Universidad Politécnica de Cartagena

Introduction to Economics

Unit 5

Markets. Perfect Competition and Monopoly

Grado en Turismo

Facultad de CC de la Empresa

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Bibliografía: Mochón, F. (2009): Economía y Turismo. Ed. McGraw Hill. Madrid.

1. Types of market

- The ability of a firm to influence the price of a good that it produces will depend on the type of market it is in
- The different types of market are distinguished by their structure, i.e. the number of firms in the market and their relative size (the number of firms as a whole in a particular market is also known as the industry)
- Market power: the ability of a firm to influence the price of a good or service
- Competitive market: composed of a large number of firms which accept the price resulting from a free market (with many sellers and many buyers). They have no market power
- Monopolistic market: made up of just one firm, which therefore has market power
- Between these two extremes there are intermediate typologies: oligopoly, monopolistic competition
- The tourism sector includes a wide range of goods and services in different types of market, each with varying degrees of market power

2. Perfect competition

- In a perfectly competitive market there exist many buyers and sellers, none of whom may influence the price of a good
- Characteristics: price-taking firms, a high number of buyers and sellers, product homogeneity, perfect information, and freedom of entry and exit
- The firms accept the price determined by the market and, though the market demand curve slopes downward, the firm faces a horizontal demand curve

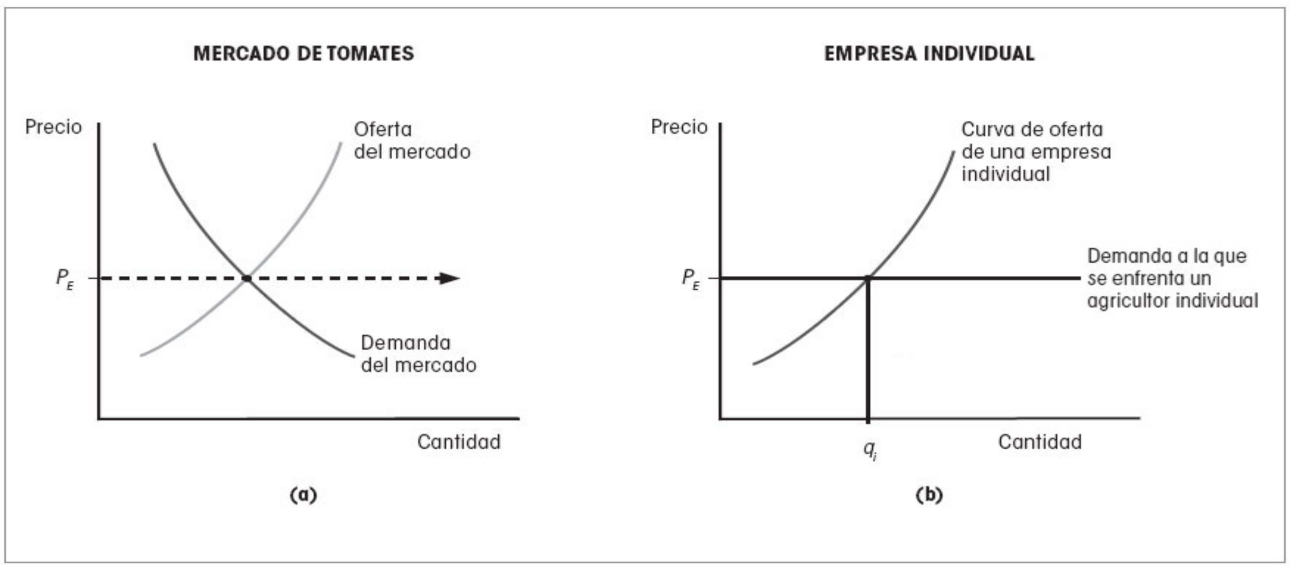

Figura 5.1 El funcionamiento de la competencia perfecta. El mercado, mediante la conjunción de la oferta y la demanda, determina el precio de equilibrio (P_E). A este precio, que es un dato para las empresas individuales, cada empresa producirá la cantidad (q_i) que le indique su curva de oferta.

Fuente: Mochón, F. (2009): Economía y Turismo. Ed. McGraw Hill. Madrid.

2. Perfect competition

- Profit is maximised when marginal revenue is equal to marginal cost

$$MR = MC$$

- For the firm in a perfectly competitive market, marginal revenue is the selling price (P). Therefore, the condition for maximum profits is:

$$P = MC$$

- The competitive firm offers the quantity such that, for this level of production, the marginal cost is equal to the market price

- If there are excess profits, new firms enter the market. If there are losses, firms leave the market. In the long run, there will be neither excess profits nor losses

- Therefore, in the long run the price will be equal to the marginal cost and equal to the minimum average cost because, in that way, the excess profit will be zero

3. Imperfect competition: monopoly

- Imperfect competition: firms have the ability to influence the price of a good by acting individually
- **Monopoly**: there exists only one seller or firm with the ability to determine the price: the firm's demand curve is the same as the market demand curve. Therefore, if the firm wishes to sell a higher quantity of a good, it must reduce the price.
- The marginal revenue of a monopolistic firm is not equal to price because, in order to sell one extra unit of output, the price of that unit and of all previous units must be reduced
- The monopolistic firm decides the quantity to supply, matching the marginal revenue to the marginal cost
- Compared to perfect competition, the monopoly market implies a higher price and lesser quantity of output
- The causes of monopoly: exclusive control of a factor of production, a patent, state control of supply, natural monopoly (the average cost decreases indefinitely)
- **Price discrimination** is frequent in a monopoly
- Discrimination in the tourism sector: the prices of flights, hotels, etc.

4. Other imperfectly competitive markets

- Oligopolistic market: a reduced number of sellers exert a certain amount of control over price and are mutually interdependent
- In an oligopoly there exists strategic interdependence: the plans of a firm depend on the conduct of its rivals
- Cartel: a group of firms which act in unison
- Market share: the portion of a market controlled by a particular firm or product
- Monopolistic competition: many firms sell similar products. Differentiation is the key to gaining market power
- With monopolistic competition the market is fragmented, products are differentiated, each firm has limited market power and there are no barriers to entry
- Publicity plays an important role in monopolistic competition by accentuating the differences between products