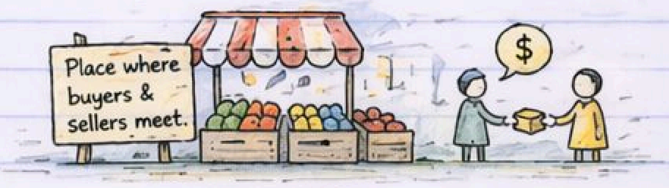
Economics

Module-5 Notes

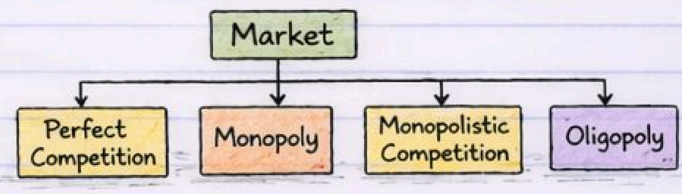
by pyqfort.com

Contents Covered:

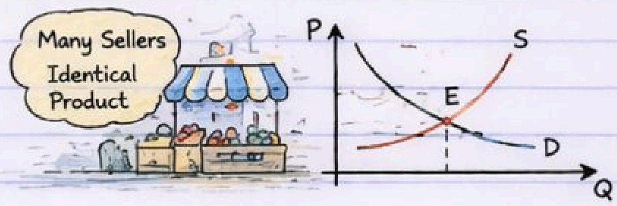
- Meaning of Market



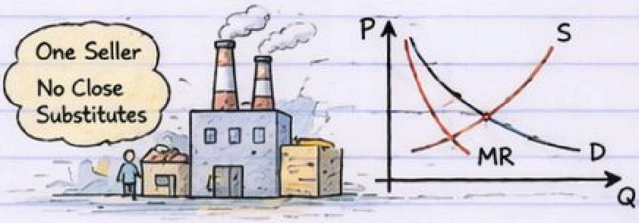
- Classification of Market



- Perfect Competition

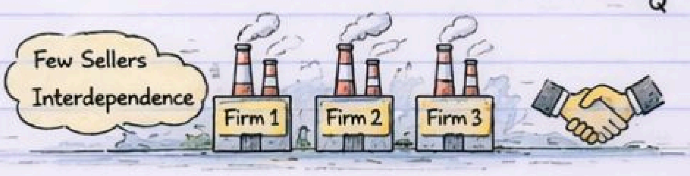


- Monopoly

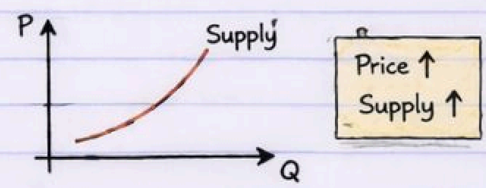


- Monopolistic Competition

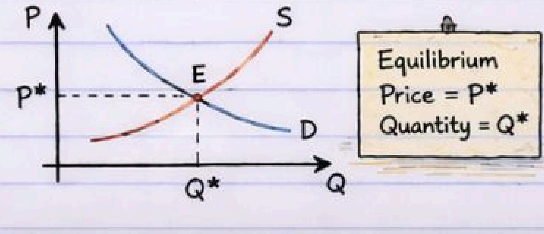
- Oligopoly



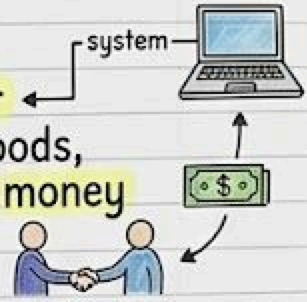
- Law of Supply



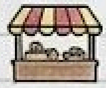
- Price, Demand & Supply in Price Determination



Meaning of market



☆ Market refers to a place, system, or environment where buyers and sellers interact to exchange goods, services, or information, typically involving money as a medium of exchange.

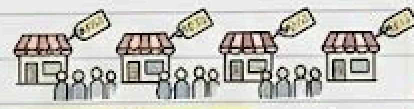


☆ Two Basic Components of a Market:

→ Buyers: Individuals or entities with the willingness & ability to purchase goods or services.

