

Monopolistic competition



Is Starbucks's coffee really different from any other?

Monopolistic competition

- A *monopolistically competitive* producer is one amongst many producers of goods or services that are *differentiated*.
- The industry has the structure of *monopolistic competition*.
 - A *differentiated product* is slightly different from the goods or services offered by other close competitors.
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Elasticity of Demand

Perfect Competition:

- The demand curve is a horizontal line (perfectly elastic)

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Monopoly:

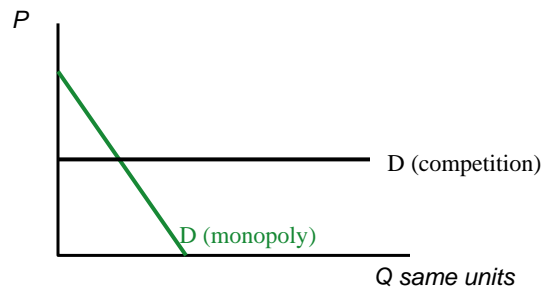
- Demand curve is industry demand (downward sloping)
- Much less elastic than under perfect competition

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Elasticity of Demand

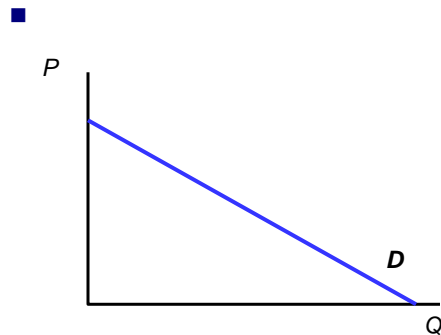
Monopolistic Competition:

- Only producer of a “unique” product
- Unlike monopoly there are many close substitutes
- How will the elasticity of demand compare?



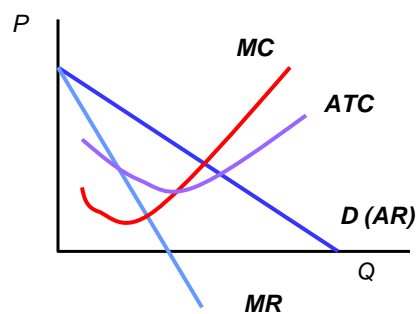
Marginal Revenue Curve

- What will the monopolistic competitors marginal revenue curve look like?



Profit Maximization

- The monopolistic competitor also faces perfect competition in input markets
 - Thus, cost curves are similar to competition and monopoly



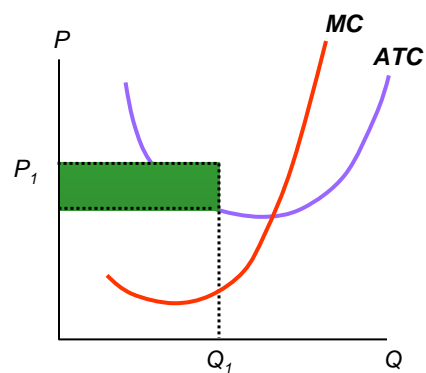
- What quantity and price should the firm choose?

Long-Run Equilibrium

- Unlike under monopoly firms can enter or exit
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- This results in a shift in demand for the goods produced by existing firms in the industry
 - Example, short-run profits
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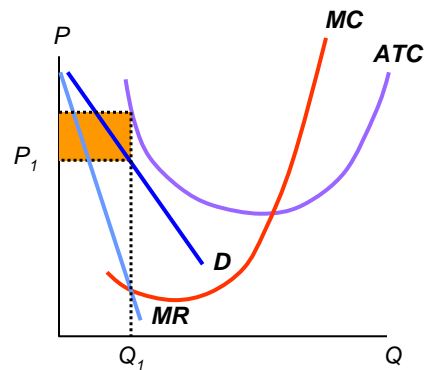
Profits and entry

- With profits other firms enter the industry (in the long run).
- Demand for each producer's output falls.
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Losses and exit

- With losses existing firms leave the industry (in the long run).
- Demand for each producer's output increases.
- Demand rises until economic profits are zero.
 - When the demand curve is tangent to ATC



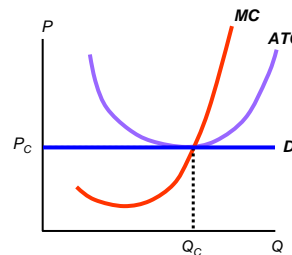
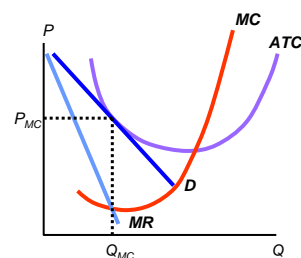
Monopolistic vs perfect competition

- Monopolistic competition:

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- Perfect competition:

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The assessment

- When there is monopolistic competition, the unregulated “market” outcome creates some inefficiency.
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- Compared to perfect competition it may or may not be “better”:
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That's it, folks

