LECTURE 10: MONOPOLISTIC COMPETITI

Today's Topics: Brands and Advertising

1. **Between Monopoly and Perfect Competition:** number of sellers? type of products? oligopolies, monopolistic competition.
2. **Monopolistic Competition:** competition in the short run, in the long run; compared with perfect competition, and efficiency.
3. **Advertising:** pros and cons, as a signal of quality, brand names.

1. BETWEEN TWO POLES

	Number of Sellers:		
	One	**A Few**	**Many**
Homogenous Product	***Pure Monopoly***	***Homogeneous Oligopoly***	***Pure Competition***
Differentiated Product		***Differentiated Oligopoly***	***Monopolistic Competition***

Assume: *Many Buyers*

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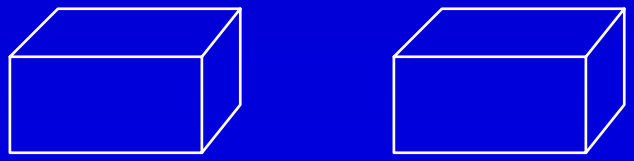
***Oligopoly*: a market structure in which only a few sellers offer similar or identical products. Often behave strategically. (Lecture 17.) Examples?**

***Monopolistic Competition*: a market structure in which many firms sell products that are similar but not identical.**

DIFFERENTIATED PRODUCTS



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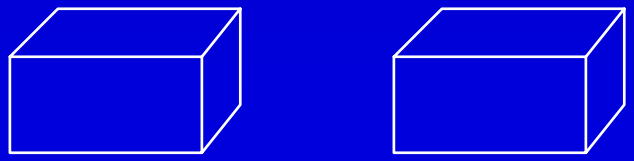

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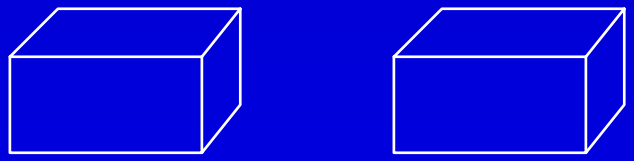

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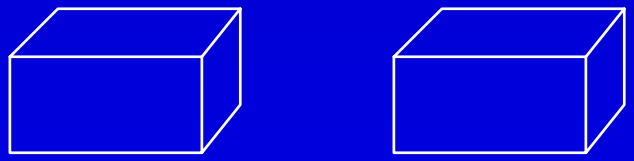

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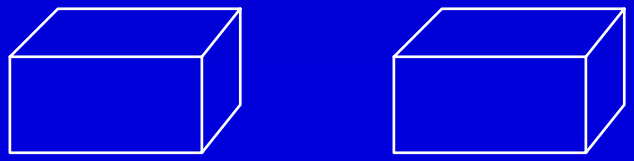

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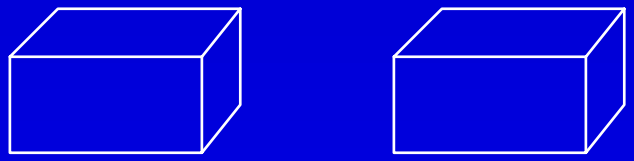

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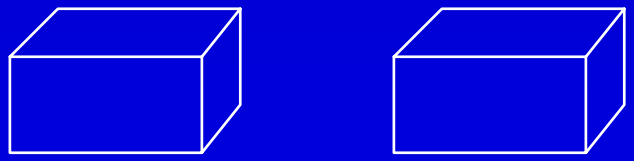

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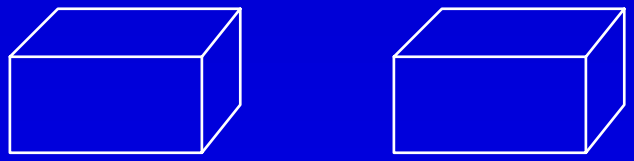

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Attributes:

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- **Ancillary Services**
- **Geographical Location**
- **Subjective Image**

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Examples?

