THE EFFICIENCY AND WELFARE IMPLICATIONS OF MONOPOLISTIC COMPETITION

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Abstract: *In this article, provide information about "Monopolistically Competitive Market Equilibrium." We can learn about the advantages and disadvantages of monopolistic competition for society, the role of competition in economic development and its negative aspects, the benefits and harms of monopolistic competition to the economy, and what measures are currently being taken to combat monopolies.*

Keywords: *monopolistic competition, competition, monopoly, short-term, long-term*

INTRODUCTION

Monopolistic competition is a type of market in which many sellers offer similar but not identical products. Although the names monopolistic competition and monopoly may seem similar, in practice, these two types of competition differ sharply.

This type of competition, at first glance, has elements of perfect competition but belongs to the category of imperfectly competitive markets (monopolized markets). In monopolistic competition, there are a relatively large number of firms operating, and there are minor barriers for new firms to enter the market or for existing firms to exit. However, this type of competition still differs from a free market.

The difference is that in a monopolistically competitive market, the product is differentiated, meaning each firm produces and sells a product that satisfies the same need in its own unique way, and its product may differ from the products of other firms in terms of quality, appearance, type of service, style, materials used, and brand. Product differentiation means that the goods sold in the market are diverse and not of a single pattern.

Because each firm has its own product brand, it has a certain degree of market power. For example, in every city, there are fast-food restaurants, restaurants, and places selling baked goods (especially pastries). These economic entities sell a variety of products that satisfy a similar type of need. Fast-food restaurants in Tashkent, such as Feed Up, Oq-Tepa Lavash, and Evos, have similar menus (lavash, burgers, french fries, and other consumer goods), but differ slightly in shape, taste, service, and price.

In 1933, American economist Edward Hastings Chamberlin introduced a new type of competition—monopolistic competition—in his work, "The Theory of Monopolistic Competition." He believed that real-world market types operate within the boundaries between perfect competition and monopoly. Later, in 1977, a co-authored paper by Avinash Kamalakar Dixit and Joseph Eugene Stiglitz brought

monopolistic competition to its current form. This model was later named the Dixit-Stiglitz model. However, according to the main theory proposed by Michael Porter, any product is perceived as "unique" by at least a group of consumers. Therefore, the degree of differentiation is determined according to their perception. In 1986, Merton Howard Miller suggested naming marketing and innovation as the two main strategies for differentiation. In 1988, Henry Mintzberg proposed specific and broad categories: quality, design, image, and price.

Characteristics of a Market with Monopolistic Competition

A market with monopolistic competition is characterized by the following features:

- Firms sell products that are variants of a single good, with a high degree of substitutability, and compete with each other (the price elasticity of substitute goods is high).
- The entry of new firms into the market and their operation, as well as their exit from the market, are virtually unrestricted.
- Many firms operate in the market, and each of them has a share of the market demand for the good based on its production costs and product characteristics.
- Imperfect information, where producers and consumers are not fully aware of the market conditions or there is insufficient information (asymmetric distribution of information).
- Firms are free to make decisions in setting prices for their products and determining sales volume. For example, any firm can increase or decrease the price of its product according to its elasticity to gain additional profit. For instance, if the elasticity is 5, and a firm reduces its product price by 10 percent, its sales volume will increase by 1.5 times.
- This increase comes not from a single firm but from many firms, so this price policy can cause significant harm to many firms. If a firm in a perfectly competitive market cannot change the price, under monopolistic competition, a firm's price policy operates within small limits: if a firm raises the price excessively, loyal customers will switch to competitors; if it lowers it too much (i.e., produces too much), the increasing cost function can lead to losses. Even if it doesn't incur losses, the price of a unit of product may fall below its average total cost (ATC).

Characteristics of Inter-firm Competition. In monopolistic competition, price wars are almost never observed because there are a large number of firms in the market. Although firms here can influence prices to a certain extent (they are price-takers), this influence is weak. Therefore, firms compete using the following non-price factors:

Firm Equilibrium in Monopolistic Competition. Short-Run Equilibrium: Because a firm's product is differentiated and its volume has a certain impact on total market demand, its demand curve (Average Revenue, AR) is downward sloping. Here, AR represents the demand for only a single firm's product; the market demand curve does not change due to one firm's price policy. Since a firm maximizes its profit when

marginal cost equals marginal revenue (MC=MR), it maximizes profit by producing the quantity Qs. The equilibrium price Ps is determined through the firm's demand curve. Since the equilibrium price is greater than the average cost, the firm earns an economic profit, which is depicted by the shaded rectangle in the figure. In a market with monopolistic competition, if a firm makes a profit, it wants to increase its production volume to the point where MC=MR, and thus increases the volume of the product produced (Figure 1.1).

