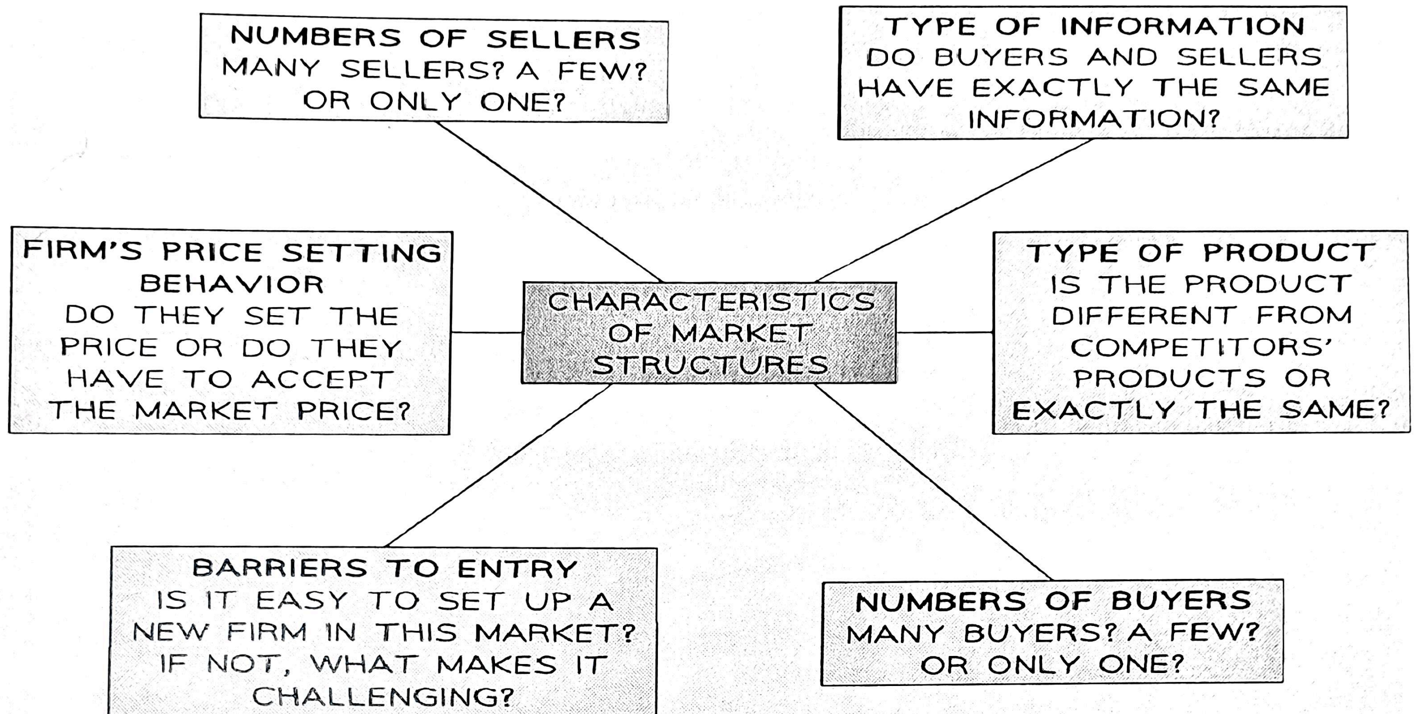
BISES

Grade: 9
Subject: Economics
Unit 23: Market structure 2nd semester

Market structure: The condition which exist in a market including the number of firms.



The six characteristics which determine the type of market structure a firm operates in - competitive or monopoly

- The **answers to the questions** above determine the type of **market structure** in which a firm is operating in
  - If a firm is selling a unique product (e.g. handmade car) it is likely operating in a monopoly market & setting high prices.

HOD 06/12/2023

An Introduction to Competitive & Monopoly Markets

- Each firm operates in a **specific market**
- The conditions in different markets can **vary significantly** & are determined by the **market structure** in which the firm operates
- There are a range of market structures, however **your syllabus** only requires you to know the characteristics of two - **competitive markets & monopolies**
- Competitive markets are those with an extremely **high degree of competition**
- A monopoly is a market structure in which one firm dominates the market & has **significant market power.**

Competitive Markets:

A market with a number of firms that compete with each other. Firms compete in the market to increase their customer base, sales, market share and profits.