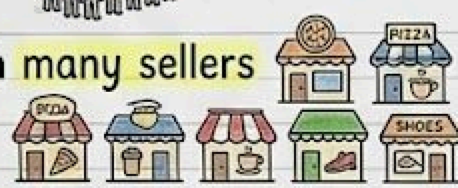
→ Sellers: Individuals or entities that provide goods, services, or resources for sale.

☆ The major forms of markets are:

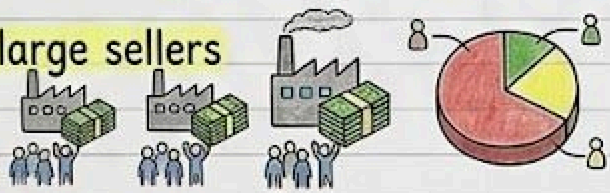


→ Perfect Competition: A market with many buyers and sellers where no single entity can influence the price.

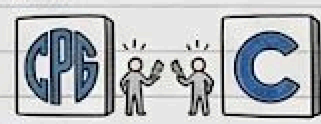
→ Monopoly: A market dominated by a single seller with no close substitutes for the product.



→ Monopolistic Competition: A market with many sellers offering differentiated products.



→ Oligopoly: A market with a few large sellers dominating the industry.



→ Duopoly: A special case of oligopoly with only two dominant sellers.

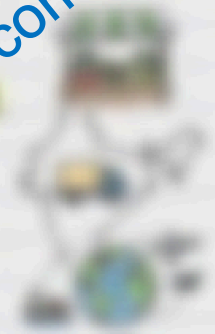
→ Monopsony: A market with only one buyer and multiple sellers.

→ Oligopsony: A market with a few buyers and many sellers.

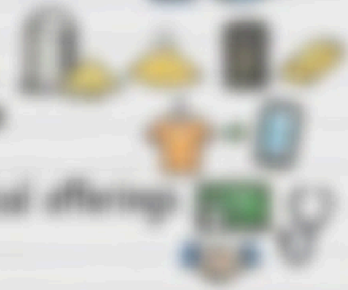
Classification of Market

Types of Market

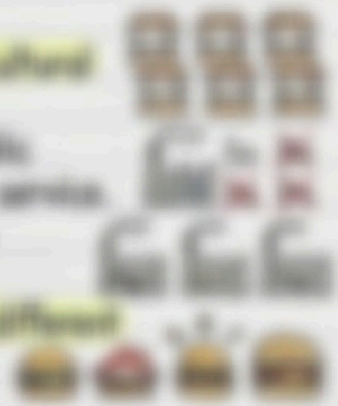
1. Based on Area:
   - Local Market: Specific area
     - Goods bought and sold in a specific region, like a vegetable market.
   - National Market: Nationwide
     - Goods and services offered nationwide, like FMCG products.
   - International Market: Between different countries
     - Involves trade (import/export) across borders, like car trade.



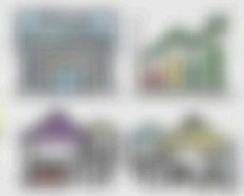
2. Based on Nature of Goods:
   - Commodity Market: Deals in raw materials like grains, gold, oil.
   - Consumer Market: focuses on items ready for personal use, like clothing or electronics.
   - Service Market: deals in Intangible services: it deals in non-physical offerings like banking, education, or healthcare.



3. Based on Competition:
   - Perfect Competition: many buyers and sellers selling identical agricultural goods of same price.
   - Monopoly: Single seller dominates, No close substitutes of public utilities like water or electricity where one company provides the service.
   - Oligopoly: a few major companies controlling an industry like auto manufacturing.
   - Monopolistic Competition: many sellers offering similar but slightly different goods like fast food chains.



4. Based on Regulation:
   - Organized Market: governed by specific legal rules, (e.g., stock exchange).
   - Unorganized Market: has no central rules, often informal like flea markets.



5. Based on Time:
   - Short-term Market: perishable items like fresh bread or urgent requirements.
   - Long-term Market: products built to last, like real estate, over long periods.