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5. **Buyers are price takers; *no bargaining.***

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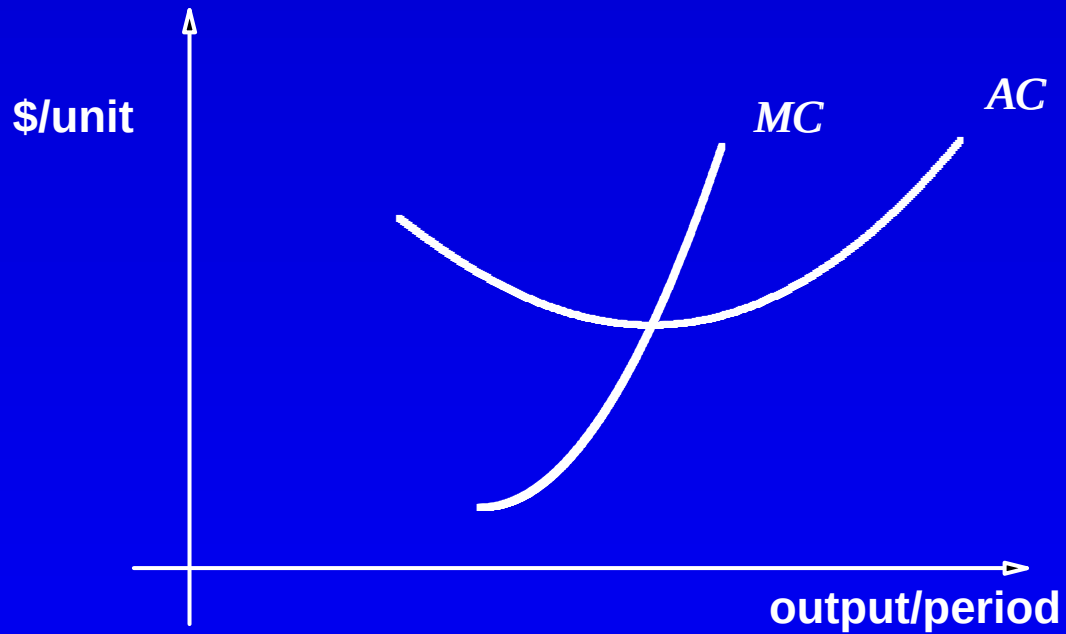
3. **In general, $P^*_{SR} > AC(y^*)$ for each firm, so that profit π is positive in the short run.**
   $\therefore$ attractive for new firms to produce close substitutes in the long run.

POSITIVE PROFITS



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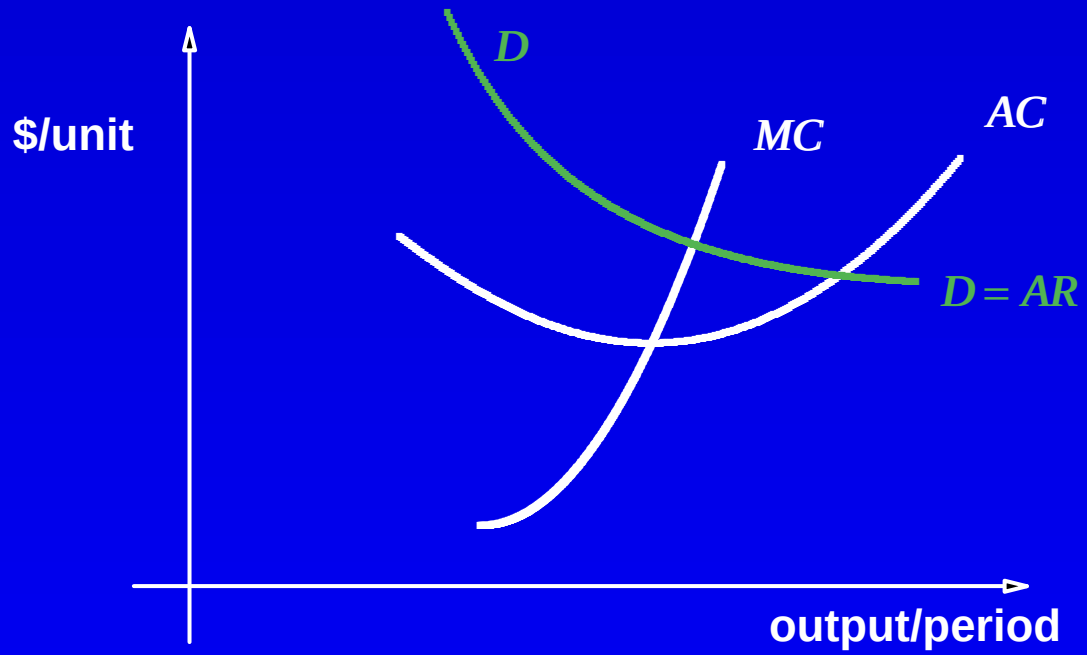

