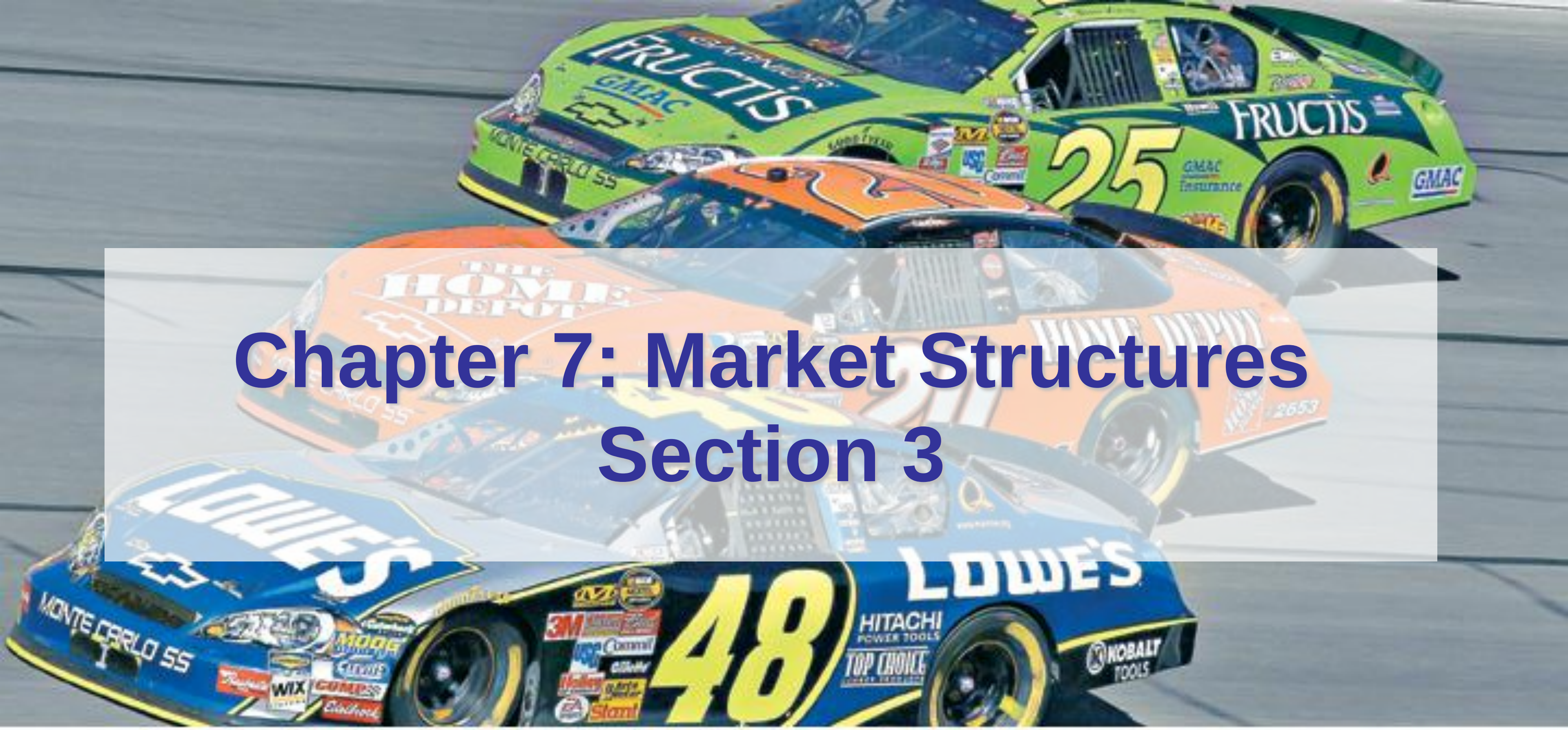

Chapter 7: Market Structures
Section 3

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ECONOMICS

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Objectives

1. **Describe** characteristics and give examples of monopolistic competition.
2. **Explain** how firms compete without lowering prices.
3. **Understand** how firms in a monopolistically competitive market set output.
4. **Describe** characteristics and give examples of oligopoly.