Characteristics of Competitive Markets

- The characteristics of a competitive market are as follows

1. **There are many buyers and sellers:** due to the number of market participants sellers are **price takers**
2. **There are no barriers to entry & exit from the industry:** firms can start-up or leave the industry with relative ease which increases the level of competition
3. **Buyers & sellers possess perfect knowledge of prices:** this assumption presupposes perfect information e.g if one seller lowers their price then all buyers will know about it
4. **The products are homogenous:** this means firms are unable to build brand loyalty as **perfect substitutes exist** & any price changes will result in losing customers.

The behavior of competitive firms:

In competitive market there is a pressure for firms to keep the prices low. If an individual firm charges a higher price, it runs the risk of losing all of its sale of its rivals as a products are likely to be close substitutes. Firms may seek to gain a competitive advantage by improving their products. They are likely to respond quickly and fully, to any changes in demand.

Easy entry and exit will mean that in the long run firms will probably earn relatively low profits. In some cases, this may be just enough profit to keep them producing the product.

In the short run, they may earn more or less, than this level of profit which is referred to as **normal profit** (the minimum level of profit required to keep a firm in the industry in the long run.) if demand for the product rises, the firms in the industry will make higher than normal profit. This level of profit is called **supernormal or abnormal profit**, will attracts new firms into the industry. Their entry will increase supply which, in turn, will lower the price and return profit to the normal level. If on the other hand, demand falls, firms would initially make a loss. This will force some firms out of the industry. The exit of the firms will reduce supply, causes prices to rise and restore normal profits.

Advantages & Disadvantages of Competitive Markets

Advantages	Disadvantages
• Lower prices: competition causes firms to lower prices for consumers in an attempt to gain market share • Better quality: firms innovate & continuously seek to improve their quality of their goods/services in order to become recognised in a crowded market • More choice: more sellers equals more choice for consumers	• Worse quality: in a bid to lower prices, product quality may actually deteriorate over time • Too much choice: consumers may be overwhelmed & not explore the full range of market offerings, instead sticking to what they know • Worker welfare: the greater the competition the greater the need to cut costs, often resulting in low wages & poor working environments

MONOPOLY

A market with a single supplier. Dominant firms who have market power to restrict competition in the market are called monopolies.

Sole supplier of a product having 100% of share of the market **(pure monopoly)**

Some governments define a monopoly as a firm that has 25% or more share of the market, and dominant monopoly when a firm has a 40% share of the market.

Characteristics of Monopoly Markets

- A monopoly is a market structure in which there is a **single seller**
- There are no **substitute products**
- The firm has **complete market power** & is able to set prices & control output
  - This allows the firm to **maximise profit**
  - There is no long-run erosion of profit levels as competitors are unable to enter the industry
- **High barriers to entry exist**
  - One of the main barriers is the ability of the monopoly to **prevent any competition** from entering the market
    - E.g. by purchasing companies who are a potential threat

- Many governments define a monopoly as any firm having more than 25% **market share**
  - Regulators act to **prevent** market share increasing beyond this level
  - It helps to maintain competition within the market

The behaviour of a monopoly

The existence of barriers to entry, means that a monopoly can earn supernormal profits in the long run. Firms outside the industry may not be aware of the high profits being earned. Even if they do know about the high profits and want to enter the industry, they are kept out by the high barriers to entry and exit.

A monopoly has control over the supply of the product, but although it can seek to influence the demand, it does not have control over it. In fact, a monopoly has to make a choice. It can set the price, but then it has to accept the level of sales that consumers are prepared to buy at that price. If, on the other hand, it chooses to sell a given quantity, the price will be determined by what consumers are prepared to pay for this quantity. Figure 23.1 shows that if a firm sets a price P, the demand curve determines that it will sell amount Q. If it decides to sell amount Q_1, it will have to accept a price of P_1.

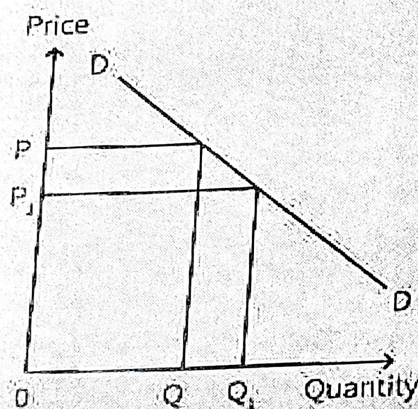


Fig. 23.1: The choice f...

