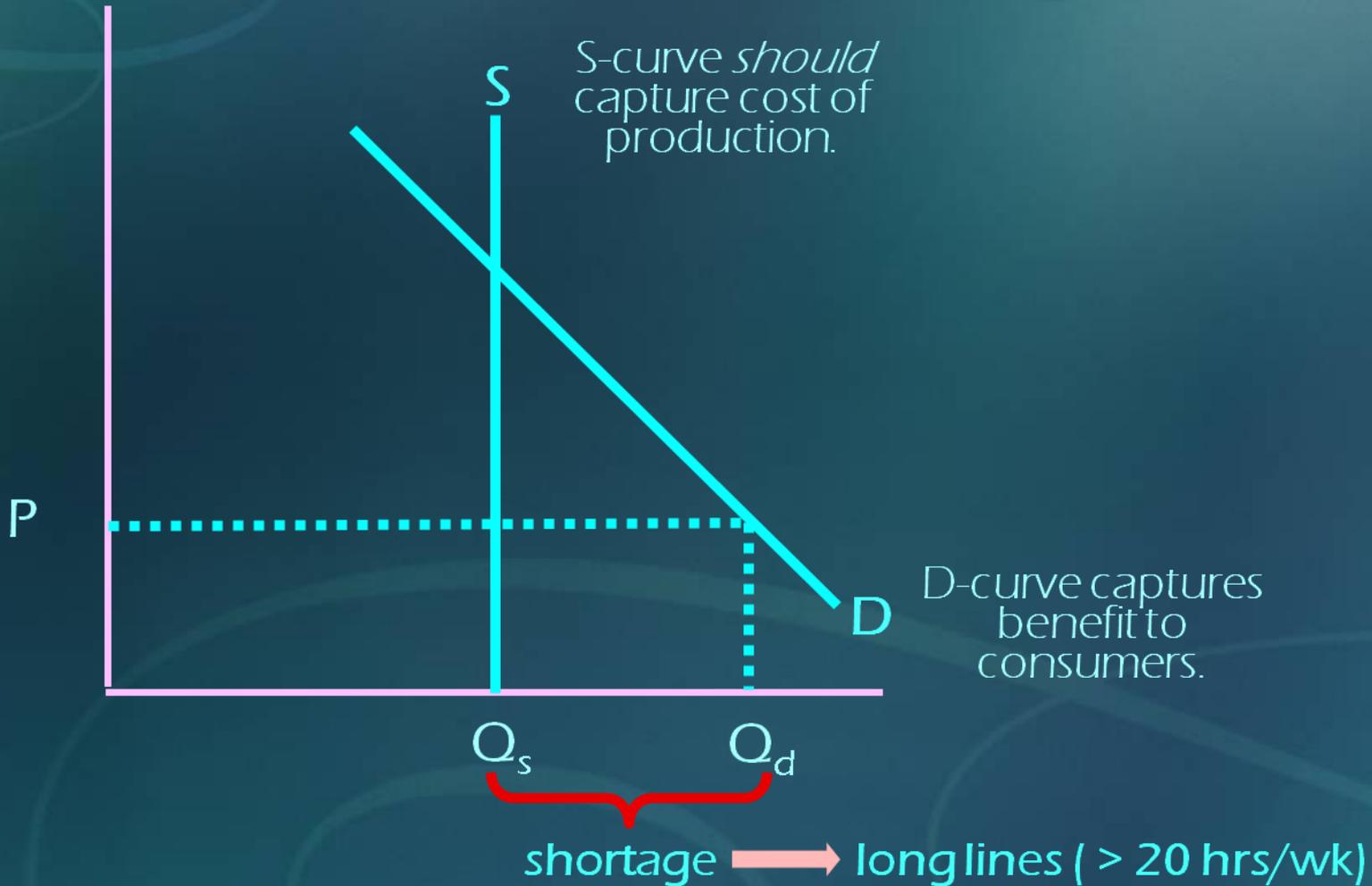