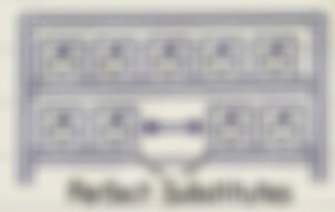
PERFECT COMPETITION AND ITS MAIN FEATURES

Market structure with MANY firms selling a HOMOGENEOUS product. Many buyers & sellers. Firms have NO control over price level, they are PRICE TAKERS. Price is determined by forces of DEMAND & SUPPLY.

*Ferguson: "Absence of direct competition."

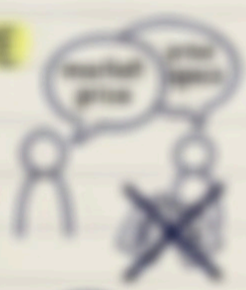
① **Large No. of Buyers & Sellers**: The market consists of MANY buyers & sellers, ensuring NO SINGLE entity can influence the price.

② **Homogeneous Products**: 'IDENTICAL or SIMILAR' products, perfect substitutes for one another. Product unit is identical in shape, colour, weight & size. zero degrees of differentiation.



③ **Free Entry and Exit**: Firms freely enter or leave market. 'freely enter or leave' without significant barriers. No legal or social restriction.

④ **Perfect Knowledge**: Both buyers & sellers have COMPLETE information about market conditions, prices, products. It implies no differences in prices for different buyers, ruling out 'price discrimination'. sellers cannot charge different prices from different buyers.



⑤ **Price Taker**: 'Individual accepts market-determined price'. No single participant can influence.

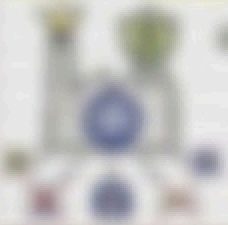
⑥ **No Government Intervention**: 'Minimal or no Government interference' in determining prices or supply.

⑦ **Perfect Mobility of Factors of Production**: Resources can move freely in and out without restrictions. Will move foindustry where they get a higher price. Uniform factor prices prevail.

Monopoly and its Features

I. Monopoly Definition & Core Concept

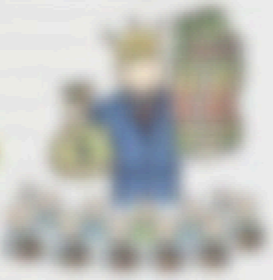
A **monopoly** is a **market structure** dominated by a **single seller** with **no close substitutes** for their product or service.



★ Key Concept: The seller is a **price maker** with full **control over supply**.

e.g., **Indian Railways**: Government of India is a sole provider of railway transportation in the country.

II. Features of Monopoly



1. Single Seller, Many Buyers

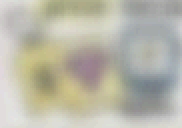
The **monopolist firm** is the **entire industry**. Full **control** over the market's **supply**.

2. No Close Substitutes

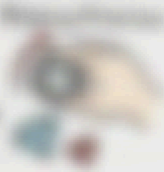
Consumers have **limited** or **no alternative** products. The good/service is unique.

3. Price Maker

The monopolist has the power to set the **price** because there is **no competition**.

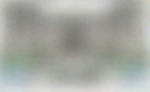


For example: In diamonds, De Beers group is price maker for ... description.

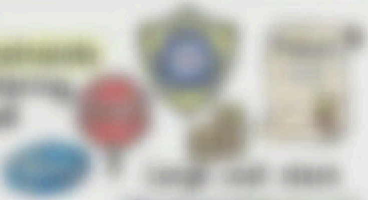


4. Barriers to Entry

Legal, cost, or resource **constraints** prevent **new firms** from entering.

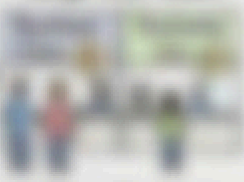


⊙ high barriers wall + ... / large cost ...



5. Price Discrimination

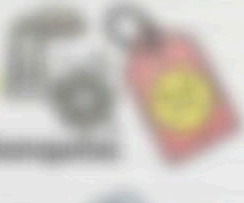
Charging different **prices** to different groups of **consumers** for the same good/service.



