Detailed Comparison of Market Structures

FOR BEE QUESTIONS 6(pg 23.3.9), 7(pg 23.3.16), 10(pg 23.3.23) & 12(pg 23.3.30)

| **Characteristics** | **Perfect Competition** | **Monopoly** |
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| **Equity**  ***Equity →“fairness” in terms of income distribution***  ***Income is derived from ownership of businesses/firms in the form of profits or dividends.*** | If markets are perfectly competitive firms will end up earning only normal profits in the long run. Thus, what owners (e.g. shareholders) earned from dividends/profits will be spread out evenly, as there is none making supernormal or excessive profits. Thus it can be said, income earned from ownership of businesses is being “fairly” distributed.  ***HOWEVER****, perfect competition does not rectify pre-existing income inequality. For example, even with the development of perfectly competitive markets in an economy, it may retain all its old structure of unequal wealth distribution, with factory workers being exploited by wealthy owners.* | Monopolies may earn supernormal profits in the long run. Supernormal profits represent excessive profits.  Thus, the presence of monopolies **exacerbates income inequality** in the economy as the supernormal profits are concentrated in the hands of the owners/shareholders of monopoly firms e.g. oil giants. And this is at the expense of consumers paying high prices for limited quantities.  ***HOWEVER****, the government can intervene by having corporate/profit taxes on such firms and redistribute the income to the households in the forms of subsidized goods and services such as healthcare and education and generous welfare handouts like unemployment benefits and good coupons for the poor.*  ***Note: The corporate taxes should not be so high that discourages investment.***  ***Note:*** *While governments can tax the firms to redistribute some of their profits to the lower-income groups, it is unlikely that governments would impose a heavy tax as this reduces the incentive for the oligopolistic firms to engage in research and development to improve their goods or services. Thus inequity is likely to worsen or persist even if the government intervenes.* |
| **Innovation (Dynamic efficiency)**  ***To do R&D, firm must have both incentive and ability to do so*** | **No incentive and no ability to do R&D**  **No Incentive:**  **Homogeneous products:**  Innovation to differentiate homogeneous products will not have an impact on consumer’s perception of the product. In other words, consumers consider the products essentially identical regardless of any innovation. There will therefore be no impact on firm’s demand/revenue.  **Perfect information:** innovations are quickly replicated by rival firms or attract new firms. This discourages R&D since the innovating firm will not be to reap the fruits of its innovations. In other words, it is possible to “free ride” on the innovation done by other firms.  (no differentiating effect on costs)  **No $$:**  **Earn normal profits in the long-run:** Such profits are just enough to survive or remain in the industry. There is no excessive profits/supernormal profits which could be used to invest in R&D or fund costly innovation.  ***NONETHELESS****, it must be noted that in reality, a* ***highly*** *competitive market (not the theoretical* ***perfect*** *competition) does drive innovation as it makes the firms want to improve the quality of their products (revenue impact) or reduce the cost of production (cost impact) to earn higher profits.* | **No incentive but have the means to do R&D**  **No Incentive:**  Assuming there are **high barriers to entry**, the dominant position of the monopolist is secured and thus there is no need for the firm to do R&D. The lack of competition leads to complacency or X-inefficiency.  Also, innovation may erode the value of a monopoly’s existing products and thus it may prefer to stay status quo. For example, the discovery of a cheaper and faster microprocessor will lower the price of all its existing microprocessor.  ***NONETHELESS****, if the market is contestable\* – barriers to entry and exit are low, then the monopolist will innovate to secure its position. Innovation is a means to erect barriers to entry to deter entry of new rivals and to stay ahead of the competition (e.g. introduce new products and better techniques of production). It can innovate in terms of production processes/machines that reduce costs so as to enable the monopolist to charge a low price to deter other firms which cannot match the low price from joining; or to come up with better quality goods (revenue side) to harness loyalty from consumers and this will serve as a barrier to entry to potential competitors.*  *If the monopoly has sold the goods to most of its potential buyers, it needs to come up with better products to sell to the existing consumers and at the same time attracts new consumers. For example, Apple introduced iPhone 3, 3S, 4, 4S, 5 & 6 and iPad 1, 2 and 3 within a few years making existing consumers to constantly upgrade and new consumers to buy its products. All these add on more revenue and thus profits to the firm.*  ***\*Note: A contestable market is market where there is no actual competition. However, there are potential competitors (new entrants) waiting to enter into the industry if the incumbent is complacent.***  **Have $$:**  The monopolist has the ability to do R&D as it retains supernormal profits in the long-run and this allows it to fund expensive projects. |
| **Choices**  **(variety and firms)**  ***Consumers choice = consumers sovereignty/Consumer is King.***  ***3 contexts:***   * ***Choice in terms of products*** * ***Choice in terms of sellers*** * ***Choice in terms of output*** | **Choice of Products:**  Consumers have **no variety of goods and services** since they are assumed to be homogeneous in nature.  *However, such markets usually sell products where choice is unimportant to the consumer. In other words, the consumer is not “brand conscious”. For example, in the real world, some consumer electronic products like batteries; simple clocks have become “commoditized” to the extent that brand isn’t the most important factor in deciding what to buy. In fact, these products are sold in “discount shops” where, consumers prefer a “good” or low price rather than a branded product.*  *Moreover, under perfect competition, consumer surplus is maximized as prices are lower and output higher compared to monopoly where competition is removed. There is both productive and allocative efficiency respectively. Thus it can said, consumers are getting a “good” deal.*  **Choice of Sellers:**  Consumers do have a choice of many producers.  **Choice of output:**  Consumers do have a choice in terms of how much to produce (i.e. output is allocatively efficiently, where P=MC). From the market point of view, a perfectly competitive market reacts to consumer’s demand responsively since changes in demand will lead to changes in equilibrium price and output and thus resource allocation. In other words, there is consumer sovereignty. | **Choice of Products:**  Consumers do not have a choice given that the monopolist’s good is unique and there is no similar product in the market.  *However, a big monopoly firm like Apple Inc can produce a wide range of products to cater to different tastes and preferences. Such a strategy is called product proliferation. But the question is whether the differences may be apparent or perceived than real. Example: Is there significant real differences between iphones 4, 5 or 6? Are the new features a significant improvement? Or just superficial?*  **Choice of Sellers:**  Depends on whether it is a Pure Monopoly or a Dominant-firm Monopoly  **Pure monopoly:** Only ONE seller  This type of monopoly is found in network industries such as public utilities and public transportation. They are sometimes also called natural monopolies. Consumers will have no choice but turn to this only firm for its goods/services.  *However, if it is a dominant firm or legal monopoly, consumers* ***do have a choice of sellers.***  *In reality, a monopoly may exist even if there are more than one seller, provided amongst them there is a dominant firm that controls a substantial market share (e.g. 25% in UK). Example: Retailing – Big retailers v small retailers; In USA, Walmart is the largest retailer. So there are still other producers the consumers can choose from.*  **Choice of output:**  Monopolist restricts output below the competitive or socially efficient level (i.e. P>MC). As a result, consumer sovereignty is restricted or consumers are exploited. This is often referred to as an abuse of monopoly power.  *However, it is possible to produce at the allocatively efficient output if monopoly is regulated ie P=MC pricing regulation.* |