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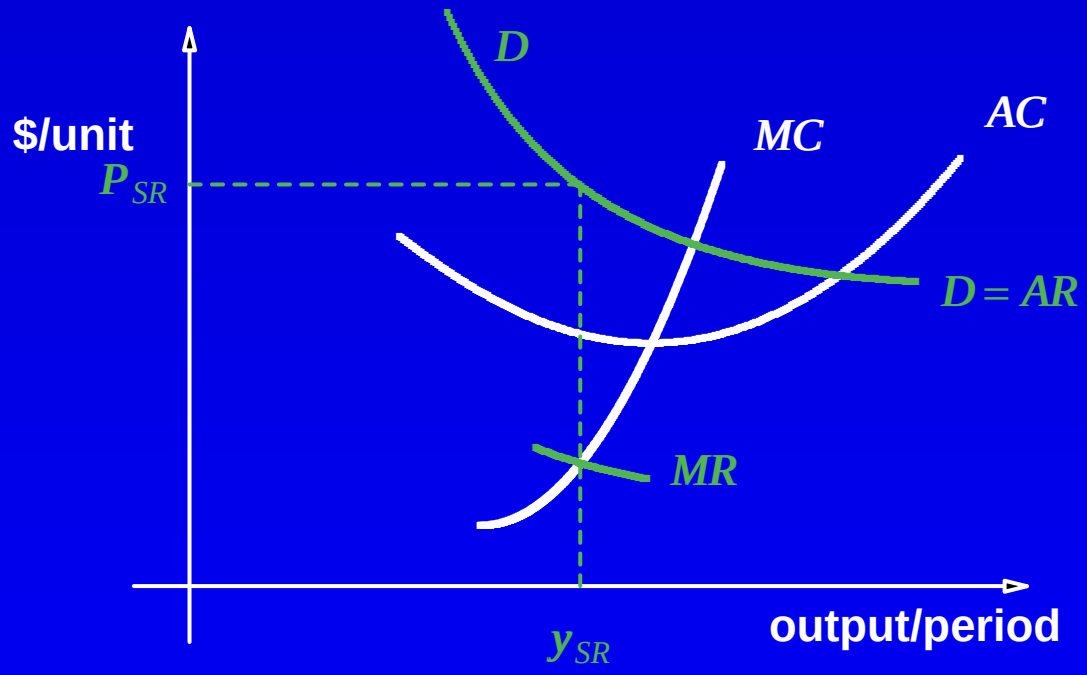

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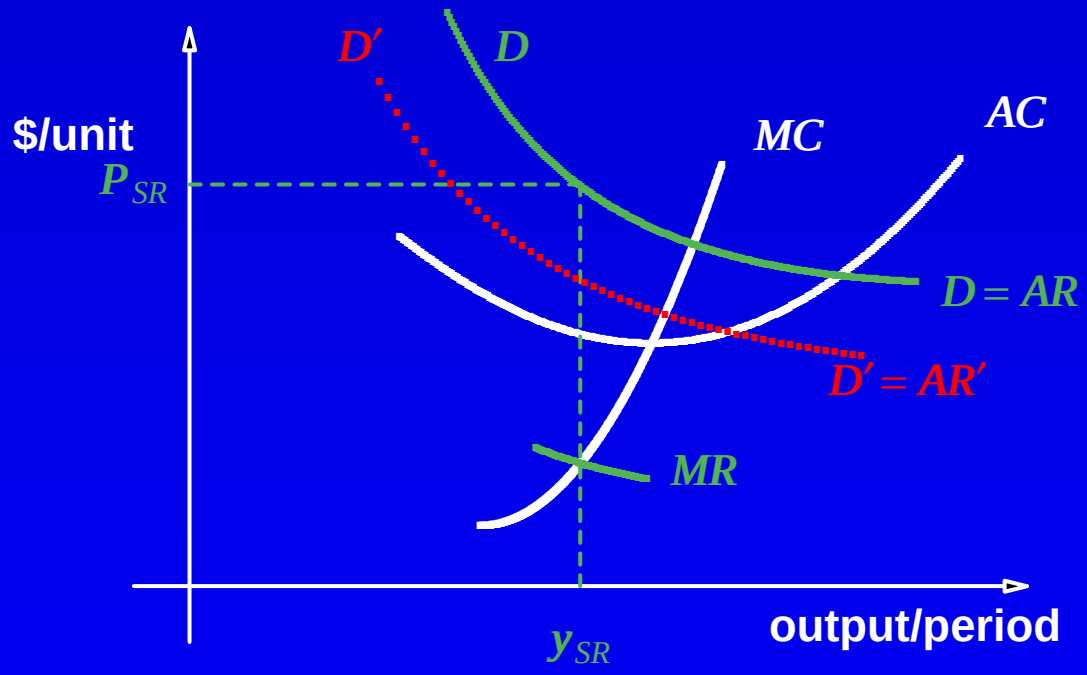