The Advantages & Disadvantages of Monopoly Power

Stakeholder	Advantages	Disadvantages
The Firm	• **Large profits** generate money for continued investment in technology & **product innovation** • Market power enables the firm to increase its **global competitiveness** • **Economies of scale** can increase thereby lowering	• Due to a lack of competition, there is a reduced incentive to be efficient • **Cross subsidisation** can create inefficiencies • Monopolies lead to a **misallocation of resources** as they limit supply in order to increase price

	the average cost • **Price discrimination:** the firm can charge consumers different prices based on the different price elasticity of demand for the product e.g. peak (inelastic) & off-peak (elastic) travel on trains	• Due to a lack of competition, **innovation sometimes lacks effectiveness**
Employees	• Large profits often result in **higher wages**	• Having only one supplier in the industry limits the opportunity to **change employers**
Consumers	• Product innovation due to the firm's large profits may result in a **better-quality product** • **Cross subsidisation** can lower prices on some products that the firm provides • **Prices may fall** If firms pass on their cost savings to consumers (due to economies of scale) in the form of lower product prices	• A lack of competition is likely to result in **higher prices** as **no substitute goods** are available • A lack of competition may result in **no product innovation** & worse product quality over time • May experience **worse customer service** as the incentive to improve it is limited • Cross subsidisation is likely to **increase prices on some products** offered by the firm
Suppliers	• **Increased sales volume** for some suppliers as they are able to supply products that are distributed nationally or internationally	• There is less competition for their products & a monopoly often has the power to **dictate what price** they will pay to suppliers

SOLUTION:

ctivity 1:

a. Three reasons for accounting for consumer preference for one firm's product over that of rival firms.

   i. Products are cheaper.

   ii. Products have better quality

   iii. Enjoy a better brand image.

b. It will attract more consumers and gain a higher market share.

Activity 2:

a. Barriers to entry include takeoff and landing slots at airport, safety requirements and brand loyalty.
b. Barriers to entry include brand loyalty and monopoly ownership of retail outlets.
c. Barrier to entry include high set costs and scale of production.
d. There are few barriers. It is cheap to enter and leave, startup costs are low, large scale production does not lower unit costs significantly and branding and advertising are not particularly significant.

Four part Questions

a. Define a barrier to entry. (2)

b. Explain two characteristics of a competitive market. (4)

Analyse how a change in the number of firms in a market can affect the profits that are earned. (6)

d. Discuss whether or not a monopoly benefits consumers. (8)

Grade: 9

Subject: Economics

Topic: Macroeconomics aims of government

Semester: 2nd

The Role of Government

The public sector in every economy plays a major role, as a producer and employer. Governments work locally, nationally and internationally. Here are the roles they play in the economy:

1) As a producer, it provides, at all levels of government:
   a) Merit goods (educational institutions, health services etc.)
   b) Public goods (streetlights, parks etc.)
   c) Welfare services (unemployment benefits, pensions, child benefits etc.)
   d) Public services (police stations, fire stations, waste management etc.)
   e) Infrastructure (roads, telecommunications, electricity etc.).

2. As an employer, it provides at all levels of government, employment to a large population, who work to provide the above mentioned goods and services. It also creates employment by contracting projects, such as building roads, to private firms.
   a) Support agriculture and other prime industries that need public support.
   b) Help vulnerable groups of people in society through redistributing income and welfare schemes.
   c) Manage the macro economy in terms of prices, employment, growth, income redistribution etc.
   d) Governments also manage its trade in goods and services with other countries by negotiating international trade deals.

Tess HoD 18/01/2024

Government Macroeconomic Aims

The government's major macroeconomic objectives are:

- **Economic Growth:** economic growth refers to an increase in the gross domestic product (**GDP**), the amount of goods and services produced in the economy, over a period of time. More output means economic growth. But if output falls over time (economic recession), it can cause:

  I. fall in employment, incomes and living standards of the people
  II. fall in the tax revenue the govt. collects from goods and services and incomes, which will, in turn, lead to a cut in govt. spending
  III. fall in the revenues and profits of firms
  IV. Low investments, that is, people won't invest in production as economic conditions are poor and they will yield low profits.

When an economy experiences economic growth there is an increase in its output in the short run. This is referred as **actual economic growth**. In the long run, for an economy to sustain its growth the productive potential of the economy has to be increased. Such an increase can be achieved as a result of a rise in the quantity and\or quality of factors of production. This is referred to **potential economic growth**.

The difference between actual and **potential economic growth** can be shown on a production possibility curve. In Figure 25.1, the movement from point A to point B represents actual economic growth – more capital and consumer goods are made. The shift outwards of the production possibility curve from YY to ZZ represents potential economic growth – the economy is capable of producing more.