6. Inefficiency

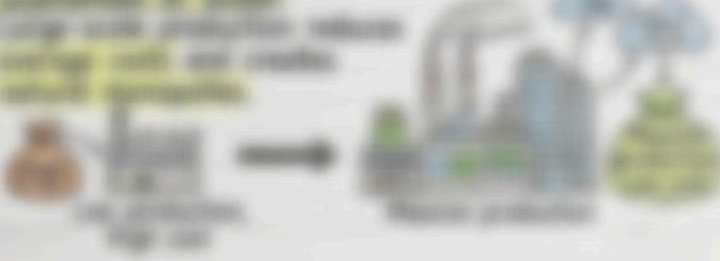
Lack of competition often leads to **production inefficiencies** and **higher prices** for consumers.

→ Not example: and public sector monopolies



7. Economies of Scale

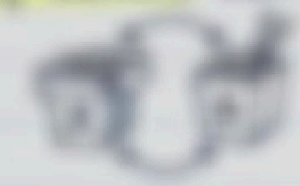
Large-scale production reduces **average costs** and creates **natural monopolies**.



Monopolistic Competition & Its Features

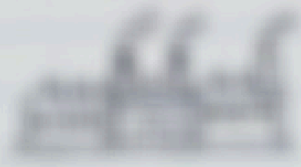
Intro: This is a market structure that is a mixture of Monopoly and Perfect Competition.

Definition: Market form where a **large number of sellers** sell **differentiated products**. Differentiation is often promoted via **trademark or brand name** (e.g., Maggi, Sunfeast noodles). Firms have **partial control over prices.**

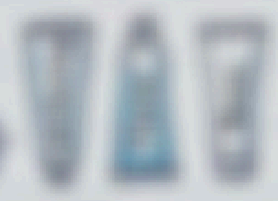


Features of Monopolistic Competition (Synthesized from points 1-8)

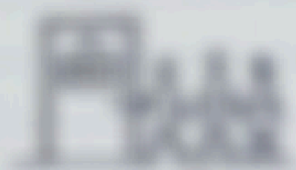
1) **Large No. of Sellers**: Many sellers, each with a small share. No single control.



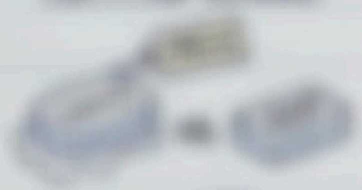
2) **Product Differentiation**: Similar but not identical. based on quality, packaging, branding.



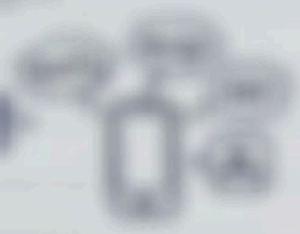
3) **Freedom of Entry & Exit: Low barriers** to entering or leaving the market.



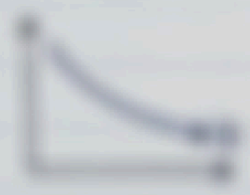
4) **Some Control over Price**: Limited control. Prices can be higher/lower based on customer perception of uniqueness.



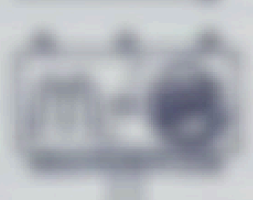
5) **Non-Price Competition**: Compete on advertising, quality, ecosystem, features – not just price.



6) **Elastic Demand Curve**: Downward-sloping & relatively elastic curve. Customers will switch for high prices.



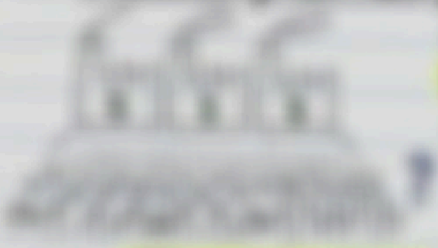
7) **Advertising & Branding**: Crucial for product differentiation and attracting customers.



8) **Profit (S.R vs L.R)**:
Short Run: supernormal profits (differentiation).
Long Run: profits normalize (competition).