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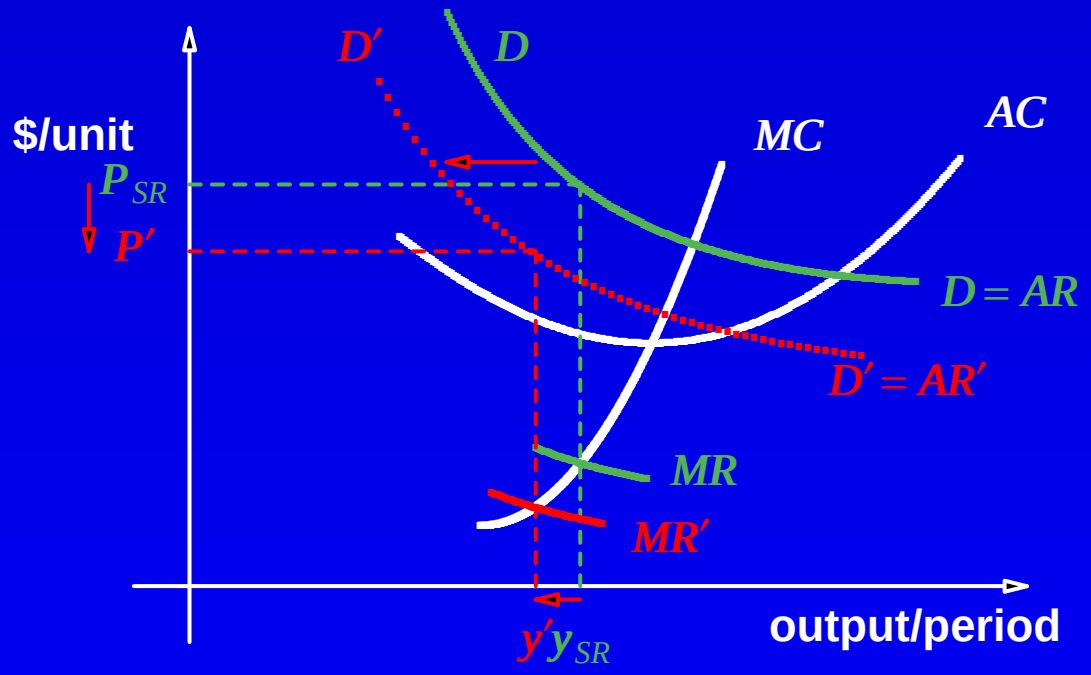

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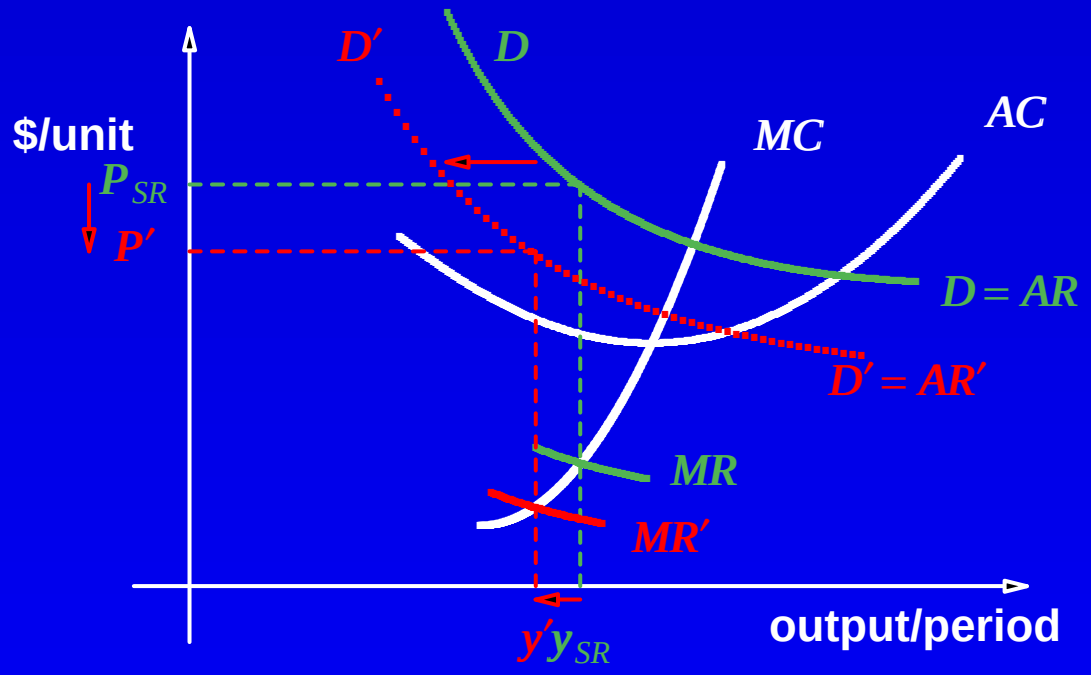

