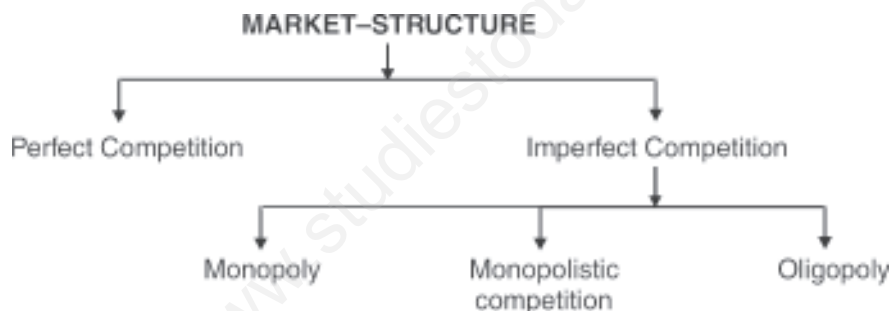


## UNIT 4

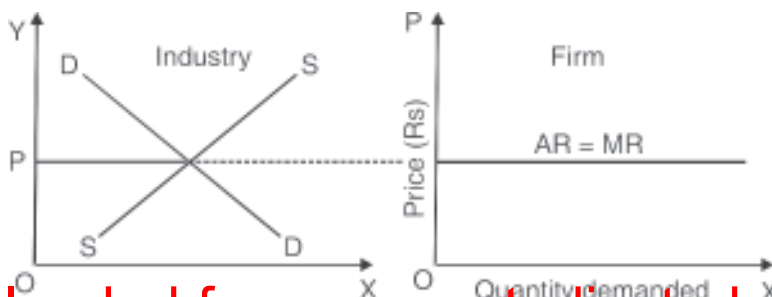
# FORMS OF MARKET & PRICE DETERMINATION

### POINTS TO REMEMBER

- Market implies a system with the help of which the buyers and seller of a commodity or service come to contact with each other and complete the act of sale and purchase.



- Perfect competition is that type of market in which there are very large number of sellers, sell homogenous goods at constant price without any competition to consumer who have perfect knowledge about the market.
- Under perfect competition, price remains constant therefore, average and marginal revenue curves also remain constant and parallel to ox-axis.



- ❑ Under perfect competition price is determined by an industry (a group of producers and consumers) with the forces of demand and supply. No individual firm or buyer can influence the price or supply of the product. So industry is price maker and firm is price taker.