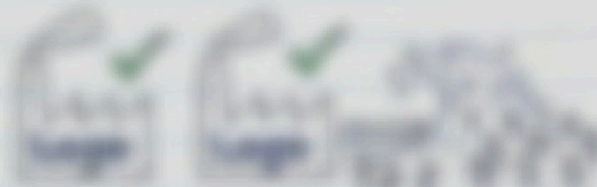
OLIGOPOLY & ITS FEATURES

- **Meaning of Oligopoly:**

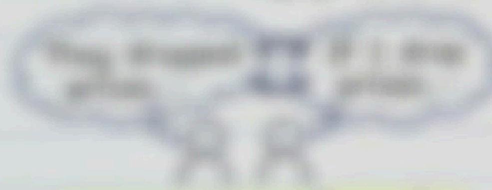


A market dominated by a **FEW BIG PRODUCING FIRMS** and a **LARGE NUMBER OF BUYERS**. There is a state of **LIMITED COMPETITION**.

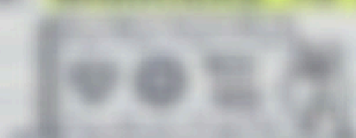
- 1. **FEW SELLERS, MANY BUYERS**: Small number of large firms dominate the market.



- 2. **INTERDEPENDENCE**: Firms consider actions of competitors when making pricing & production decisions.

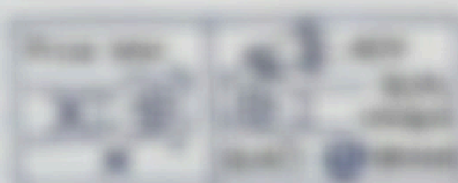


- 3. **BARRIERS TO ENTRY**: High barriers like **economies of scale**, and, **brand loyalty**, or **legal restrictions** prevent new entry.

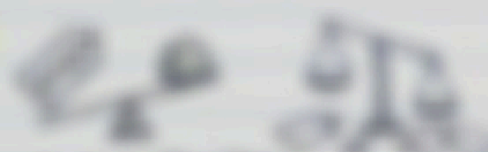


- 4. **PRODUCT DIFFERENTIATION**: Products can be **homogeneous** (e.g., STEEL) or **differentiated** (e.g., CARS).

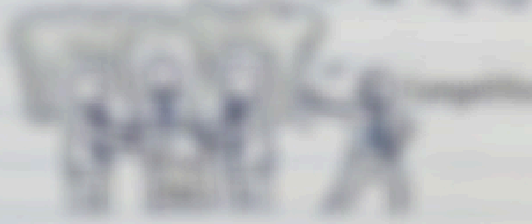
- 5. **NON-PRICE COMPETITION**: Compete via advertising, product quality, or branding (not price wars).



- 6. **PRICE RIGIDITY**: Prices tend to **remain stable** to avoid harmful **price wars**.

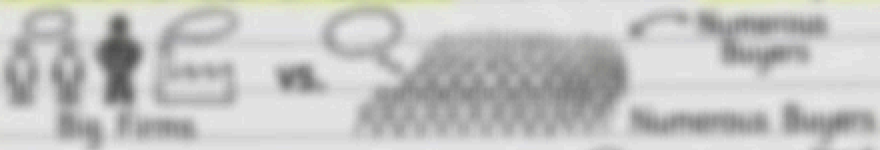


- 7. **COLLUSION**: Cartels or agreements to **control prices** and output, reducing competition.

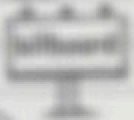


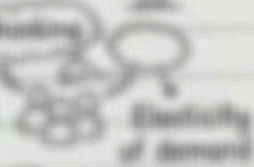
Oligopoly Characteristics

Market defined by **FEW LARGE PRODUCERS** and a **LARGE NUMBER OF BUYERS** with mutual **interdependence**.

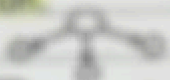


1. FEW SELLERS, MANY BUYERS
Small number of large firms **dominate** the market. Thush **partial control over price** through **brand loyalty**. Heavy ads create **brand loyalty**.

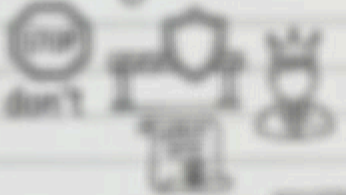




2. HIGH DEGREE OF INTERDEPENDENCE
* It is meature, **Interdependence**. Affected by other firms' decisions, **conflict**, **cooperation**.
→ high cross elasticity of demand.

