CHAPTER 8: SECTION 1
A Perfectly Competitive Market
Four Types of Markets

A market structure is the setting in which a seller finds itself. Market structures are defined by their characteristics. Those characteristics include the number of sellers in the market, the product that sellers produce and sell, and how easy or difficult it is for new firms to enter the market.

- Perfectly competitive
- Monopolistic
- Monopolistic competitive
- Oligopolistic
Characteristics of a Perfectly Competitive Market

- A perfectly competitive market has the following characteristics:
  - It has many buyers and many sellers.
  - All firms sell identical goods.
  - Buyers and sellers have relevant information about prices, product quality, sources of supply, and so on.
  - Firms can easily enter and exit the market. No entity, such as government, prevents entry into or exit from the market.
- Examples of perfectly competitive markets include wheat farming, soybean and corn farming, milk production and the stock markets.
Sellers in a Perfectly Competitive Market Are Price Takers

- **A price taker** is a seller that can only sell his or her goods at the **equilibrium** price.

- Price takers could sell at a price lower than the equilibrium price, but they have no **reason** to. All of a particular seller’s output can be sold at the equilibrium price.

- Even if a market does not perfectly match the four characteristics of a perfectly competitive market, it may still be **considered** a perfectly competitive market.
What Does a Perfectly Competitive Firm Do?

A perfectly competitive firm produces the quantity of output at which marginal revenue equals marginal cost. Because all firms in a perfectly competitive market are price takers, the competitive firm has no choice in the selling price.
Profit Is a Signal in a Perfectly Competitive Market

- In a perfectly competitive market, profit is a **signal** to firms that are currently not in the market. It says, “Come over here and get me.”

- Because it is easy to enter a perfectly competitive market, new firms will enter the market as long as firms in the market are **earning** a profit. As new firms enter the market, they increase **supply** and decrease **profits**. They will continue to enter the market until profits decrease to the point that firms in the market are not earning a profit.
Profits May Be Taxed Away

Government may enact a tax to reduce the profitability of a market. This tax will discourage new firms from entering the market, reducing competition. The unintended effect is higher prices for consumers.
Applying the Principles

5. A price taker can only sell his or her goods at the equilibrium price.
6. Buyers would not purchase the goods at a higher price because there would be less expensive alternatives. There’s no reason to sell at a lower price.
7. Marginal Revenue = Marginal Cost
8. The equilibrium price
CHAPTER 8: SECTION 2
Monopolistic Markets
Characteristics of a Monopoly

A monopolistic market has the following three characteristics:

• It has a single seller.

• The single seller sells a product that has no close substitutes.

• The market has extremely high barriers to entry. A barrier to entry is anything that prohibits a firm from entering a market.
How Monopolies Differ from Perfect Competitors

- A monopoly firm is a **price searcher** — that is, a seller that can sell some of its output at various prices.

- Over time, a monopoly firm finds the **highest** price at which it can sell its **entire** output.

- There are **limits** to how much a monopolist can charge for a product. These limits are determined by the amount of **demand** for the product.

- No monopoly seller is **guaranteed** profits. A firm earns profits only if the price is **greater** than the total average cost.
Barriers to Entry

- Legal barriers to entry in a monopoly market include public franchises, patents, and copyrights.

- A **public franchise** is a right that the government has granted to a firm. It permits the firm to provide a particular good or service, and it **prevents** all other firms from providing the same good or service. (ex. Water companies, Private mail carriers)
A **natural monopoly** occurs when a firm has such a low **average total cost** that it is the only firm that can survive in the market. If one firm can sell a product for less than it costs other firms to produce the same product, competitors will *leave* the market.

Exclusive ownership of a **scarce** resource by one firm can be a barrier to entry in a particular market.

The government can create a monopoly by legally **protecting** a firm from competition.
Antitrust and Monopoly

- **Antitrust laws** are pieces of *legislation* that are passed to control monopoly power and preserve and promote *competition*.

- Examples of antitrust laws are as follows.
  - The **Sherman Antitrust Act**, passed in 1890, states that either attempting to become a monopolist or trying to restrain trade is illegal.
  - The **Clayton Act**, passed in 1914, made certain business practices illegal when their effects “may be to substantially lessen competition or tend to create a monopoly,” through price discrimination or tying contracts.
  - The **Federal Trade Commission Act** of 1914 declared that unfair methods of competition in commerce were illegal. This act prohibited aggressive price-cutting.
Antitrust Acts

- Sherman Act (1890)
- Clayton Act (1914)
- Federal Trade Commission Act (1914)
- Robinson-Patman Act (1936)
- Wheeler-Lea Act (1938)
• The **Robinson-Patman Act** was passed in 1936. This act attempted to decrease the failure rate of small businesses by protecting them from large chain stores. It has been criticized by some economists as protecting small businesses and hurting market competition.

• The **Wheeler-Lea Act** of 1938 gave the Federal Trade Commission (FTC) the power to deal with false and deceptive acts or practices by businesses.

  ▶ Antitrust laws do not usually apply to **natural** monopolies. To deal with natural monopolies, the government often uses some kind of **regulation**. For instance, the government might set the selling price or specify a rate of profit.