LECTURE NOTES ON MANAGERIAL ECONOMICS FOR STUDENTS ACADEMIC USE BY-_DR.NEHA MATHUR MA'AM

What Is an Imperfect Market

An imperfect market refers to any economic market that does not meet the rigorous standards of the hypothetical perfectly—or purely—competitive market. Pure or perfect competition is an abstract, theoretical market structure in which a series of criteria are met. Since all real markets exist outside of the spectrum of the perfect competition model, all real markets can be classified as imperfect markets.

In an imperfect market, individual buyers and sellers can influence prices and production, there is no full disclosure of information about products and prices, and there are high barriers to entry or exit in the market.

A perfect market is characterized by perfect competition, market equilibrium, and an unlimited number of buyers and sellers.

Imperfect markets do not meet the rigorous standards of a hypothetical perfectly or purely competitive market. Imperfect markets are characterized by having competition for market share, high barriers to entry and exit, different products and services, and a small number of buyers and sellers. Perfect markets are theoretical and cannot exist in the real world; all real-world markets are imperfect markets. Market structures that are categorized as imperfect include monopolies, oligopolies, monopolistic competition, monophonies, and oligopsonies.

Understanding Imperfect Markets

All real-world markets are imperfect. Thus, the study of real markets is always influenced by competition for market share, high barriers to entry and exit, different products and services, prices set by price makers rather than by supply and demand, imperfect or incomplete information about products and prices, and a small number of buyers and sellers.

For example, traders in the financial market do not possess perfect or even identical knowledge about financial products. The traders and assets in a financial market are not perfectly homogeneous. New information is not instantaneously transmitted, and there is a limited velocity of reactions.

When considering the implication of economic activity, economists only use perfect competition models. A such, the term imperfect market is somewhat misleading. Most people will assume an imperfect market is deeply flawed or undesirable. However, this is not always the case. The range of market imperfections is as wide as the range of all real-world markets—some are much or less efficient than others.

Types of Imperfect Markets

When at least one condition of a perfect market is not met, it can lead to an imperfect market. Every industry has some form of imperfection. Imperfect competition can be found in the following structures:

Monopoly

This is a structure in which there is only one (dominant) seller. Products offered by this entity have no substitutes. These markets have high barriers to entry and a single seller who sets the prices on goods and services. Prices can change without notice to consumers.

Oligopoly

This structure has many buyers but few sellers. These few players in the market may bar others from entering. They may set prices together or, in the case of a cartel, only one takes the lead to determine the price for goods and services while the others follow.

Monopolistic Competition

In monopolistic competition, there are many sellers who offer similar products that can't be substituted. Businesses compete with one another and are price makers, but their individual decisions do not affect the other.

Monopsony and Oligopsony

These structures have many sellers, but few buyers. In both cases, the buyer is the one who manipulates market prices by playing firms against one another.

Perfect markets are characterized by having the following:

An unlimited number of buyers and sellers. Identical or substitutable products. No barriers to entry or exit. Buyers have complete information on products and prices. Companies are price takers meaning have no power to set prices.

In reality, no market can ever have an unlimited number of buyers and sellers. Economic goods in every market are heterogeneous, not homogeneous, as long as more than one producer exists. A diverse range of goods and tastes are preferred in an imperfect market.

Perfect markets, though impossible to achieve, are useful because they help us think through the logic of prices and economic incentives. It is a mistake, however, to try extrapolating the rules of perfect competition into a real-world scenario. Logical problems arise from the start, especially the fact that it is impossible for any purely competitive industry to conceivably attain a state of equilibrium from any other position. Perfect competition can thus only be theoretically assumed—it can never be dynamically reached.