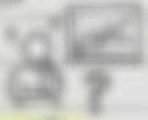


3. ENTRY BARRIERS FOR NEW FIRMS



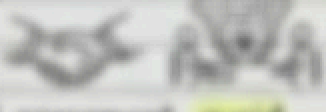
* It is the **Entry Barriers**, existing firms don't worry, new entry, patent rights.

4. DIFFICULT TO DETERMINE THE DEMAND CURVE



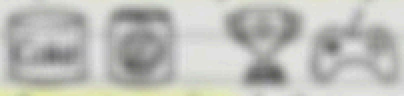
* It is not **difficult to determine**. This, trase lines, effects of price changes, **difficult to trace**, **no specific response fomo change** in this market.

5. FORMATION OF CARTELS (Collusion)



* With a view to avoiding **Collusion**, formal agreement, **avoid competition**. In the firms in smoke-filled room paper pact arrows to output levels. → Group **fixes output and price**.

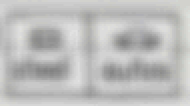
6. NON-PRICE COMPETITION



→ Coke and Pepsi sell **product of same price** but use **aggressive non-price competition** (sponsoring games, sports).

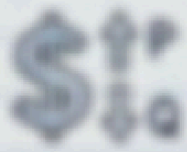
7. PRICE RIGIDITY (from synthesised list)
→ Prices tend to **remain stable** to avoid **harmful price wars**.

8. PRODUCT DIFFERENTIATION (from synthesised list)
→ **homogeneous** (steel) or **differentiated** (autos).



LAW OF SUPPLY

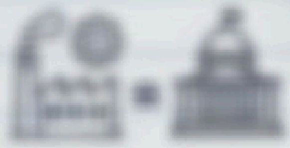
The **Law of Supply** is a fundamental principle in economics that states: "Other things being equal, the **quantity of a good supplied increases** as its **price increases**, and **decreases** as its **price decreases**."



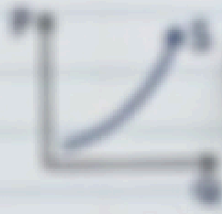
KEY POINTS:

① **Direct Relationship:** There is a direct relationship between price and the quantity supplied. **Producers** are **willing to supply more** at **higher prices** because higher prices usually lead to **greater profits**.

② **Ceteris Paribus:** The law holds true only when **other factors influencing supply**, such as **production technology**, or **government policies**, **remain constant**.

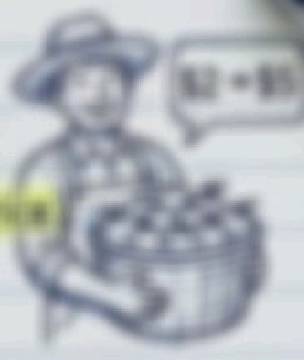


③ **Supply Curve:** The law is graphically represented by the supply curve, which is **upward-sloping**, indicating the **positive relationship** between price and quantity supplied.



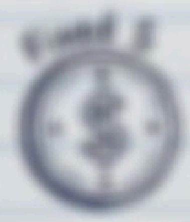
EXAMPLE:

If the price of apples **increases** from $2 to $5 per kilogram, farmers are likely to produce and supply **more apples** to the market to capitalize on the **higher price**. Conversely, if the price drops to $1, farmers may **reduce the quantity of apples** supplied because it may **not be profitable**.

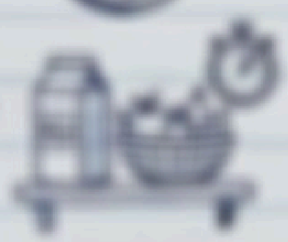


EXCEPTIONS:

① **Fixed Supply:** Goods like **land** or **rare collectibles** **cannot increase in supply** even if prices rise.



② **Perishable Goods:** Suppliers may not increase supply significantly due to the **limited shelf life** of the goods.