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Profit falls, but still positive: $AR'(y') = P' > AC(y')$.

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$\therefore$ **the demand curve *D″* must be tangent to the *AC* curve at the price & output chosen.**

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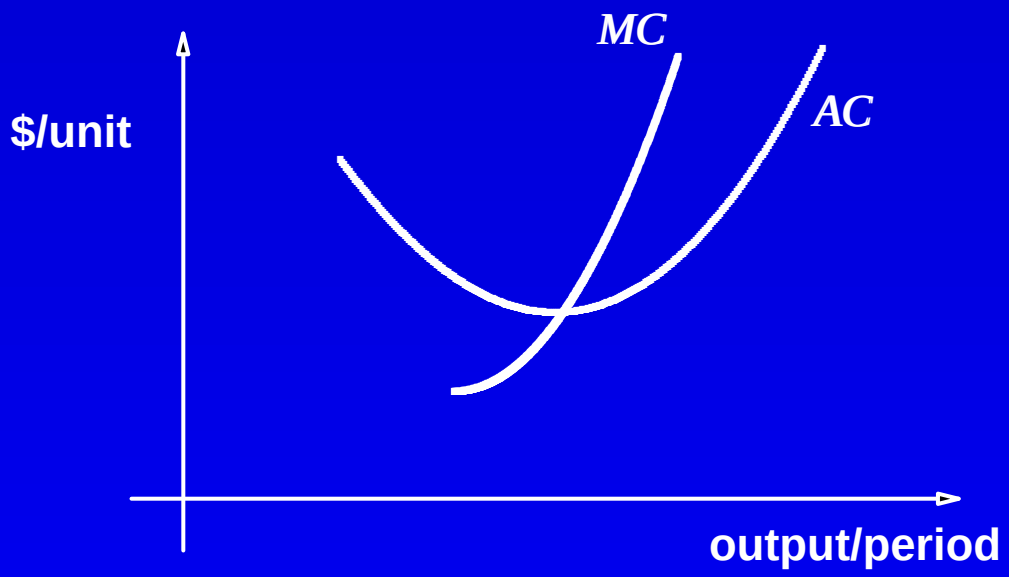

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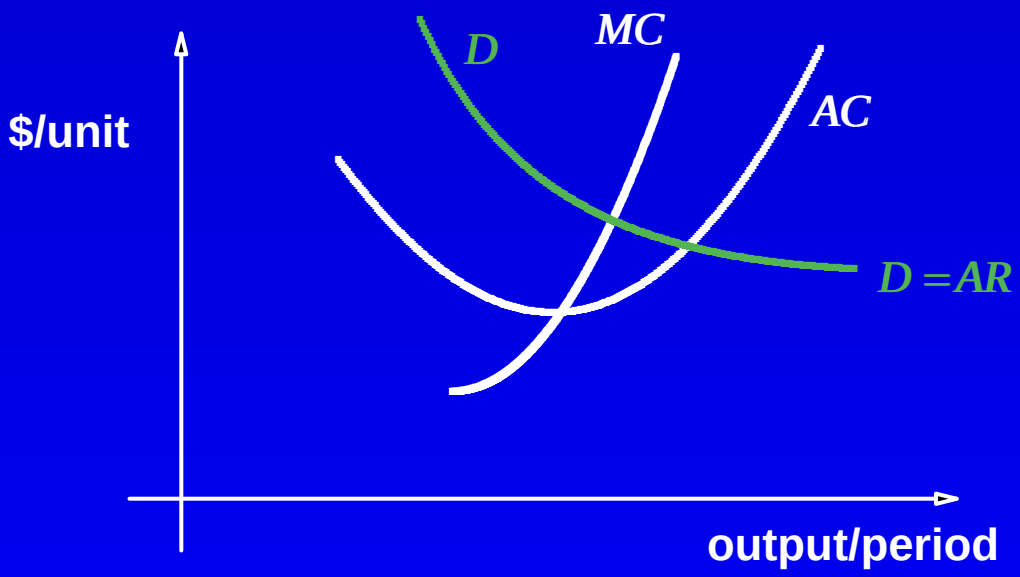

