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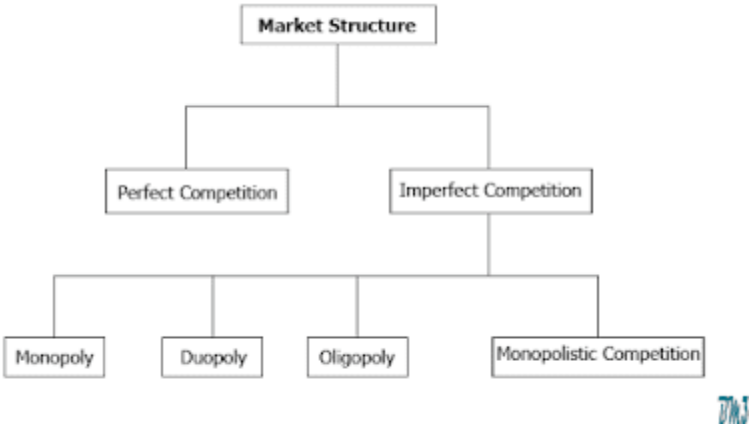
ECONOMICS E-NOTE FOR YEAR 11

In common language, the term market is referred to the place where goods are bought and sold. But in economics, it has different meaning. In economics, market is the arrangement or situation in which buyers and sellers contact with another to carry on business transactions. There is no need of fixed location, face to face contact between buyer and seller. They only need to communicate each other for trading, which may be through letters, mobile phone, internet or any other medium.

Types of Markets

The types of markets are following. Each type is explained in detail.

1. Perfect market. (Perfect competition)
2. Imperfect market. (Imperfect competition)



1. Perfect Market (Perfect Competition)
In perfect market, goods are bought and sold under perfect competition. Following are the characteristics or conditions of perfect market or competition.

1, Large number of buyers and sellers: There is a large number of buyers and sellers exist in the perfect market. Therefore, neither sellers nor buyers can influence the market price. Consequently, the market price remains unchanged. If the price of a good increases by a single seller, the buyer will immediately move to another seller.

2. Homogeneous products are being traded: Under perfect market or competition all the firms produce identical goods having same quality and features. The products are perfectly substituted. A buyer can buy a product from any seller in the market.

3. Free entry and exit of firms: There is no legal, social or market restrictions on entry and exit of the firm. Any firm can enter and leave the industry.

4. Perfect awareness of market conditions: All the buyers and sellers know the prevailing price of the good and its availability in the market. So, by having perfect awareness of the market conditions, no one can sell or buy the product at a higher rate.

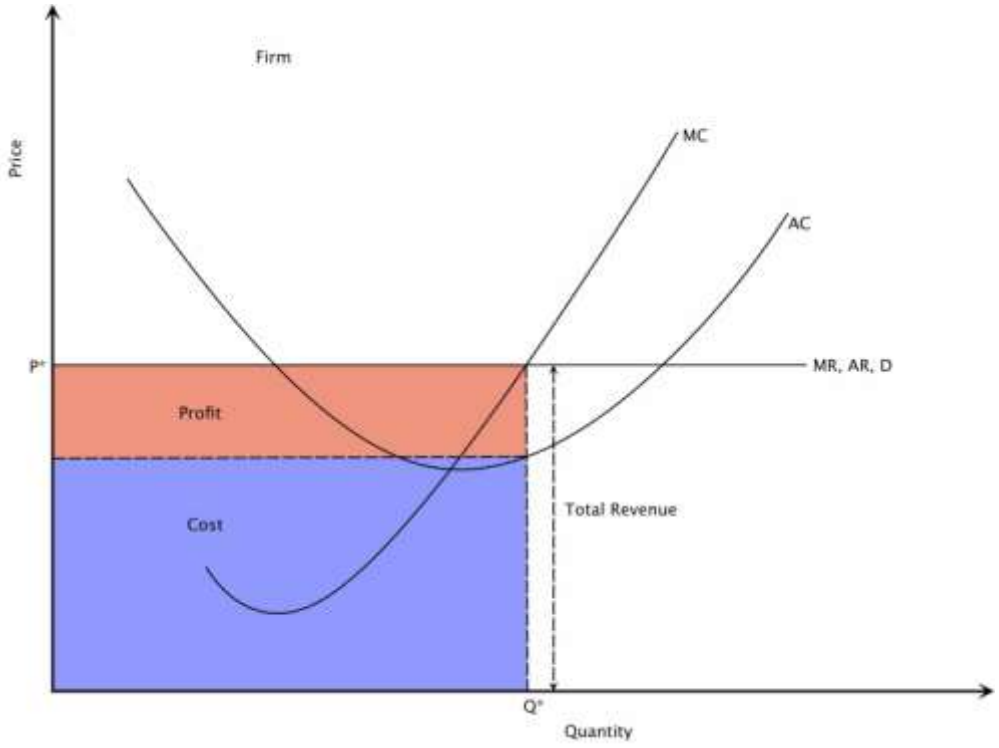
5. Factors of production are perfectly mobile: All factors of production (land, labor, capital and organization) are freely mobile. Land can be bought or rented. Labor and capital can be moved from one firm to another. In the same way, any organization can enter or leave the industry.