### **MONOPOLY MARKET**

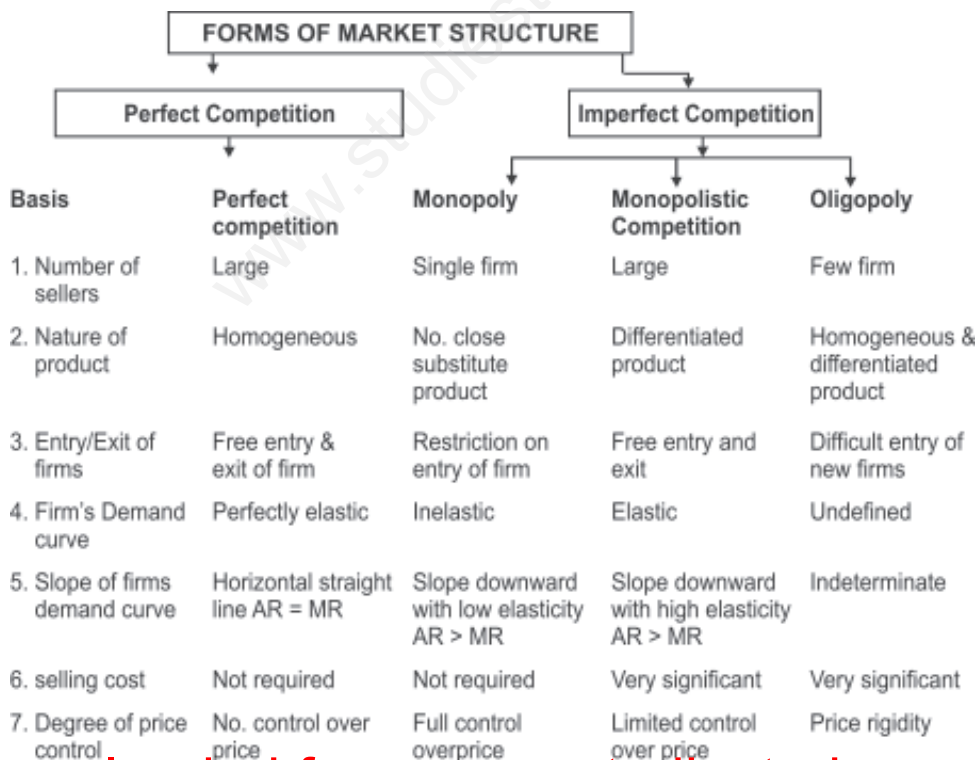
- ❑ Monopoly is that type of market where there is a single seller, selling a product which does not have close substitutes.
- ❑ Under monopoly, due to absence of free entry and exit, firm earn abnormal profit in the long run.
- ❑ Under monopoly, monopolist himself determines price of the product according to the elasticity of demand as he has full control over the supply of the product.
- ❑ Under monopoly elasticity of demand for the good is less than one, therefore, demand curve has steeper slope. ( $E_d < 1$ ).
- ❑ Under monopoly, average revenue and marginal revenue has negative slope, as per unit price falls with increase in output sold.
- ❑ A monopolist may charge different price from different buyers for the same good it is called price discrimination.

### **MONOPOLISTIC COMPETITION**

- ❑ Monopolistic competition is that type of market in which there are large number of firms, sell differentiated product to the consumers who have imperfect knowledge about the product and there is tough competition between firms.
- ❑ Under monopolistic competition due to lack of control over supply each firm determines the price of their product, keeping in view the price level set by other firms.
- ❑ Under monopolistic competition elasticity of demand for the product is greater than one therefore demand curve (AR curve) has flatter slope.
- ❑ Each firm has to incur selling costs (expenditure on advertisement etc.) to promote its sales. This is because, there is a large number of close substitute available in the market.

## OLIGOPOLY

- ❑ Oligopoly is the form of market in which there are few sellers. All the firms produce a certain amount of output of total market supply.
- ❑ All the firms under oligopoly produce homogenous or differentiated product.
- ❑ Under oligopoly entry of firms is not restricted but difficult.
- ❑ Under oligopoly demand curve is undefined.
- ❑ All the firms are interdependent in respect of price determination under oligopoly market.
- ❑ On the basis of production, oligopoly can be categorised in two categories.
  - (i) Collusive oligopoly is that form of oligopoly in which all the firms determine price and quantity of output on the basis of cooperative behaviour.
  - (ii) Non-collusive oligopoly is that form of oligopoly in which all the firms determine the price and quantity of output according to the action and reaction of the firms.



- ❑ Equilibrium Price : Which corresponds to the equality between market demand and market supply of a commodity.
- ❑ Equilibrium quantity which corresponds to the equilibrium price in the market.
- ❑ Market equilibrium is a state in which market demand is equal to market supply. There is no excess demand and excess supply in the market.

### **VERY SHORT ANSWER TYPE QUESTIONS (1 MARK)**

1. Define market.
2. What do you mean by homogenous product?
3. How is price determined under perfect competition?
4. What is the common feature shared by perfect and monopolistic competition?
5. If the firms are earning abnormal profits, how will the number of firms in the industry change?
6. Define the monopoly market.
7. Under which market there is no difference between firm and industry?
8. What is normal profit?
9. Under which form of market the firm is price taker.
10. What is cartel?
11. What is the relationship between AR curve and demand curve in a monopoly market?
12. What do you mean by price discrimination?
13. Define oligopoly.
14. Define equilibrium price.
15. When does the situation of excess supply arise?
16. What will be the effect on equilibrium price when increase in demand is more than increase in supply?
17. Under what situation does the equilibrium price remains unaffected when there is simultaneous increase in demand and supply.