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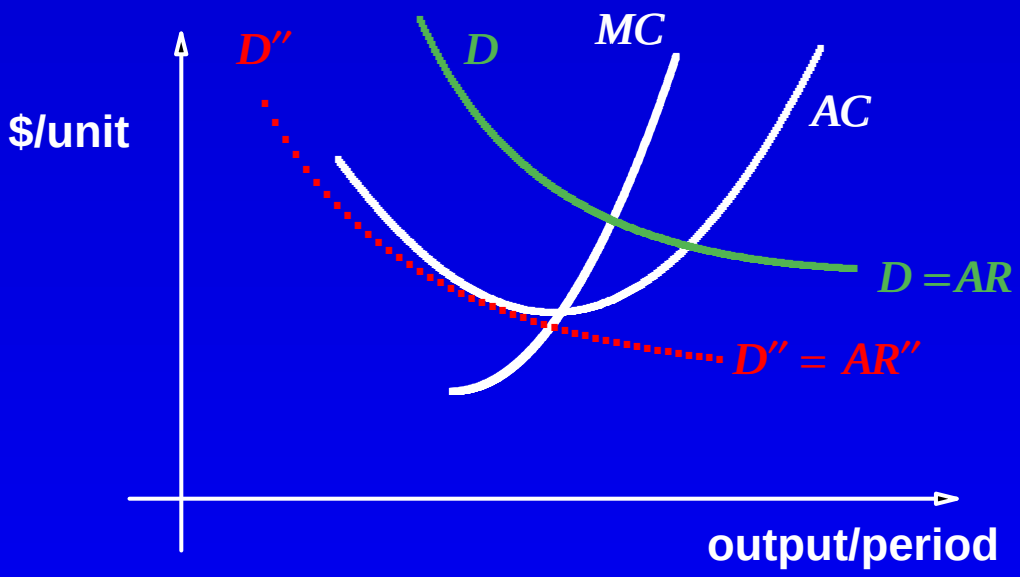

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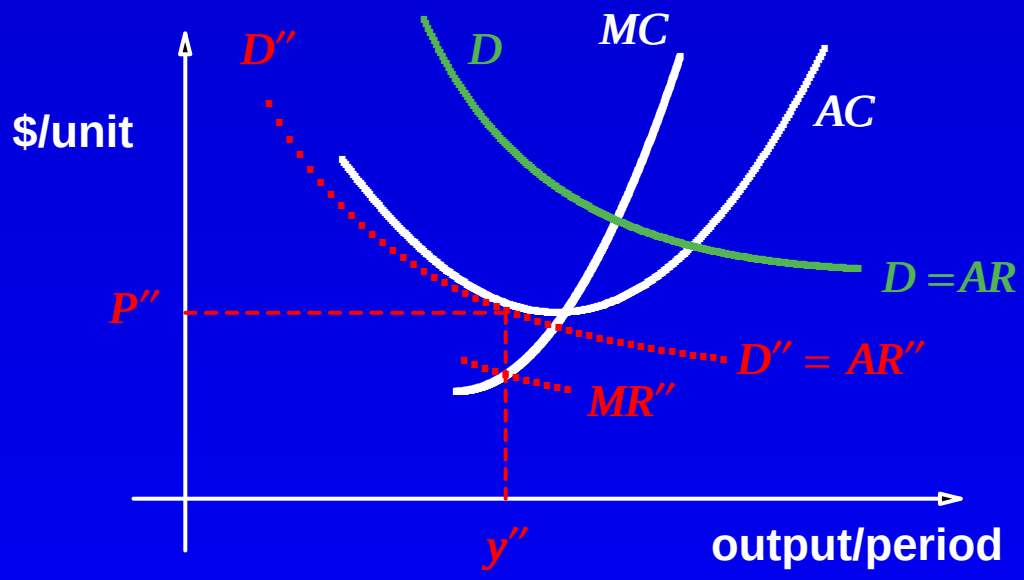