Production Volume (Q)	Price §	Total Revenue (TR)	Marginal Revenue (MR)	Total Cost (TC)	Marginal Cost (MC)	Profit (π)
0	5.25	0.00	0.00	3.00	0.00	3.00
1	5.20	5.25	5.20	5.15	5.00	3.65
2	5.15	10.30	5.10	8.85	2.35	-2.00
3	5.10	15.30	5.00	12.30	1.65	0.75
4	5.05	20.20	4.90	14.55	2.25	5.70
5	5.00	25.00	4.80	16.20	3.45	6.30
6	4.95	29.70	4.70	18.30	2.25	7.80
7	4.90	34.30	4.60	21.90	5.67	6.55
8	4.85	38.80	4.50	27.75	40.25	0.40
9	4.80	43.30	4.40	38.40	18.30	-13.40
10	4.75	47.50	4.30	56.40	27.45	-36.20

As can be seen from the table, at the beginning of production, the firm incurs losses due to a lack of production resources and high fixed costs. Then, according to the law of increasing returns to production, marginal costs decrease. After production reaches 6 units, the law of diminishing marginal utility takes effect, marginal costs exceed marginal revenue, and total profit decreases. In a market economy, any rational firm stops production precisely when profit is maximized. According to economists, in the Union of Soviet Socialist Republics, precisely because of the inefficient production model, where not profit but the quantity of products produced and the number of employed workers were important, such firms were considered completely inefficient in the short run.

Short-Run Scenarios

1. Excess Profit Situation If P > ATC:

• The firm earns an economic profit.

• Profit = (P - ATC) × Q

2. Loss Situation If P < ATC:

• The firm incurs a loss.

• If P > AVC, the firm continues to operate in the short run.

3. Normal Profit Situation If P = ATC:

• The firm earns a normal profit.

• This situation corresponds to long-run equilibrium.

Long-Run Equilibrium

Process of Reaching Equilibrium In the long run, due to the freedom of entry and exit, the short-run equilibrium is not stable:

• In a situation of excess profit:

• New firms are attracted to the market.

• Each firm's market share decreases.

• The demand curve shifts to the left.

• In a situation of loss:

• Some firms leave the market.

• The market share of the remaining firms increases.

• The demand curve shifts to the right.

Final Equilibrium Conditions In the long run, a firm reaches equilibrium under the following conditions:

1. MR = MC (the condition for profit maximization)
2. P = ATC (the condition for zero economic profit)

Over time, firms aspiring to enter profitable industries increase. For this reason, if a farm operating in the agricultural sector makes a conditional profit of 600 million soums in the first year, firms outside the sector (which usually have all the necessary production resources), upon learning of this, will cause an oversupply of goods. As a result, firms in the sector will earn less profit, no profit, or even incur losses.

For this reason, additional producers with substitute goods that have entered the market, or firms that have joined to gain a share of the market demand, take over customers from the demand curve of firms previously operating in the market. For this reason, the demand curve in Figure 1.2 shifts down and to the left, and the equilibrium price in the market also decreases.

In the long run, firms do not earn economic profit; all earn normal profit. If there are too many firms in the sector, they even incur losses, and only those firms for whom AVC < P (i.e., where the price of the good sold is higher than the average variable cost) can continue to operate in the sector.

Conclusion. Monopolistically competitive market equilibrium has its own unique characteristics, distinguished by a large number of market participants, product differentiation, and conditions of free entry and exit. In such a market, although each firm has a certain degree of control over the market, competitive pressure in price setting is always present.

The equilibrium state is formed at the point where the firm's demand curve is tangential to its average cost curve.

As a result, in the short run, a firm may earn an economic profit or a loss, but due to the entry of new firms or the exit of existing ones, economic profit becomes zero in the long run.

In long-run equilibrium, even if a firm operates at its optimal production volume, it does not fully utilize its production capacity—this gives rise to the problem of "excess capacity." While this situation is one of the main disadvantages of monopolistic competition, it also yields positive results for the market through product variety and expanded consumer choice.

Furthermore, competition among firms in advertising, branding, and quality improvement incentivizes innovative processes.

Overall, monopolistically competitive market equilibrium provides a balance between the efficient use of resources, product variety, and market freedom. This market model is widely found in real economic systems and plays an important role in the formation of modern service and consumer goods markets.

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