AP Microeconomics

Review #4

Market Structure

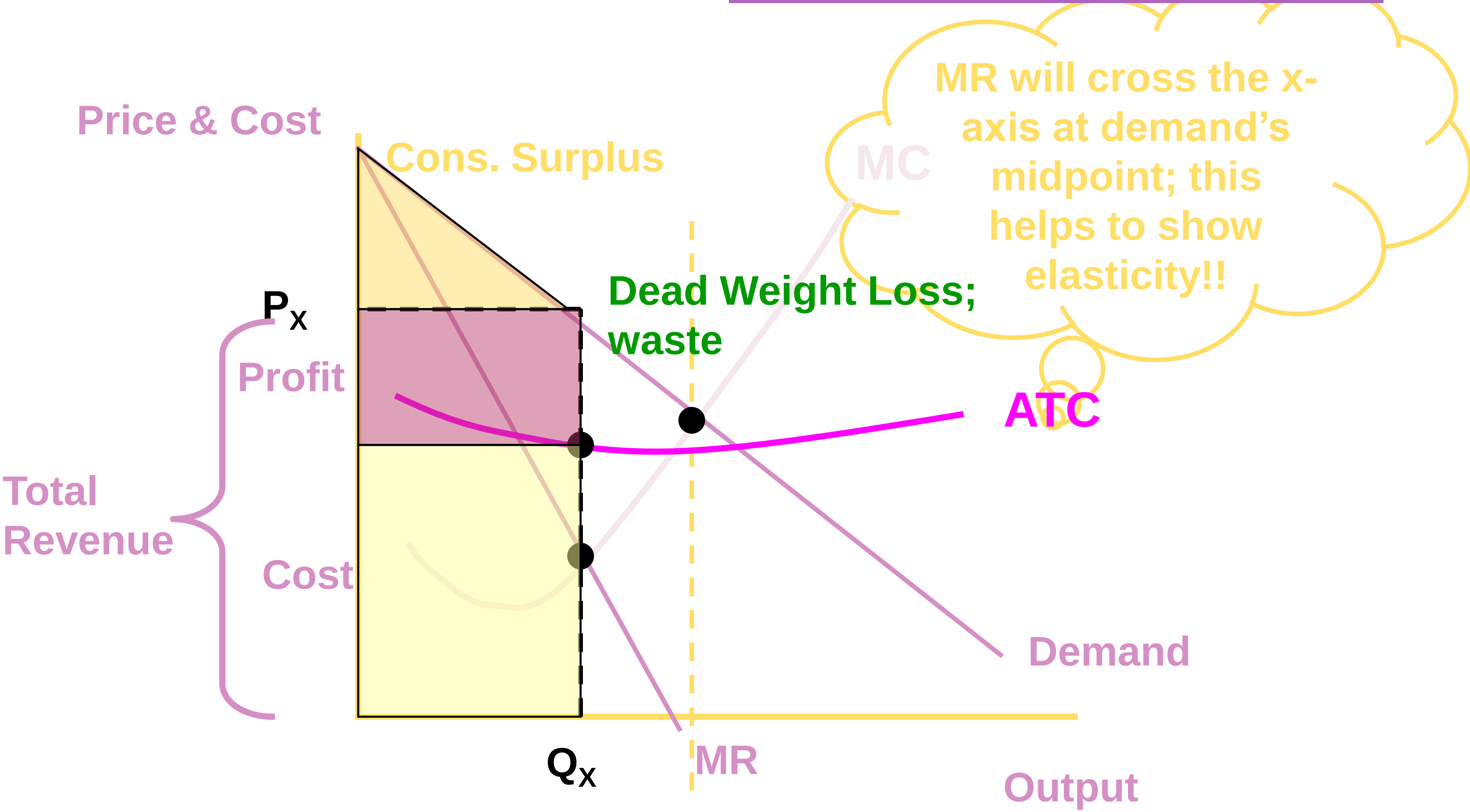
- The nature and degree of competition between firms in the same industry
  - 4 Categories:
    1. Perfect Competition
    2. Monopolistic Competition
    3. Oligopoly
    4. Monopoly

Monopoly

- Price-Maker, only provider of product, perfectly inelastic good
- Still faces elasticity…there is a limit to how high they can raise prices
- Downward sloping demand and MR curve

Gra

P = MC; allocative efficient, if perfect comp where P_x = price of resources



- Natural Monopolies (*regulated*)
  - Better for whole to have one efficient supplier of product; large companies show economies of scale as they grow
  - Ex) utilities
  - Gov't will choose fair-return price (P = AC)

Monopolistic Competition

- **Characteristics**:
  - Many firms
  - Very similar products
  - Product differentiation (advertising) leads to pricing power (P>MC)
  - No barriers to entry

- **Graph**:
  - Same graph as monopoly; all represent imperfect competition
  - Why?