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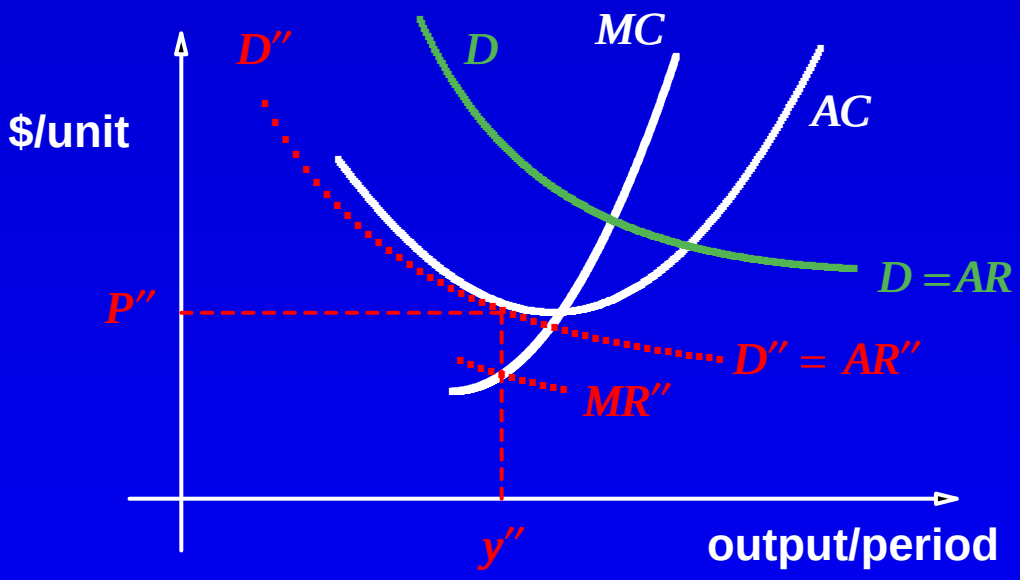

Long-run equilibrium at the margin.

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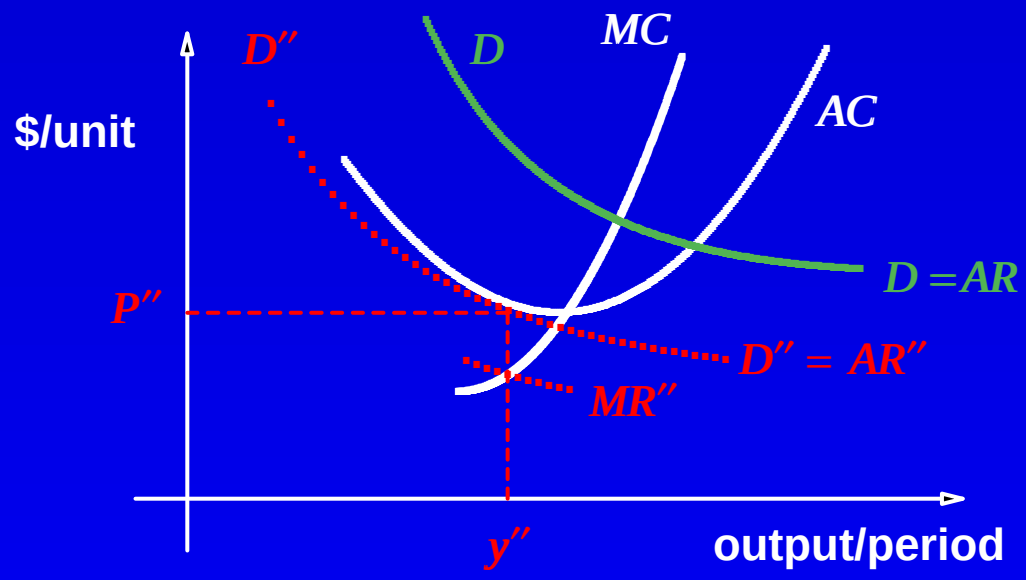

