Test Yourself: Market Structures

To determine whether any industry is workably competitive, therefore, simply have a good graduate student write his dissertation on the industry and render a verdict. It is crucial to this test, of course, that no second graduate student be allowed to study the industry.
~ George Joseph Stigler

What is a market?

A market is one of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

A market is the process by which the prices of goods and services are established. Markets facilitate trade and enable the distribution and allocation of resources in a society.

What do we mean by *market structure*?

Market structure refers to the interconnected characteristics of an industry, such as:

the number and relative strength of buyers and sellers

the degree of collusion among them

the degree of competition

the extent of product differentiation

the ease of entry into and exit from the market

What are the four basic types of market structure?

The four basic types of market structure are:

pure competition

monopolistic competition

oligopoly

monopoly

What is perfect competition?

Perfect competition is a market structure in which the decisions of buyers and sellers as individuals have no effect on market price. Each firm is so small that it cannot significantly affect the price of the product in question.

What are the characteristics of a purely competitive market?

The characteristics of a purely competitive market are:

many firms

identical products (homogeneous)

firms are price-takers

easy entry and exit

no non-price competition

What is meant by a *large* number of firms?

A *large* number of firms means enough firms so that each firm is too small (relative to the total industry) to be able to influence the market price of the product the industry sells.

What does homogeneous mean?

Homogeneous goods are goods that cannot be distinguished from one another. They're not identical ... There are simply no distinguishing differences (at least in consumers' perceptions).

For example, one potato is about the same as another potato. The same could be said about computer chips, petroleum, copper, notebook paper and etc.

What difference does it make if the products an industry sells are homogeneous products?

If a product is homogeneous, buyers don’t care which seller’s product they buy. One seller’s products are pretty much the same as the others’ products.

What is a price-taker?

A large number of firms means each firm is too small (relative to the total industry) to be able to influence the price of the product the industry sells.

Since the sellers have no control over the price of their product they must “take” the price set by the market, i.e. price-takers.

If the firms in an industry don’t set the price, who does?

Supply and demand sets the price.

Because the firms sell products identical to each other, each firm must charge a price no higher than the competition or it won't sell its product.

The market price is determined by consumer *demand* and the total *supply* of all firms in the industry. Once an equilibrium price has been established, each firm takes this price as given.

What does easy entry mean?

A barrier to entry is a cost of doing business required of firms wanting to enter an industry but not required of firms already in the industry.

Examples are the need to advertise, capital equipment, raw materials, customer loyalty, government regulations, etc.

In a competitive market, those barriers don't exist, making it easy for new firms to "jump in" when the profits are good, i.e. easy entry.

What is the most common type of market structure?

Monopolistic competition is the most common type of market structure.

What are the characteristics of a monopolistic competitive market?

The characteristics of a monopolistic competitive market are:

many firms

some difference in products, imperfect substitutes

some control over prices if product differentiation is successful

fairly easy entry and exit

a lot of non-price competition

What is an oligopoly market structure?

An oligopoly market structure exists where a few firms have some control over market prices and supply. Oligopolistic markets are more and more common today.

What are the characteristics of an oligopolistic market structure?

The characteristics of an oligopolistic market structure are:

few firms

no or slight difference in products, close substitutes

significant control over prices with the possibility of collusion

significant barriers to entry and exit

a lot of non-price competition

What is a monopoly market structure?

In a monopoly market, a single firm has complete control over market prices and supply.

What are the characteristics of a monopolistic market structure?

The characteristics of a monopolistic market structure are:

one firm (or a cartel)

product with no close substitutes

firm is a price-searcher with significant control over prices

significant barriers to entry and exit

non-price competition may exist due to advertising

Within a market, what causes a change in market equilibrium?

A shift in demand or a shift in supply causes a change in market equilibrium.

What would cause a demand curve shift?

A demand curve shift might be caused by:

the number of buyers in the market

tastes and preferences

income

expectations of buyers

prices of related goods

What would cause a supply curve shift?

A supply curve shift might be caused by:

technology

number of sellers in the market

resource prices

taxes and subsidies

expectations of sellers

In the long-run, what happens when economic profits are made?

When firms make *more* than a normal profit, new firms enter the industry. As supply increases, a *downward* pressure is put on prices.

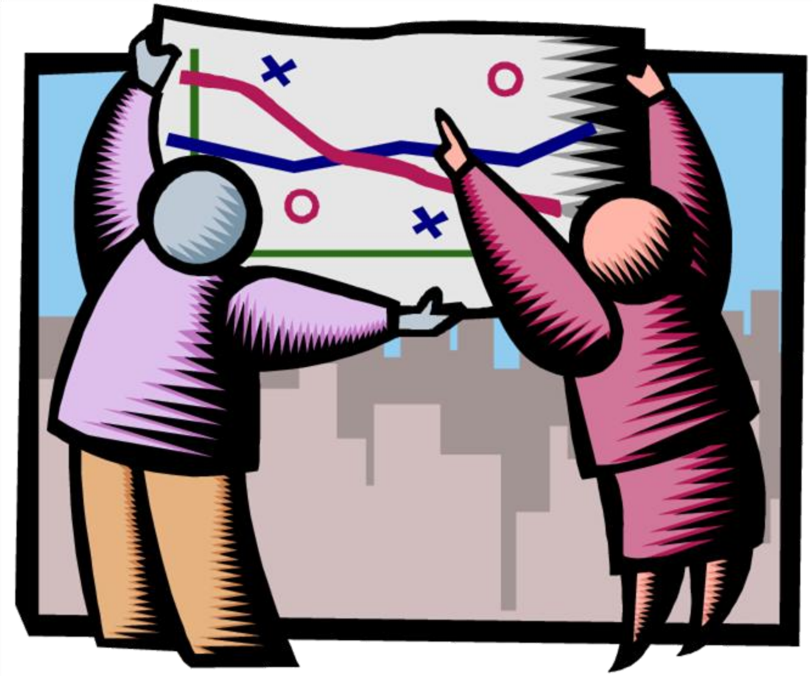
In the long-run, what happens when losses are made?

When firms make *less* than a normal profit, firms leave the industry. As supply decreases, an *upward* pressure is put on prices.

In the long-run, where is equilibrium?

In the long-run, equilibrium is at the market price that enables firms to *make a normal profit*.

How did you do?! If you didn’t do as well as you’d like, review the margin notes and presentations and test yourself again.



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Test Yourself: Competition