Key Terms

- **monopolistic competition**: a market structure in which many companies sell products that are similar but not identical
- **differentiation**: making a product different from other, similar products
- **nonprice competition**: a way to attract customers through style, service, or location, but not a lower price
- **oligopoly**: a market structure in which a few large firms dominate a market

Key Terms, cont.

- **price war**: a series of competitive price cuts that lowers the market price below the cost of production
- **collusion**: an illegal agreement among firms to divide the market, set prices, or limit production
- **price fixing**: an agreement among firms to charge one price for the same good
- **cartel**: a formal organization of producers that agree to coordinate prices and production

Introduction

- What are the characteristics of monopolistic competition and oligopoly?
  - Monopolistic Competition
    - Many firms in the market
    - Some variety of goods
    - Minimal barriers to entry
    - Little control over prices
  - Oligopoly
    - Few firms in the market
    - Some variety of goods
    - Many barriers to entry
    - Some control over prices

Monopolistic Competition

- In monopolistic competition, many companies compete in an open market to sell similar, but not identical, products.
- Common examples or monopolistically competitive firms are:
  - Bagel shops
  - Gas stations
  - Retail stores

The market for jeans is monopolistically competitive because jeans can vary by size, color, style, and designer.

Monopolistic Competition Conditions

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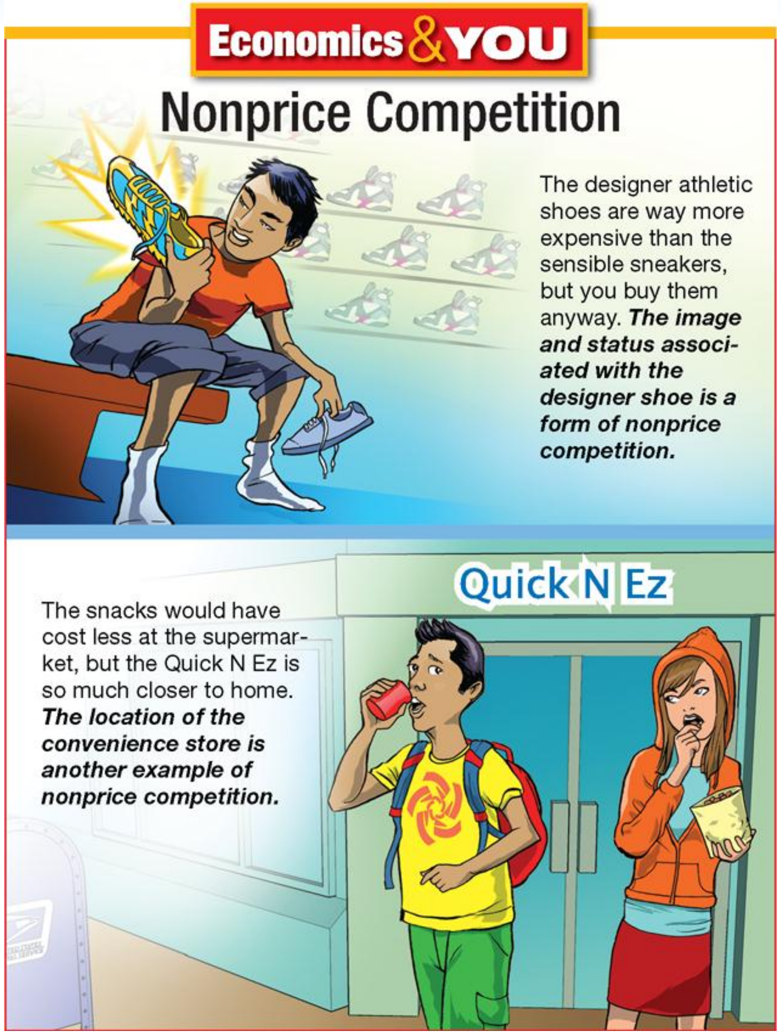
- Many Firms
  - Low start-up costs allow many firms to enter the market.
- Few barriers to entry
  - It is easy for new firms to enter the market.
- Little control over price
  - If a firm raises their prices too high, consumers will go elsewhere to buy the product.
- Differentiated products
  - Allows a firm to profit from the differences between their product and a competitor's product.

