

Topic 11 Part 4

Monopolistic Competition (Chapter 13)

Monopolistic Competition

Assumptions

- 1) Many Buyers
- 2) Many Sellers
- 3) Free entry and Exit
- 4) Product Differentiation

When firms have **horizontally differentiated products**, they each face downward-sloping demand for their product because a small change in price will not cause ALL buyers to switch to another firm's product.

Examples: Restaurants and Local Doctors

Monopolistic Competition

A simple way to think about monopolistic competition is that it is a combination between monopoly and perfect competition.

It is similar to monopoly because of the product differentiation, so firms in both monopolistic competition and monopoly face downward-sloping demand curve.

But note that unlike monopoly, monopolistic competition assumes FREE ENTRY AND EXIT.

It is similar to perfect competition because of the many buyers and sellers and the free entry/exit condition.

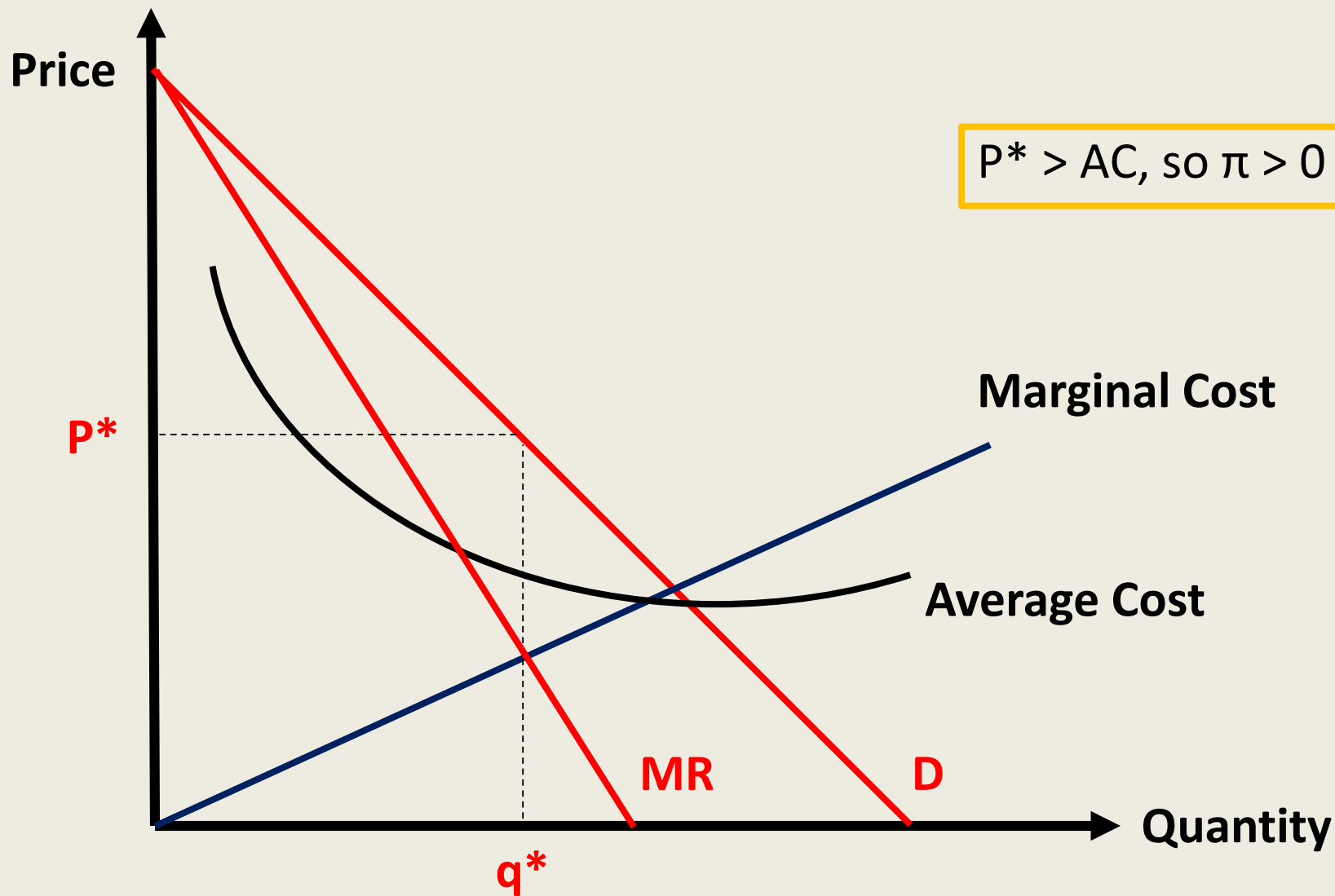
Monopolistic Competition

Profits in the Three Market Structures

Market Structures	Short Run Profit	Long Run Profit
Monopoly	Can be positive (abnormal profit)	Can be positive (abnormal profit)
Monopolistic Competition	Can be positive (abnormal profit)	Zero (normal profit)
Perfect Competition	Can be positive (abnormal profit)	Zero (normal profit)

In monopolistic competition and perfect competition, **new firms can enter the market in the long run** until profits of incumbent firms become zero.

Short-Run Equilibrium with $\pi > 0$



Long-Run Equilibrium with $\pi = 0$

