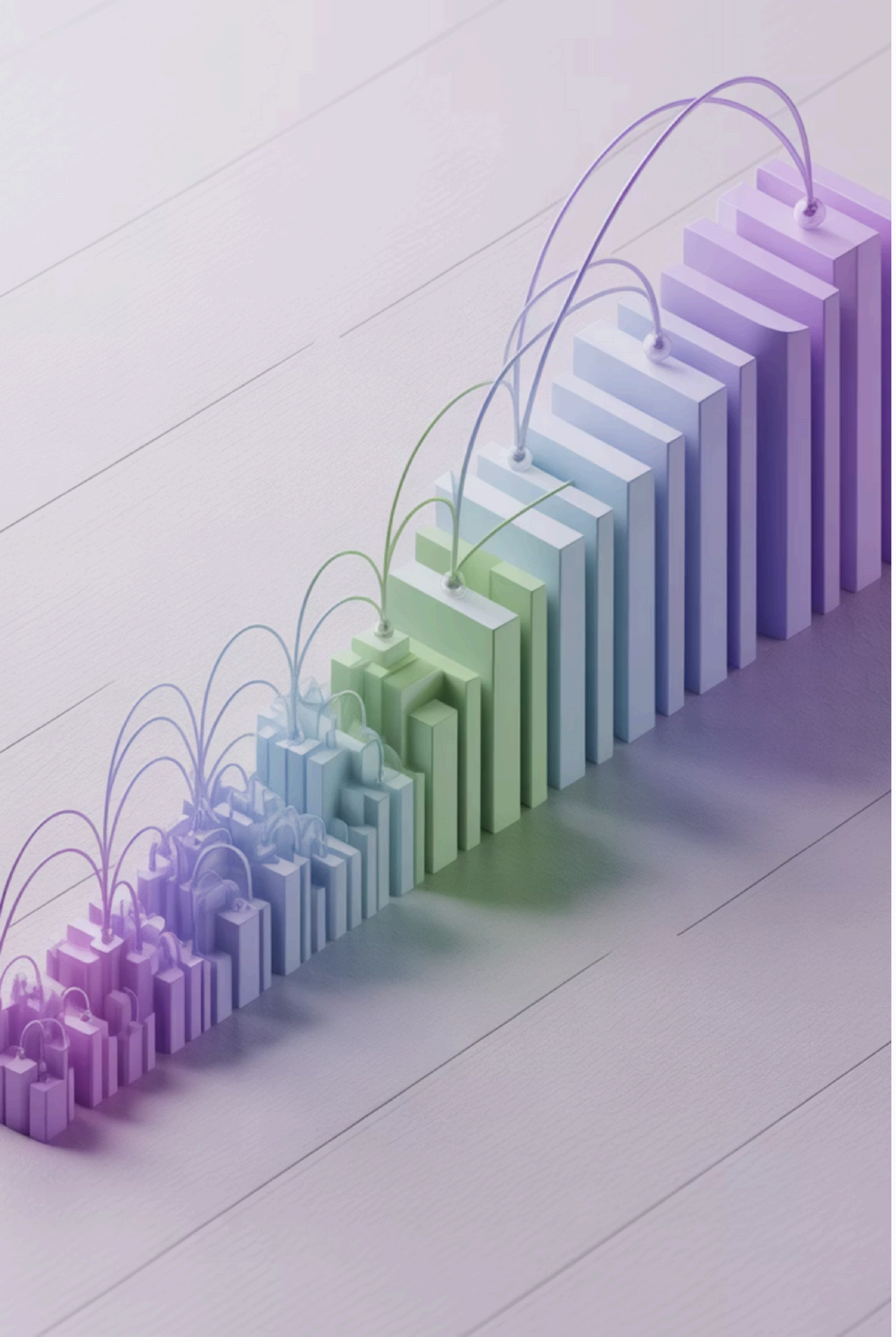
Market Structures: From Competition to Monopoly

Welcome to Week 5 of our economics course, where we'll explore the spectrum of market structures that shape our economy. From the idealized perfect competition to the concentrated power of monopolies, we'll examine how different market arrangements influence pricing, output, and innovation.



Overview of Market Structures

Perfect Competition

Many small firms, identical products, price takers, free entry/exit

Monopolistic Competition

Many firms, differentiated products, some price control, free entry/exit

Oligopoly

Few large firms, strategic interdependence, significant barriers to entry

Monopoly

Single seller, unique product, price maker, high barriers to entry

Perfect Competition vs Monopoly

Perfect Competition

- Many small firms with no market power
- Homogeneous products
- Price equals marginal cost
- Zero economic profit in long run
- Efficient resource allocation
- Examples: agricultural commodities, foreign exchange

Monopoly

- Single seller with significant market power
- No close substitutes
- Price exceeds marginal cost
- Potential for economic profit
- Deadweight loss to society
- Examples: utilities, patented pharmaceuticals

Characteristics of Oligopoly and Monopolistic Competition

Oligopoly

Market dominated by a small number of large firms with significant interdependence. Firms must consider competitors' reactions when making decisions.

