

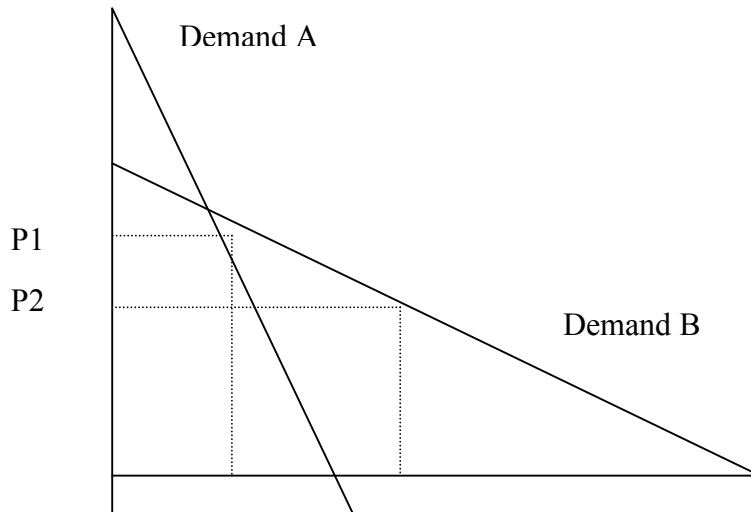
Math Recitation #5– October 20, 2009

**Comparing perfect competition and monopoly**

	<b>Perfect competition</b>	<b>Monopoly</b>
<b>Demand</b>	Horizontal line, constant	Downward sloping
<b>Demand elasticity</b>	Perfectly elastic	Elasticity varies along line
<b>Marginal revenue</b>	Horizontal line, constant	Downward sloping, steeper than demand
<b>Firm market power</b>	None, firms are price takers	Yes, quantity produced affects market price
<b>Product</b>	Homogeneous, many substitutes	No substitutes, unique
<b>Exit/Entry</b>	Free exit and entry, no barriers	Barriers to entry, high entry costs
<b>Profit maximization</b>	$MR=P=MC=\min AC$	$MR=MC$
<b>Firm profits</b>	Zero economic profits	Positive profits

**Elasticity and monopoly**

Monopolies will only set a price in the elastic portion (where there is positive marginal revenue) of the demand curve, which is above the half-way point on the curve.



Demand A: More inelastic

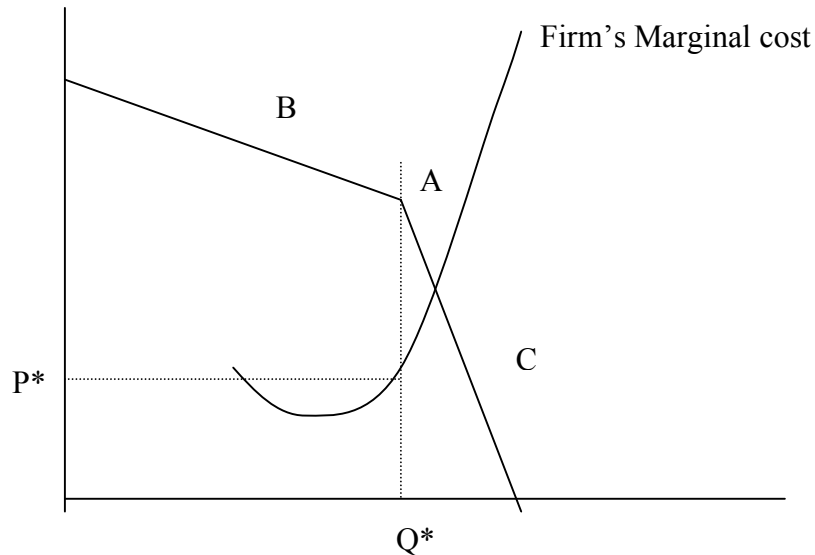
Demand B: More elastic

P1: Minimum price monopoly will charge if faced with Demand A

P2: Minimum price monopoly will charge if faced with Demand B

If the demand for a good is more inelastic, monopolies will charge a higher price to be in the positive marginal revenue area of the demand curve.

### Oligopoly - Kinked demand curve facing the firm



There are three 'regions' on the demand curve facing an oligopoly

A: The kink is at the 'established market price'. This is the point where firms in an oligopoly will want to be

B: This region shows what happens if a firm decided to raise its price. It will lose market share rapidly because there are cheaper alternatives available, For a small price increase they will see a big drop in quantity (shallow slope)

C: This region shows what happens if a firm decides to drop their price to undercut their competitors. Other firms will follow and undercut that price, causing a rapid drop in prices due to responses from other firms, but each firm isn't going to gain many new customers because of this. So we see a large price drop for a small increase in quantity (steeper).

Firms will want to be producing at the quantity where the kink is. They will set their price where their marginal cost intersects with this quantity. Firms in this situation will not want to compete on prices, but on other elements of quality (advertising, packaging, product differentiation). Market price will be higher than in perfect competition.

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