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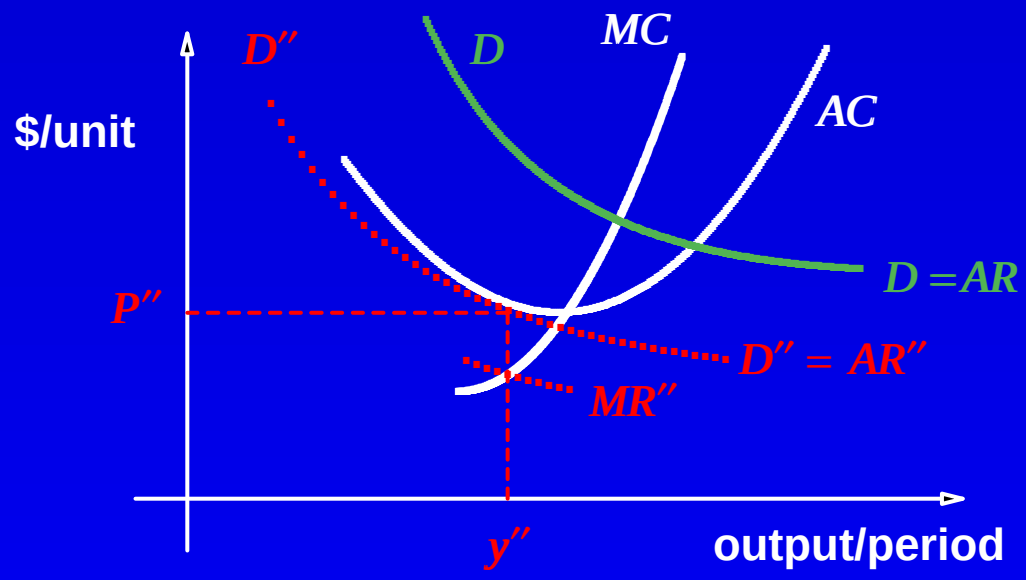

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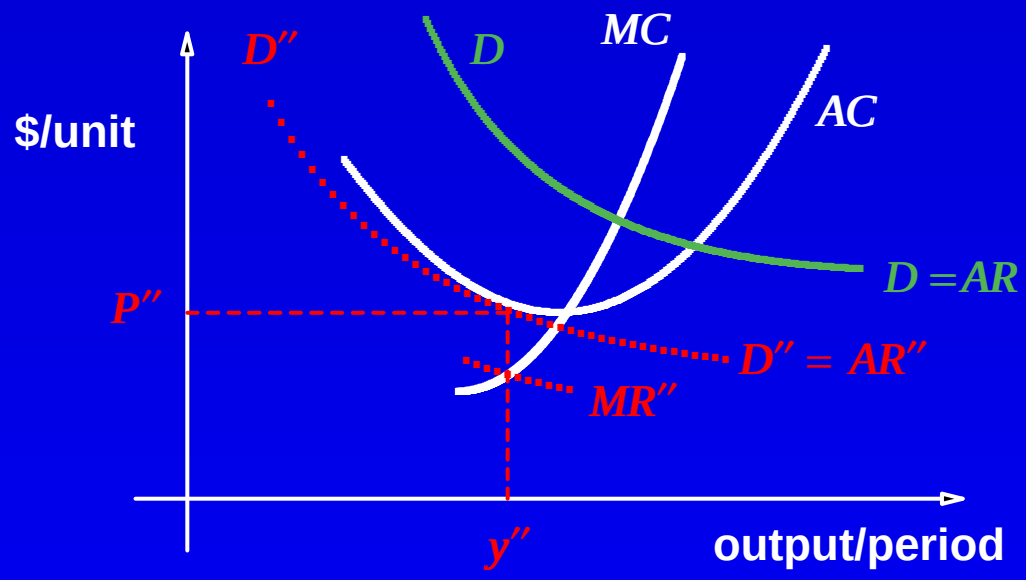

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Always eager to make another sale: an extra unit sold at the current price means more profit, not unwilling.

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Empirical results: Across 50 states: price of spectacles 20% lower when advertising allowed.

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Is what the advert says important? Not much — just that it is expensive and paid for.

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Rationality: irrational preference for brand names, or for good reason?

SUMMARY

1. Between monopoly and perfect competition lie most markets: oligopolies (few sellers) or monopolistic competition (many sellers).
2. Monopolistic Competition: Neither perfect competition, nor pure monopoly: many sellers and zero profit, but a price mark-up.
3. Many products $\rightarrow$ variety for consumers!
4. Advertising to increase sales. Justified or not?

APPENDIX

Under what conditions is it true that the slope of the *MR* curve ($\frac{dMR}{dQ}$) is twice that of the *AR* (i.e demand) curve ($\frac{dP}{dQ}$)?

$$R = Q \bullet P(Q)$$

$$\therefore MR = \frac{dR}{dQ} = P(Q) + Q\,\frac{dP}{dQ} = P \bullet (1 + \frac{1}{\eta}).$$

The slope of the *MR* curve is given by:

$$\frac{dMR}{dQ} = 2\,\frac{dP}{dQ} + Q\,\frac{d^2P}{dQ^2}$$

So it is only true in general for linear demand curves, for which $\frac{d^2P}{dQ^2} = \frac{d}{dQ}(\frac{dP}{dQ}) = 0$, because their slopes are constant (but not, of course, their elasticities).