Models of Monopolistic Competition

The Hotelling Model

• Bathers scattered along the beach.
• Two ice cream vendors, charging the same price for the same product.
• People will go to the closer vendor
• Where should the vendors locate?

The Right Solution

• The right solution is to locate one at ¼ and the other at ¾

The Right Solution

• Bathers scattered along the beach.
• Two ice cream vendors, charging the same price for the same product.
• People will go to the closer vendor
• Where should the vendors locate?
The Right Solution

- The right solution is to locate one at \( \frac{1}{4} \) and the other at \( \frac{3}{4} \).
- This minimizes bathers travel costs to get a cone.

The Actual Solution

- In fact, they will locate just at the middle.
- If either vendor moves away, he will lose market share.
- For example, if one vendor moved back to \( \frac{1}{4} \), he would lose sales.

The Hotelling Model

- Also applies to political campaigns.
- Explains why politicians move to the center.

Attribute Spaces

- Tartness
- Caffeine
If Y raises his price, he loses attribute space.

Other colas with different combinations of tartness and caffeine will enter the market.

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– Each time a cola enters, prices decline and fixed costs rise.
Attribute Spaces

• Other colas with different combinations of tartness and caffeine will enter the market.
  – Each time a cola enters, prices decline and fixed costs rise.
  – This process will continue until manufacturers are earning zero profits.

End

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