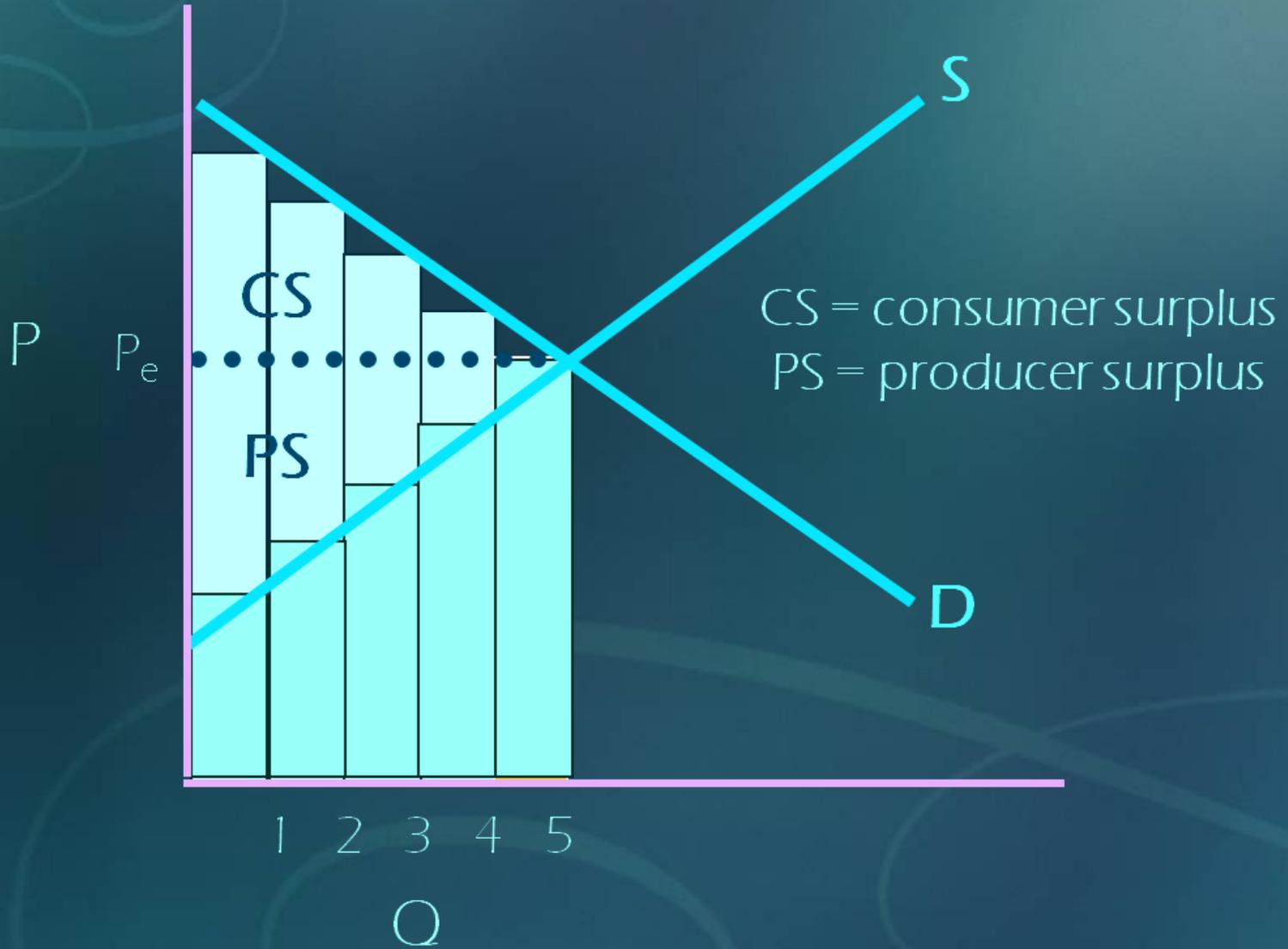