### **H.O.T.S.**

18. What is the relation between average revenue curve and demand curve under monopolistic competition?

**SHORT ANSWER TYPE QUESTIONS (3-4 MARKS)**

1. Why is firm under perfect competition a price taker and under monopolistic competition is price maker. Explain?
2. How is the demand curve under monopolistic competition different from demand curve of a firm under perfect competition?
3. Why is a firm under perfect competition a price taker? Explain.
4. Explain three features of perfect competition.
5. Explain the implication of large number of seller feature of perfect competition.
6. What will happen if the price prevailing in the market is above the equilibrium price.
7. Distinguish between monopoly and oligopoly.
8. Explain the concept of excess demand with the help of diagram.
9. Differentiate between 'Collusive and non-collusive oligopoly.
10. Explain the determination of equilibrium price under perfect competition with the help of schedule.
11. Explain why is the equilibrium price determined only at the output level at which market demand and market supply are equal.

**H.O.T.S.**

12.  $MR = AR$  in perfect competition but  $MR < AR$  in monopoly and monopolistic competition why?
13. In which condition decrease in demand can not change the price of commodity?
14. Explain how firms are interdependent in an oligopoly market.
15. In which competition the availability of close substitutes is present? How does it effect the price?
16. Explain the implication of 'freedom of entry and exit to the firms' under perfect competition.

### **LONG ANSWER TYPE QUESTIONS (6 MARKS)**

1. Explain the characteristics of monopolistic competition.
2. Market for a good is in equilibrium. There is simultaneous increase both in demand and supply of the good. Explain its effect on market price.
3. Explain the term market equilibrium. Explain the series of changes that will take place if market price is higher than the equilibrium price.
4. How will a fall in the price of tea affect the equilibrium price of coffee. Explain the chain of effects.
5. Explain the following features of perfect competition.
  - (i) Large number of firms or Sellers and Buyers
  - (ii) Homogeneous Product.
6. Explain features of Oligopoly.
7. Explain how change in price of a substitute commodity would affect market equilibrium of the commodity X.
8. With the help of a diagram explain the effect of “decrease” in demand of a commodity on its equilibrium price and quantity.
9. There is simultaneous decrease in demand and supply of a commodity, when it result in
  - (i) no change in equilibrium price
  - (ii) a fall in equilibrium price.

### **ANSWERS**

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#### **1 MARK QUESTIONS**

1. Market is a system with the help of it the buyers and seller of a commodity or service come to contact with each other.
2. It means product produced by different firms is identical in all respect like quality, colour, size, weight etc. such products are perfect substitutes.
3. Price is determined by an industry by the forces of demand and supply.
4.
  - (i) Free entry and exit of firms
  - (ii) Perfect mobility of factors.

5. The number of firms in the industry will increase.
6. It is a form of market under which there is a single seller, selling a product which does not have close substitutes.
7. Monopoly.
8. It is the minimum profit which a firm must get to stay in business.
9. Perfect competition.
10. A cartel is a group of firms which jointly set 'output and price' policy of its product in such a way so as to reap benefits of monopoly.
11. Both AR curve and demand curve are the same in a monopoly market.
12. Price discrimination is a policy under which a seller sells a similar product at different prices to different buyers.
13. Oligopoly is a market structure where there are few firms competing for their homogenous or differentiated products.
14. It is the price at which demand = supply.
15. When market price is more than equilibrium price and market supply is more than market demand.
16. When increase in demand is more than increase in supply, equilibrium price will increase.
17. When increase demand is equal to increase in supply the equilibrium price will remain same.

**H.O.T.S.**

18. Both AR and MR curves have negative slope