Nonprice Competition

- In a monopolistically competitive market, nonprice competition plays a big role.



Prices

- Prices, output, and profits under monopolistically competitive market structures look very similar to those under perfectly competitive market structures.

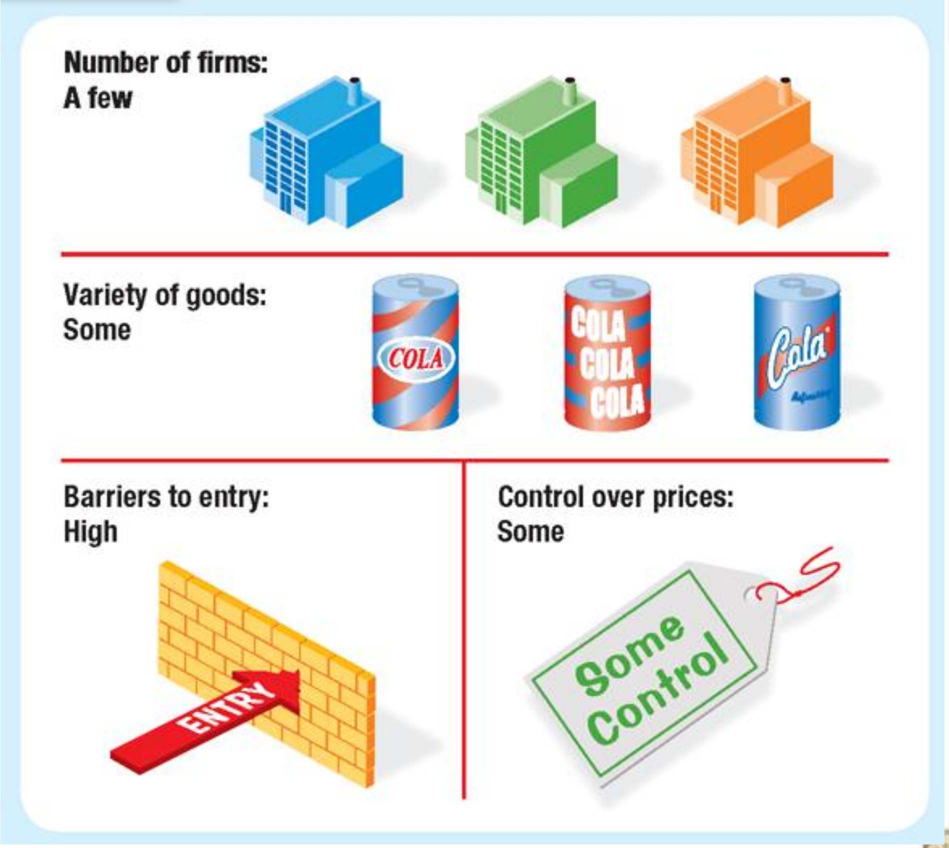
- Prices
  - Under monopolistic competition prices are higher but their demand curves are more elastic because customers can choose among many substitutes.

Output and Profits

- Output
  - As a result of the relative elasticity in monopolistically competitive firms, the total output falls somewhere between that of a monopoly and that of perfect competition.
- Profits
  - Monopolistically competitive firms earn just enough to cover all of their costs.
  - They can earn profits in the short run, but too many competitors make this hard to maintain in the long run.
- Checkpoint: What keeps monopolistically competitive firms from making high profits?

Oligopoly

- Oligopoly describes a market dominated by a few, profitable firms.
  - Why are high barriers to entry an important part of oligopoly?
  - Why are there only a few firms in an oligopoly?



