Webnote 2114. 4 Models – 4 Key ideas

4 Models: Key Government Objective Competitive markets:

1. **Perfect Competition**

(Imperfect models):

2. **Monopolistic**
3. **Oligopoly**
4. **Monopoly**

6 Key formulas:

1. **mc = ac at lowest point (productively efficient)**
2. **mc = ar (allocatively efficient)**
3. **mc =mr (profit maximisation)**
4. **ar = ac (normal profit)**
5. **ar>ac = supernormal/abnormal profit**
6. **ar<ac = losses (in long run firm must cover its ac. It can stay open in the short run as long as it covers its variable costs.**

4 KEY Questions for each model:

Government wants competitive markets where consumers have choice and where price is competitive (lower) for consumers and where output is as efficient as possible. Governments are concerned about abnormal profits as a possible outcome could be anti-competitive markets where large firms collude to take advantage of consumers (google: Tschibo price fixing coffee in Düsseldorf and the response of the Kartelamt). Governments are concerned about barriers to entry where these barriers reduce competition, efficiency and cause higher prices with lower choices for consumers. This is why these 4 questions are critical to consider for each of the 4 competitive models.

1. **Price + Output:**
   What is the price and output of the firm and is it good for society (mb=mc)? Note the firm locates its price and output using the profit maximization formula: MR=MC
2. **Profit maximizer:**
   with supernormal profits (AR>AC)or not?
   Firms can have other goals e.g. sales revenue maximization or sales growth maximization e.g. more prestige /status for firm and managers?
3. **Efficiency**:
   Allocatively efficient or not (mc = ar)?
   (Productively efficient or not (mc cuts ac at lowest point)?
4. **Barriers:**
   Does the firm have power to set up barriers to entry? (if a firm has price power it can earn S/N profits in the long run. Barriers can be uncompetitive and governments therefore regulate. It is essential that consumers are offered choice. Competition brings larger markets, lower prices and higher levels of efficiency and consumer choice along with higher levels of community surplus.