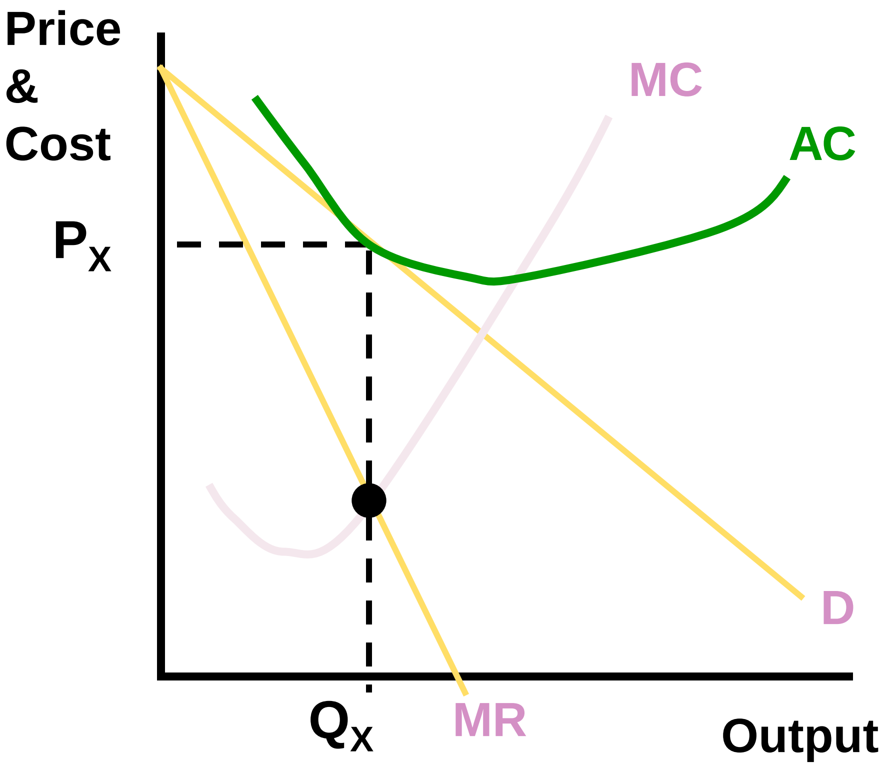
1. Has some price power, therefore downward sloping MR!!!

Long Run Equilibrium

- **<u>Why?</u>**

1. LR means making profit and can expand
2. Very similar products and no barriers to entry means more firms will enter a profitable market.
3. Demand for individual firms decrease as more suppliers enter driving down profits!!

- **<u>Graph:</u>**



Oligopoly

- Price Leader
  – One major firm and a few small firms
- Cartel
  – Firms working together to set price and quantity (collusion)

Game Theory

- Strategy theory that choices made by players based on the reaction expected by opponents.

- Dominant Strategy: a strategy that is best no matter what the opposition does
- ***Nash Equilibrium***: the result of all players playing their best strategy given what their competitors are doing.

Game Theory

- Circle Test: use to find dom. strategy: circle your opponents best move based on your move; if player gets two circles in same decision, then it is a dominant strategy

Rick

Jim	Left	Right
Top	+100, 0	+100, +100
Bottom	-100, 0	+200, +100

gy?

e in

Best Play: Rick will always choose Right, Jim will see Rick's strategy and will always choose Bottom

Market Failures & Need for Govt

- When the market (firms & households) cannot determine price or quantity there is a need for gov't to do so!!