Barriers to Entry

- Barriers to entry in an oligopoly can be technological or they can be created by a system of government licenses or patents.
  - Economies of scale can also lead to an oligopoly.

Cooperation, Collusion, and Cartels

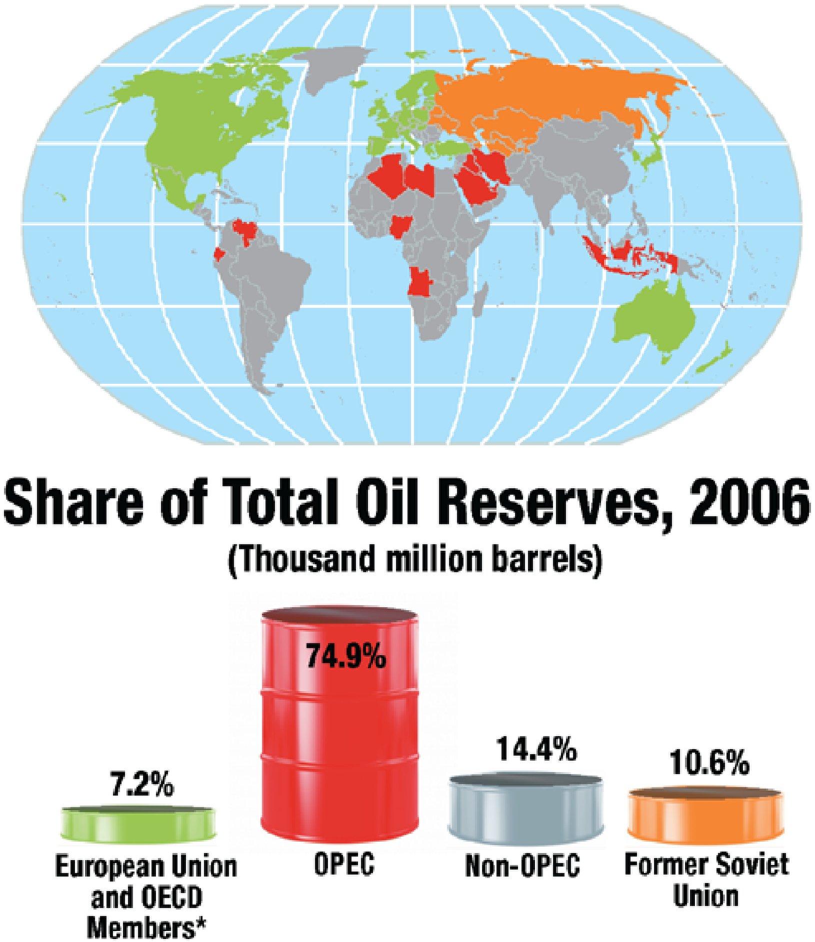
- There are three practices that concern government regarding oligopolies.
  - **Price leadership**: This can lead to price wars when companies in an oligopoly disagree
  - **Collusion**: This leads to price fixing and is illegal in the United States
  - **Cartels**: By coordinating prices and production, cartels offer its members strong incentives to produce more than its quota, which leads to falling prices.

FUTURE WATCH

Global Impact

The OPEC Cartel

The organization of Petroleum Exporting Countries (OPEC) is an international cartel of major oil producers. OPEC members produce about 40 percent of the world's oil and control 75 percent of the world's oil reserves. Members meet regularly to set production quotas. Most experts agree that world oil supplies are not sufficient to meet increased demand. In 2008, the head of Libya's OPEC delegation made a prediction: "The easy, cheap oil is over." ***How can OPEC affect world oil prices?***



* Organization for Economic Cooperation and Development Note: Total may exceed 100 percent because of rounding.

SOURCE: *BP Statistical Review of World Energy, June 2007*

Review

- Now that you have learned the characteristics of monopolistic competition and oligopoly, go back and answer the Chapter Essential Question.
  - How does competition affect your choices?