- High concentration ratio
- Strategic behavior (game theory)
- Potential for collusion
- Non-price competition

Monopolistic Competition

Many firms selling differentiated products, giving each some price-setting ability while maintaining competitive pressure.

- Product differentiation
- Brand loyalty
- Advertising emphasis
- Excess capacity

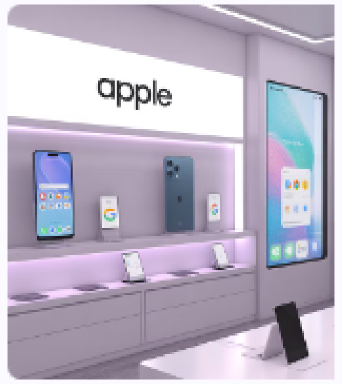
Real-World Examples of Market Structures

Perfect Competition

Agricultural markets (wheat, corn), foreign exchange markets, stock markets

Monopolistic Competition

Restaurants, clothing retailers, hair salons, independent bookstores



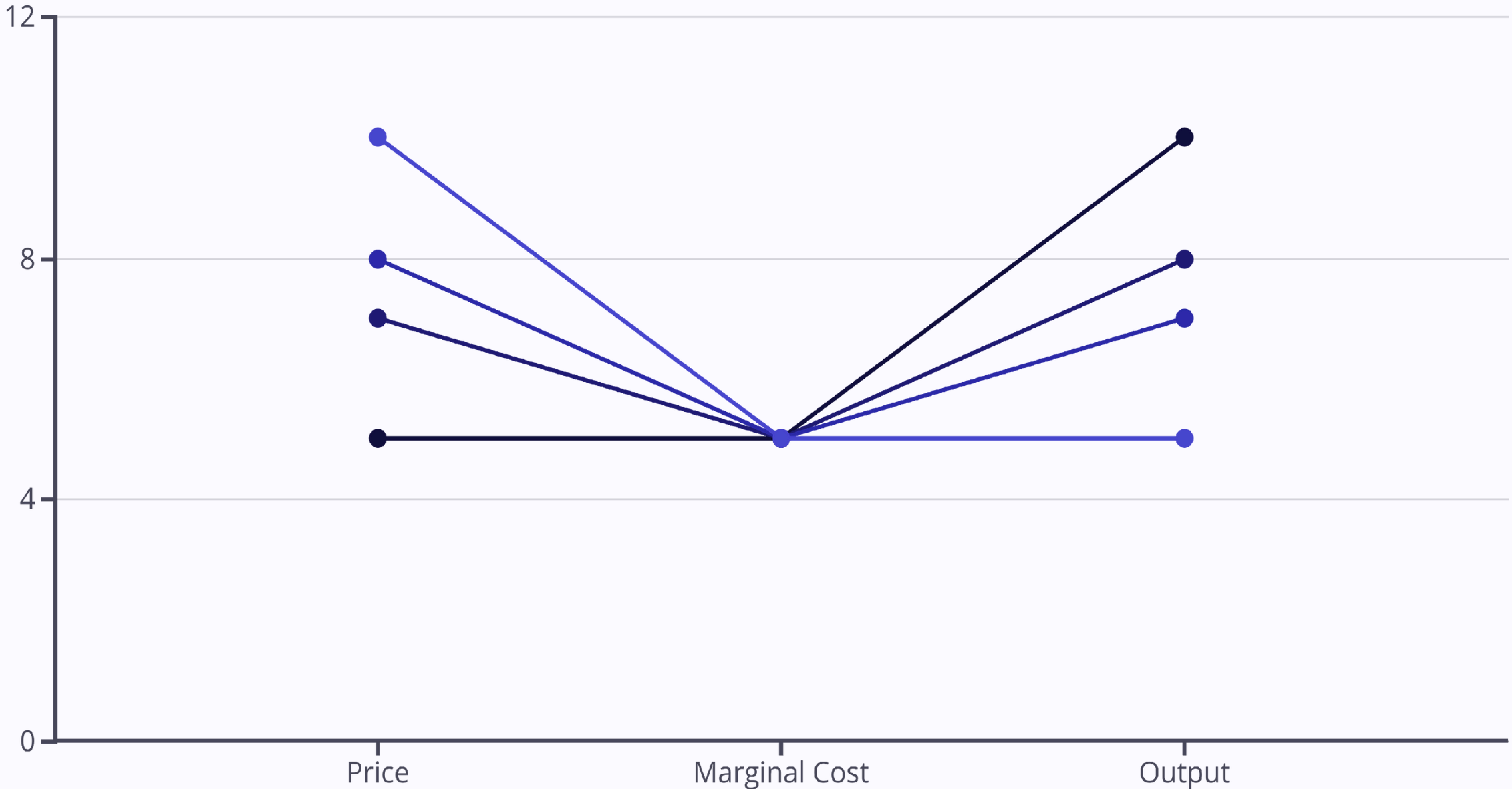
Oligopoly

Smartphones (Apple, Samsung), airlines, automobiles, soft drinks (Coca-Cola, Pepsi)