6. Free from government interference: There is no government interference in the market. A seller can sell his product to any buyer in any quantity.

EQUILIBRIUM POSITION OF A PERFECT MARKET

In the diagram below, the firm is making supernormal profits. The total cost to the firm is in blue, and the profit is in the red. We can intuitively tell it makes profit because its average costs are lower than the average revenue. To calculate the cost, see where the quantity hits the average cost line, and then draw a horizontal line to the Y axis. Whatever area is above the cost is the profit or the loss.
Since we assume that all individual firms are profit maximizers, we take MC = MR for profit maximization. If a company is loss-making, the rule still applies, so the loss is minimized. Similarly, the least Total Cost is taken to maximize profit or minimize loss.

Perfect Competition Short Run Equilibrium: Supernormal Profits



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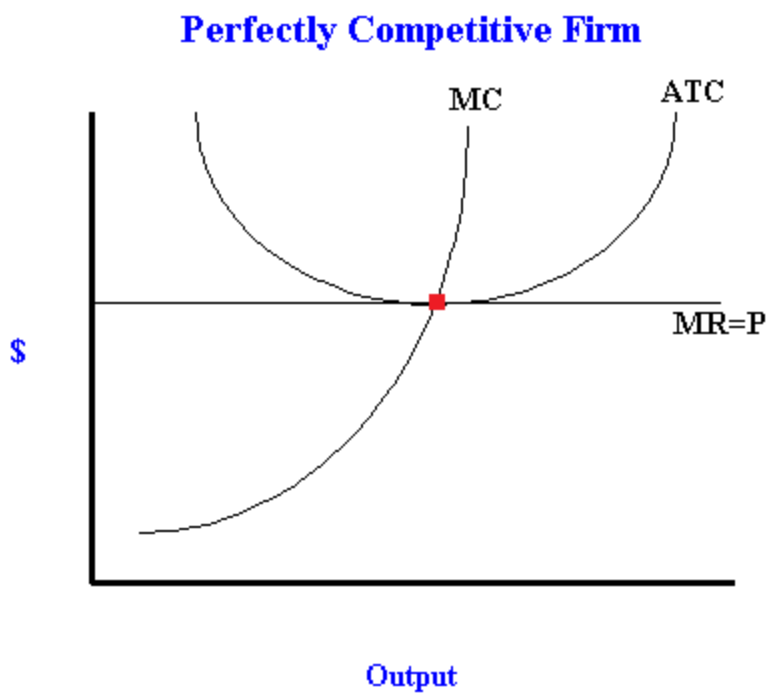

2. Imperfect Market (Imperfect Competition)
In imperfect market, goods are bought and sold under imperfect competition. Following are the kinds of imperfect market:

a. Monopoly

b. Oligopoly
c. Duopoly
d. Monopolistic competition

a. Monopoly
Under monopoly there is only one seller or producer exists in the market and he has full control over the price of a good. Monopoly has the following features.

1. Single seller: In monopolist market there is a single seller or a producer or a group of producers offering a particular product. Under monopoly, the firm itself is an industry.

2. No perfect substitute: The product monopolist sells has no close or perfect substitute available in the market.

3.No entry of new firm: There are many barriers (e.g. Legal, technical, economic, high initial investment etc.) on entry of the new firm to the monopolist market.

4. Price setter: The entire control of supply is in the hands of monopolist firm. This advantage enables the monopolist firm to set its own price of the product.

b. Oligopoly
In oligopolistic market, there are few numbers of sellers or producers exist in the market who dominates the entire industry. The product they offer may be homogeneous or differentiated. Following are some of the features of oligopoly.