Externalities

- Unintended side effects of an economic decision-activity
- <u>Negative</u>: pollution

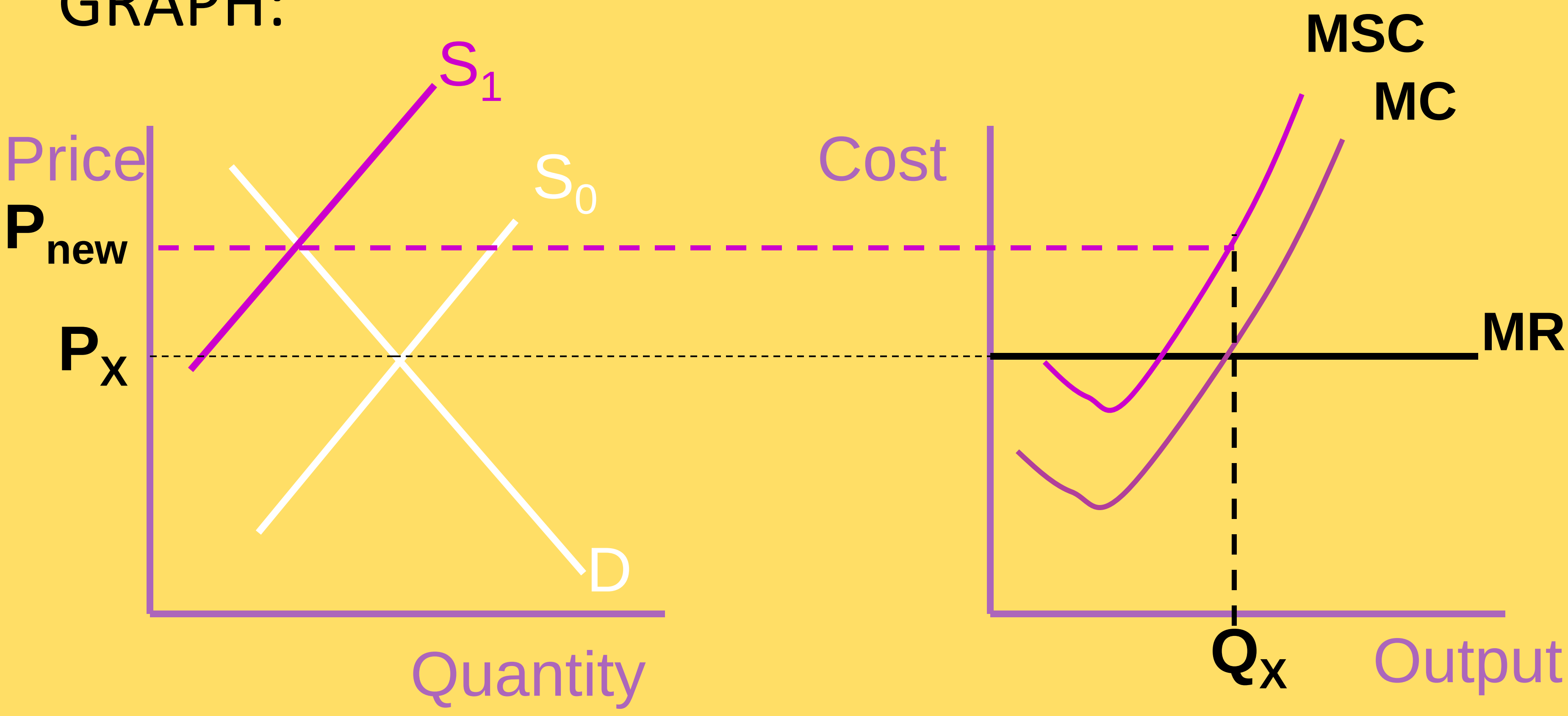
Gov't taxes firm the value of social cost

- <u>Positive</u>: education

Gov't subsidizes firm value of benefit

Internalizing Externalities

GRAPH:



Taxes on the firm will decrease supply and thus raise the price

Public Goods

- **Goods which are non-exclusive;**
  - **Private firms won't offer because can't deny**
  - **Gov't must provide with tax revenue**

- **Free Rider:**

People can receive and never pay for them

- **Rent:**

Getting more money than what is deserved, P > MC

- Imperfect Information
  - *Caveat emptor*, let the buyer beware
  - Truth in advertising laws
  - Gov’t agencies to regulate firm’s (FDA)
- Imperfect Competition
  - Monopolistic, Oligopoly, & Monopoly

Efficiency

- Allocative Efficiency
  - P = MC
  - Resources are being used efficiently to produce all society would like to have
  - P_X = value of output
  - MC_X = value of inputs to make the output