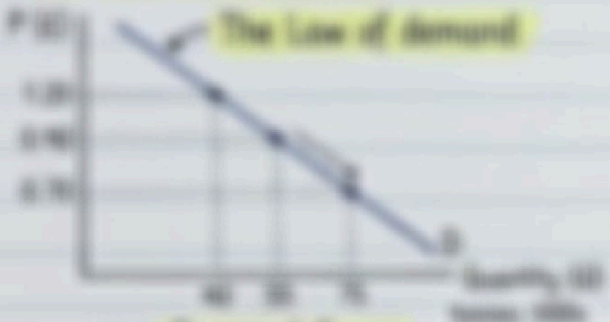
Price, Demand & Supply in Price Determination

(1) **Price**: Definition from money a consumer must pay for a good or service. It interacts with demand and supply to reflect value. Role in **allocating resources** and influencing purchasing decisions.

(2) **Demand**: refers to the quantity of a good that consumers are **willing and able** to purchase at various prices over a **specific period of time**, other things being constant.

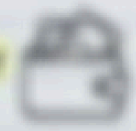
- Ferguson: "Demand refers to quantities able and willing to buy at each possible price during a given period of time, other things being equal."

- **The Law of Demand**:
  Other factors constant (**ceteris paribus**), **quantity demanded increases** as **price decreases**, and **decreases** as **price increases**. Benham: P↓ Q↑, P↑ Q↓
  The relationship is inv⟶ Prof. Marshall between quantity demanded and price.
  Add, apple example: e.g., Apple price falls, buy more; price rises, buy fewer.
- **The Demand Curve**:

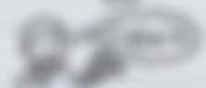


Demand Curve

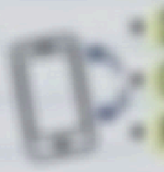
- Reasons for the Law of Demand:
  - **Income Effect: Purchasing power increases** when price falls.



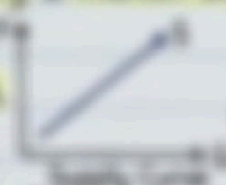
  - **Substitution Effect**: Switch to **cheaper alternatives** when price rises.
    ↳ consumats wanting Pizza.

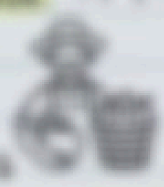


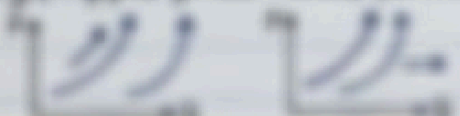
  - **Diminishing Marginal Utility**: Additional satisfaction **utility decreases** for extra units.
  - **Consumer Behavior & complementary goods: Used together** with other goods.
  - **Psychological factors/market competition**: condenses **better deal, unaffordability & market size**.



(3) **Supply**: The Law of Supply states that as the price of of a good increases, the **quantity supplied, ceteris paribus**.
e.g., Apple price rises, farmers produce more.

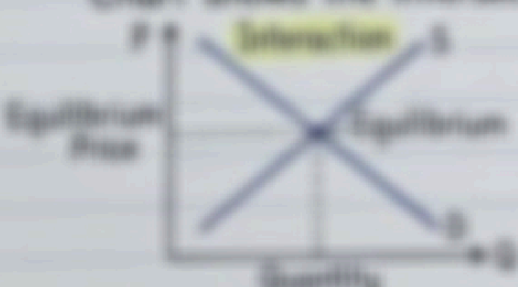




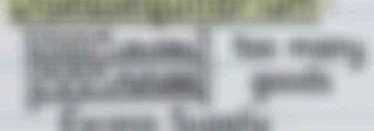


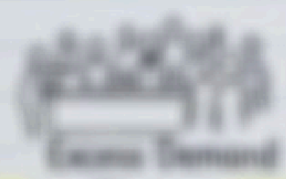
- Movement vs. **shift**: supply for advance shifting **right** (e.g., tech advances) (e.g., tech advances)

(4) **Market Price Interaction**: Their interaction determines the **market price** of a good. Chart shows the intersection point, **equilibrium price**.



- **Disequilibrium**





Excess Supply: price **above** equilibrium, **unsold goods**.
Excess Demand: price below, **shortages**.

- **Conclusion**: Ensure market **functions efficiently** by determining price and quantity, **adapting** to changes through factor shifts.

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