1. Monopoly power: The element of monopoly also exists in oligopoly. Since there are only a few firms and each firm possess a large share of the market. This large share enables the firms in oligopolistic market to control the price and output.

2. Price Rigidity: Price rigidity refers to a situation in which price is kept fixed. It is so because if a firm reduces the price in the oligopolistic market, the other firms in response will cut down their prices at a higher level. As a result, a price war occurs among them which benefits no one. Therefore, the price rigidity takes place.

3. Firms are inter-dependent: Since there are only a few firms and each firm enjoys a large share of the market and has control over the price and output. Thus, the firms are inter-dependent because each firm knows that the other firms will react to its change in price and output decisions, because each firm treats the other firm as rival by producing identical or slightly differentiated product.

4. Conflicting attitude of firms: When firms realize the disadvantages of mutual competition and they want to maximize their profits. This situation leads to the formation of collusion among them. This collusion leads to conflicts which arise by allocation of markets and distribution of profits.

c. Duopoly

Duopoly is a kind of imperfect market where two sellers exist in the market providing a particular product or service. A firm cannot take independent decisions about price and output as it has to consider the view point of other firm (competitor). Duopoly has all the characteristics of oligopoly except the number of sellers which are only two in case of duopoly.

d. Monopolistic Competition

Monopolistic competition is a form of imperfect competition where large number of producers exist in the market selling products that are differentiated by brand or quality, hence they are not perfect substitutes. Following are the characteristics or features of monopolistic competition.

1. Large number of firms: There are large number of firms selling differentiated products. Each firm possesses limited share of the market due to large number of sellers, which lead to stiff competition.

2. Product differentiation: It is one of the most important characteristics of monopolistic competition. In perfect competition, identical products are being traded. But in monopolistic competition, each firm produces differentiated products in order to maintain its separate entity. The product is differentiated by brand, design, color, size, shape, packing, quality etc.

3. Free entry and exit of firms: Any firm can enter and leave the industry at any time. This feature of freedom of entry and exit of firms increases competition in the market. This feature also ensures normal profit in the market for a long run.

4. Selling Costs: Selling costs are the expenses which are incurred on marketing, sales promotion and advertisement of the product. Under monopolistic competition each firm tries to attract customers and capture the market by incurring selling costs.

5. Absence of interdependence: Under monopolistic competition, the firms are independent. Each firm produces unique product by brand and quality, which enable them to control over the price and output of the product to some extent. Any action taken by the firm regarding price and output has no significant effect on other firms. Thus, the firms are independent.

Examples of monopolistic competition

Petrol stations, restaurants, hairdressers and builders are all examples of monopolistic competition. Monopolistic competition is a common form of competition in many areas. A typical feature is that there is only one firm in a particular location. There may be many chip shops in town but only one in a particular street. People may be prepared to pay higher prices than go elsewhere, or they may simply prefer this 'brand' of fish and chips.

Monopolistic competition in the short-run

As with other market structures, profits are maximized in monopolistic competition where MC = MR. The AR and MR curves are more elastic than for a monopolist as there are more substitutes available. The profits depend on the strength of demand, the position and elasticity of the demand curve. In the

short run therefore firms may be able to make supernormal profits. This situation is shown in the diagram below.

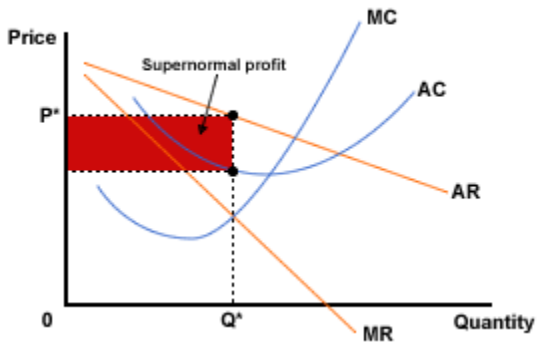

Figure 1 Equilibrium in monopolistic competition in the short-run

Monopolistic competition in the long run

In the long run firms will enter the industry attracted by the supernormal profits. This will mean that demand for the product of each firm will fall and the AR (demand curve) will shift to the left. Long run equilibrium occurs where only normal profits are being made as new firms will keep entering as long as there are supernormal profits to be made. In equilibrium, the demand curve (AR) will be tangential to the firm's long run average cost curve as shown in the diagram below.