Monopoly

Local utilities, patented pharmaceuticals, specialized software, some local internet providers

Pricing and Output Decisions in Each Structure



Barriers to Entry and Strategic Behaviour

1. ## Legal Barriers

   Government-granted monopolies, patents, licenses, and regulations that limit new entrants

2. ## Natural Barriers

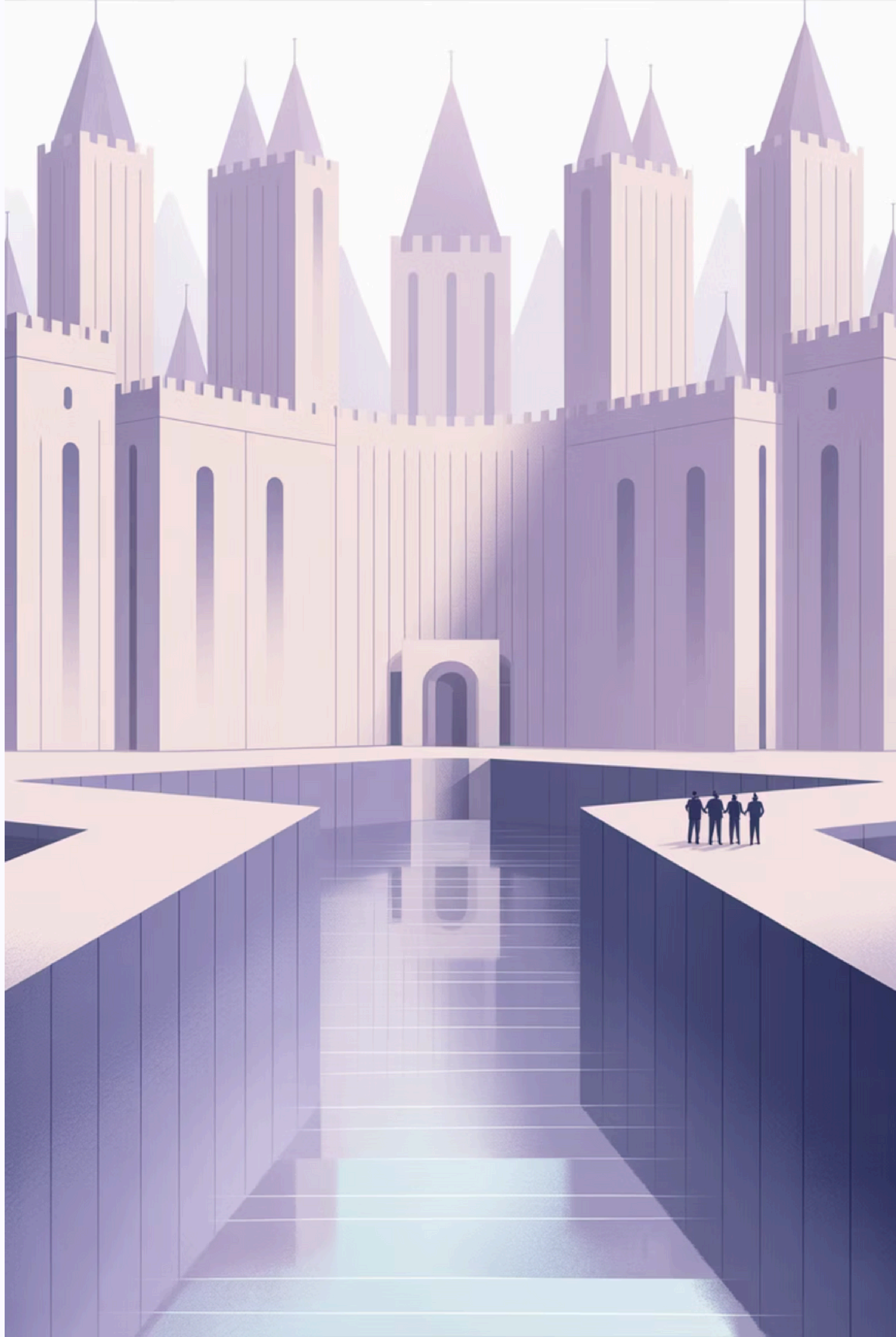
   Economies of scale, high fixed costs, network effects, and control of essential resources

3. ## Strategic Barriers

   Predatory pricing, excess capacity, product proliferation, and exclusive dealing arrangements

4. ## Brand Loyalty

   Advertising, customer relationships, and switching costs that make it difficult for new firms to attract customers



Role of Innovation and Market Power

The Innovation Paradox

Market structures create different incentives for innovation:

- Perfect competition: Limited resources for R&D but pressure to innovate to survive
- Monopoly: Resources for R&D but limited pressure to innovate
- Oligopoly: Often the most innovative structure due to combination of resources and competitive pressure

Policy Implications

Balancing efficiency and innovation:

- Antitrust enforcement to prevent harmful monopolies
- Patent protection to encourage innovation
- Regulation of natural monopolies
- Promoting contestable markets