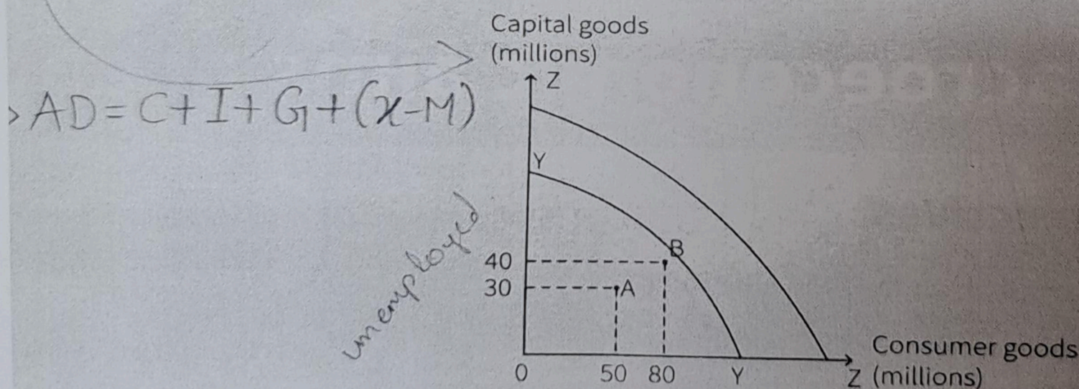


Fig. 25.1: Actual and potential economic growth

- **Price Stability:** inflation is the continuous rise in the average price levels in an economy during a time period. Governments usually target an inflation rate it should maintain in a year, say 3%. If prices rise too quickly it can negatively affect the economy because it:

I. reduces people's purchasing powers as people will be able to buy less with the money they have now than before
II. causes hardship for the poor
III. increases business costs especially as workers will demand higher wages to support their livelihood
IV. Makes products more expensive than products of other countries with low inflation. This will make exports less competitive in the international market.

- **Full Employment:** if there is a high level of unemployment in a country, the following may happen:

I. the total national output (goods produced) will fall
II. government will have to give out welfare payments (unemployment benefits) to the unemployed, increasing public expenditure while income taxes fall – causing a budget deficit
III. Large unemployment causes public unrest and anger towards the government.

The **unemployment rate** is calculated as a percentage of the labour force:

$$\frac{\text{Unemployment}}{\text{Labour force}} \times 100$$

So, if 5 million people are unemployed out of a labour force of 40 million, the unemployment rate is:

$$\frac{5\text{m}}{40\text{m}} \times 100 = 12.5\%$$

- **Balance of Payments Stability:** economies **export** (sell) many of their products to overseas residents, and receive income and investment from abroad; they also **import** (buy) goods and services from other economies, and make investments in other countries. These are recorded in a country's Balance of Payments (BoP).
  Exports > Imports = Surplus in BoP
  Exports < Imports = Deficit in BoP
  All economies try to balance this inflow and outflow of international trade and payments and try to avoid any deficits because:
  I. if it exports too little and imports too much, the economy may run out of foreign currency to buy further imports
  II. A BoP deficit causes the value of its currency to fall against other foreign currencies and make imports more expensive to buy, while a BoP surplus causes its currency to rise against other foreign currencies and make its exports more expensive in the international market.
- **Income Redistribution:** to reduce the inequality of income among its citizens, the government will redistribute incomes from the rich to the poor by imposing taxes on the rich and using it to finance welfare schemes for the poor. All governments struggle with income inequality and try to solve it because:
  i. widening inequality means higher levels of poverty
  ii. Poverty and hardship restricts the economy from reaching its maximum productive capacity.

Conflict of Macroeconomic Aims

When a policy is introduced to achieve one macroeconomic aim, it tends to conflict with one or more other aims. In other words, as one aim is achieved, another aim is undone. Let's look at some conflicts of government macroeconomic aims.

An Explanation of the Common Trade-offs That Exist between the Macroeconomic Objectives

Trade-off	Explanation
Full Employment v/s price stability	Low rates of unemployment will boost incomes of businesses and workers. This rise in incomes, mean higher demand and consumption in the economy, which causes firms to raise their prices – resulting in inflation. This is probably the most prominent policy conflict in the study of Economics.
Economic Growth and Full employment/s BOP stability	Once again, as incomes rise due to economic growth and low unemployment, people will import more foreign products and consume relatively less domestic products. This will cause a rise in imports relative to exports and a deficit may arise in the balance of payments.
Economic Growth and Full employment	In the long run, when economic growth is continuous, firms may start investing in more capital (machinery/equipment). More capital-intensive production will make a lot of people unemployed.