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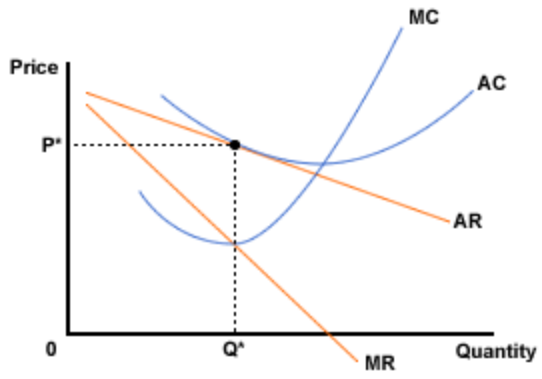

Figure 2 Equilibrium in monopolistic competition in the long run

We can see this change between the short-run and long run clearly if we combine Figures 1 and 2 together. Figure 3 shows the changes taking place as new firms enter the market.

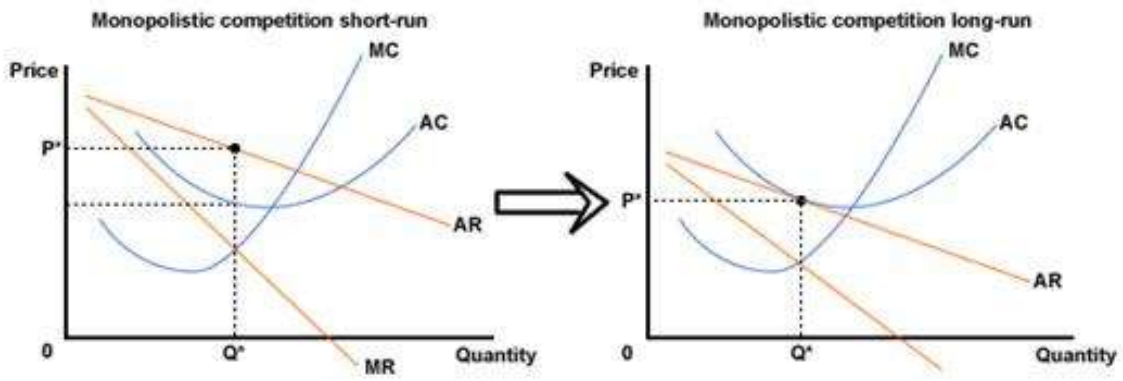

Figure 3 Changes in equilibrium in monopolistic competition short-run to long run

TO BE COPIED INTO YOUR ECONOMICS NOTE(any aspect that is not in your note)

PRACTICE QUESTION

1. The equilibrium position of a firm is attained
A. when MC = AR
B. when MC = PC
C. when MC = MR
D. when AC = AR
E. when AR = MR

2. If a producer sells 1kg of rice for N20 and his marginal products is 100kg, what is the highest wage he can pay the marginal laborer?
A. N 20.00

B. N 30.00
C. N 50.00
D. N 100.00
E. N 200.00

3. In Economics market is define as
A. A place where buyers and sellers come together to exchange goods
B. Any agreement made for consumers to buy all they need
C. any arrangement made for producers to sell all their goods
D. any arrangement whereby buyers and sellers are in close touch with one another
E. a place where only consumer goods are sold

4. An inflation in which the price rises steadily at an average rate of about 2% per annum is best described ad
A. Galloping
B. Induced
C. Creeping
D. Suppressed
E. Run-away

5. All the following are source of finance to a Joint Stock Company except
A. bank loans
B. equity shares
C. debentures
D. preference shares
E. cooperative thrift

6. Given that fixed cost is N500.00, variable cost N1,500.00 and output is 50 units, what will be the average cost of producing one unit?
A. N2,000.00
B. N60.00
C. N50.00
D. N40.00
E. N30.00

7. Which of the following reasons explains the upward sloping of supply curve in a competitive market?
A. Ceteris paribus, marginal cost increase as output increases
B. As new firms enter the market, factor price moves up
C. Firms are in business to satisfy consumers
D. Marginal cost often increases in a competitive market
E. Firms are in business to produce goods

8. A firm is said to be a Public Joint-Stock Company when it
A. is owned by the government
B. operates as a public corporation

C. is a limited liability company
D. sells its shares to members of the public
E. is administered by the public

9. Which of the following is regarded as fixed cost?
A. cost of raw material
B. cost of fuel
C. cost of light
D. rent on land
E. labour wages

10. which of the following categories of people do not gain during inflation?
A. Debtors
B. businessmen
C. Shareholders
D. Investors
E. Creditors