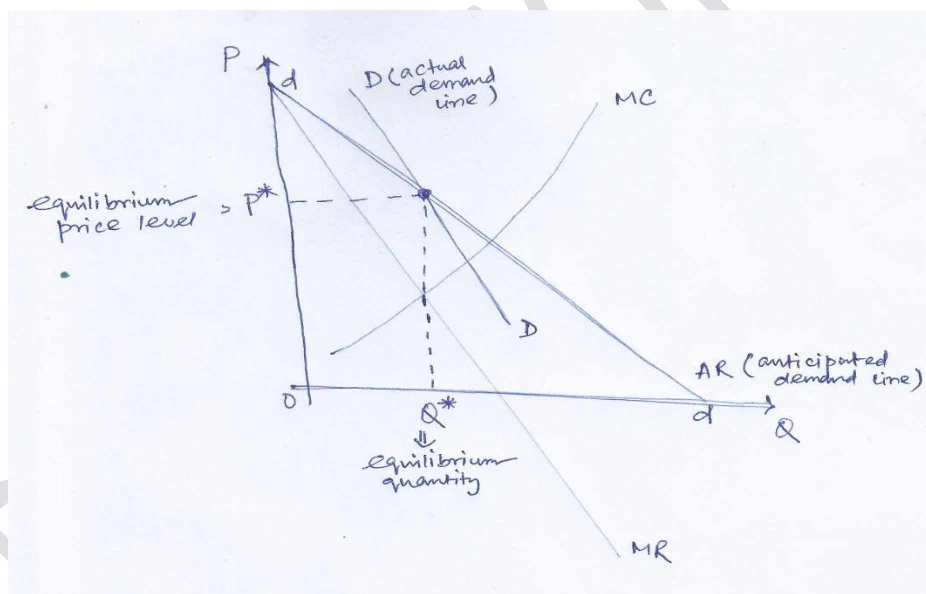
Chamberlin's two heroic assumptions:

1. Firms in the same group have identical cost curves. Demand for products of various firms in the group is uniform.
2. No conscious rivalry among firms

Short Run Equilibrium Condition under Monopolistic Competitive Market:

1. MR=MC
2. MC cuts MR from below
3. At equilibrium output level we have interaction between actual & anticipated demand lines



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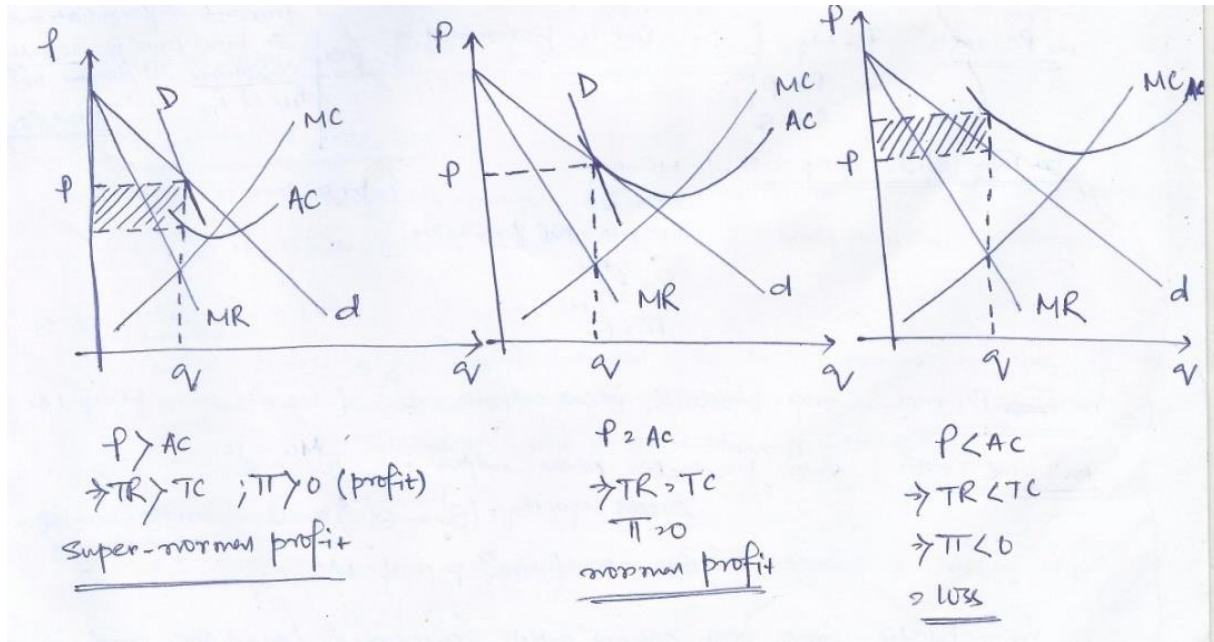
Short run Profitability Conditions:

In SR, a monopolistically competitive firm can earn normal profit or super normal profit as well as loss



Long Run Equilibrium Condition under Monopolistic Competitive Market:

1. At point E, MR=SRMC=LRMC & both SRMC & LRMC cut MR from below *(LR=long run & SR=short run)*
2. At point F, P(price)=SRAC=LRAC
3. At point F, actual demand line(DD) cuts anticipated demand line(dd)

If firms earn supernormal profit or normal profit in short run then new firms will enter in the industry as there is free entry & free exit in the market. As new firms enter actual market share will be less than before. It will cause leftward shifting of actual demand line (DD).

Now each firm will think that more can be sold offering lower price following the anticipated demand line (dd).Thus price competition will enter in the industry. As a result same quantity will be available at a lower price & anticipated demand line

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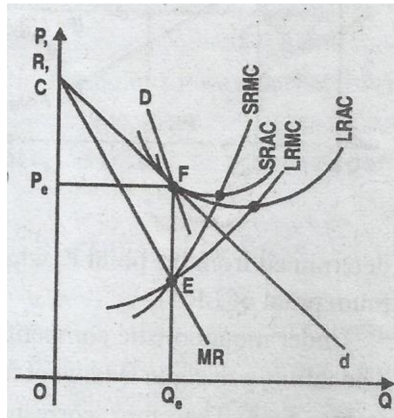
will shift parallely in leftward direction. Since all firms are identical, all firms within the group only can enjoy the normal profit.



Excess Capacity:

Ideal or optimum level of output of a firm can be determined from minimum point of long run average cost (LRAC) curve. The ideal plant size can be represented by short run average cost (SRAC) curve which is tangent at the minimum point with the minimum point of LRAC curve. Under perfect competition price line is horizontal. Therefore in long run price line is tangent to minimum point of LRAC curve. It means ideal output can be produced by perfectly competitive firm. The actual output is ideal output. Hence there is no excess capacity under perfect competition. Only a perfectly competitive firm can exploit all the economies of large scale production by full extent.

Under monopolistic competitive market price line is falling or negatively sloped. Falling price line is tangent to falling portion of LRAC curve at point F. so LRAC does not reach at its minimum point. At higher price than perfectly competitive market a monopolistically competitive firm produces quantity less than perfectly competitive market. So there is positive excess capacity = $(OQ_{PC}-OQ_{MC}) = Q_{MC}Q_{PC}$

P_{MC}=Price under monopolistic competitive market

Q_{MC}= Quantity under monopolistic competitive market

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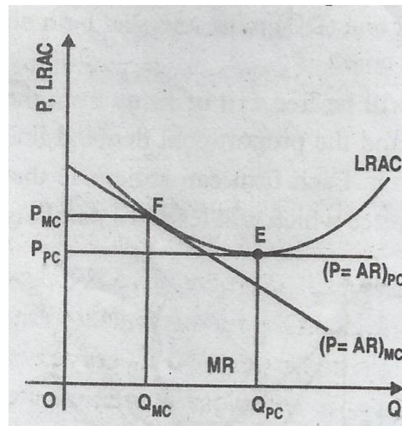
P_{PC}= Price under perfectly competitive market

Q_{PC}= Quantity under perfectly competitive market



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