Chart: Efficiency = No Surpluses





Efficiency

- The size of the pie for society is maximized when the sum of producer and consumer surplus is maximized.
 - This occurs at the market equilibrium point.
 - The equilibrium point is the point at which you've exhausted all cases where $MB(X) > MC(X)$.





Conditions for Efficiency

- well-defined, enforced and marketable property rights
- decision-makers who confront the full cost of and receive the full benefit from each decision
- competitive markets (e.g., no monopoly power)





Degrees of Competition

- In market economies, most markets are competitive .
- However, some markets are more competitive than others.
- Economists categorize markets according to their degree of competition.
- The degree of competition in a market affects the decisions made by the firms in that market ... such as what price to charge and how much to produce.



Critical Thinking: Competition

- Can you think of a local market (local builders, book stores, tanning salons, etc) that has a lot of competition?
- Can you think of a local market that has very little or no competition?



Types of Market Structures

- Most economists classify markets as one of four types of market structures based on the degree of competition in the market.
 - pure competition
 - monopolistic competition
 - oligopoly
 - monopoly

This presentation introduces all four. In the next few units, we'll look at each in more depth.



Four Market Structures Chart:

1. Pure Competition

Pure competition does not exist in real life anymore. What does exist is near pure competition, albeit in few markets. Most unbranded staple goods such as food grains & vegetables are near pure competitive markets.



Market Structure Continuum



Four Market Structures Chart: Imperfect Competition

*all markets that are
not purely competitive*

Pure
Competition

Market Structure Continuum



Four Market Structures Chart:

2. Monopolistic Competition

Monopolistic competition is the most common type of market. The products that are sold in monopolistic competition are non-homogeneous & differentiated in features but the same in actual purpose. That is, there is a difference in what is known as external features, such as branding or packaging. The actual commodity remains the same (fast food).

Pure
Competition

A thick red arrow originates from the top of the slide and points downwards towards the text 'Pure Competition'.

Market Structure Continuum



Four Market Structures Chart:

3. Oligopoly

Oligopoly exists where a few firms have some control over market prices & supply. *Duopoly* refers to a special case of oligopoly with two dominant firms in a market. Oligopolistic markets are more & more common today.

Pure
Competition

Monopolistic
Competition

Market Structure Continuum





Four Market Structures Chart:

4. Pure Monopoly

A monopoly, the opposite of pure competition, has a single firm which has complete control over market prices & supply. True monopolies generally exist only in government-controlled markets. For example, the provision of civic services such as sewage disposal are generally a monopoly created by local governments.



Market Structure Continuum



Four Market Structures: Pure Competition Revisited

- very large numbers of firms
- offer a standardized product
- price takers
- free entry and exit



Market Structure Continuum



Table: Pure Competition

Number of Firms	many
Variety of Good	Firms offer identical products. Each firm's product is a perfect substitute for the products of other firms.
Market Power	Firms are price takers. They have to take the price set by the market. They have no market power & no control over prices.
Barriers to Entry & Exit	easy for a firm to enter & exit the market
Non-Price Competition	no non-price competition
Examples	agricultural markets



Table: Monopolistic Competition

Number of Firms	many
Variety of Good	Firms have slightly different products & each firm's product is a somewhat imperfect substitute for the products of other firms.
Market Power	Firms have some control over prices if product differentiation is successful in making buyers choose their product.
Barriers to Entry & Exit	fairly easy to enter & exit with few barriers
Non-Price Competition	lots of non-price competition
Examples	gas stations, fast food, dry cleaning, clothing, stationery



Table: Oligopoly

Number of Firms	few (A duopoly has two major firms & possibly several much smaller firms.)
Variety of Good	Products are either the same or slightly different. Each firm's product is a close substitute for the products of other firms.
Market Power	Firms have significant control over prices. If a firm makes a price change, it will hold only if other firms make the price change also (collusion).
Barriers to Entry & Exit	There are significant barriers to entry: huge start-up costs, regulatory restrictions & licensing fees.
Non-Price Competition	<u>lots</u> of non-price competition
Examples	cars, airplanes, copper, pharmaceuticals



Table: Monopoly

Number of Firms	one firm (A cartel is a group of firms that collude to raise prices & increase profits. OPEC is an example.)
Variety of Good	Firm sells a product for which there are no close substitutes.
Market Power	Firm has significant control over price. Firm is price searcher, searches out the price that generates maximum profit.
Barriers to Entry & Exit	There are significant barriers to entry: "natural" barriers & regulatory restrictions.
Non-Price Competition	may exist from advertising
Examples	public utilities, cable companies, companies with patents



Critical Thinking: Which market structure is best for the consumer?

In your opinion, which of the four types of market structures is best for the consumer and which is least responsive to the consumer?



**Test your knowledge by
identifying the market structure
of the following markets.**



1. Which Type of Market Structure?





2. Which Type of Market Structure?





3. Which Type of Market Structure?



DODGE





4. Which Type of Market Structure?





5. Which Type of Market Structure?





6. Which Type of Market Structure?





7. Which Type of Market Structure?





Which Type of Market Structure?

Answers

- Coca Cola – oligopoly (duopoly)
- corn – pure competition
- Dodge and Ford – oligopoly
- US Postal Service – monopoly
- United and Frontier airlines – oligopoly
- carrots – pure competition
- Burger King and McDonald's – monopolistic competition



Continued in *Market Structures Part II*

