RATU NAVULA COLLEGE
YEAR 12 ECONOMICS 2021

WEEKLY HOME STUDY LESSON NOTES

(# 29 – 34)

Strand 2: Microeconomics **Lesson 29**

Sub Strand: (2.4) Market Structures

L/Outcome: - Discuss about market structures features of market

- Explain the essentials features of market

Market Structures

Market Structures

- ✓ Market structure refers to the nature and degree of competition in the market for goods and services.
- ✓ The structures of market both for goods market and service market are determined by the nature of competition in a particular market.
- ✓ Market refers to a particular place where goods are purchased and sold, buyers and sellers are in direct competition with one another

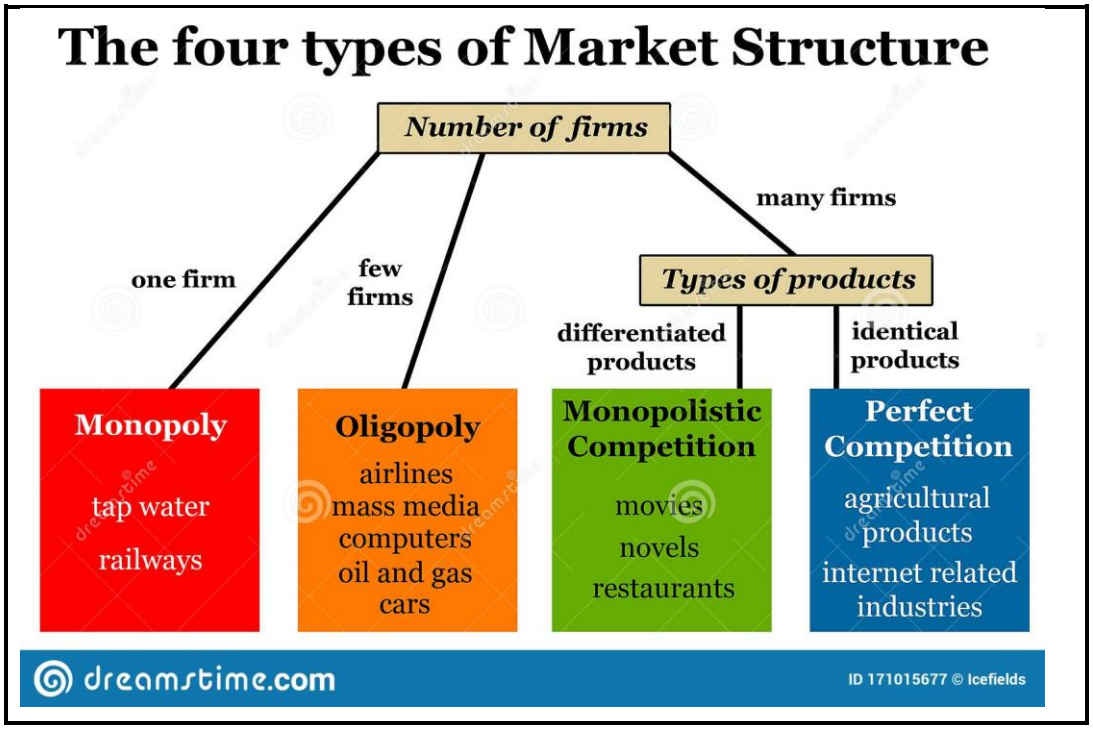
A Market can be classified in the following ways

A. Perfect competition

- ✓ A market structure in which no firm or individual is able to influence transaction in the market

B. Imperfect Competition

1. **Monopolistic Competition**: is a market situation typified by a number of firms selling products which are close substitute and which are in some way differentiated from the products of competitors
2. **Oligopoly**: is a market structure in which a small number of firms produce close to the entire output of a particular good or service.
3. **Duopoly**: is a market structure in which there are only two producers of a good or service.
4. **Monopoly**: is a market structure in which a single firm produces the entire output of a particular good or service.
5. **Monopsony**: is a market structure in which there is a single buyer of a commodity or service.



Strand: (2) Microeconomics **Lesson 30**
Sub Strand: (2.4) Market Structures
L/Outcome: - Discuss about Perfect Competition
- Explain the characteristics of Perfect Competition

PERFECT COMPETITION

Definition

- Perfect competition is a market structure where many firms offer a homogeneous product. Because there is freedom of entry and exit and perfect information, firms will make normal profits and prices will be kept low by competitive pressures.
- Examples market sellers, vegetable sellers, street food sellers etc.

Features of perfect competition

1. **Many firms**, large number of buyers and sellers
2. **Freedom of entry and exit**; this will require low sunk costs. (These are costs that have been incurred and cannot be recouped if you left the industry)
3. All firms produce an **identical or homogeneous product**. (similar product)
4. All firms are **price takers**; therefore, the firm's demand curve is perfectly elastic.
5. There is **perfect information and knowledge**. (Buyers and sellers have complete knowledge about the prices at which goods are being bought and sold)

Examples of Perfect Competition

1. **Foreign exchange markets**. Here currency is all homogeneous. Also, traders will have access to many different buyers and sellers. There will be good information about relative prices. When buying currency it is easy to compare prices
2. **Agricultural markets**. In some cases, there are several farmers selling identical products to the market, and many buyers. At the market, it is easy to compare prices. Therefore, agricultural markets often get close to perfect competition.
3. **Internet related industries**. The internet has made many markets closer to perfect competition because the internet has made it very easy to compare prices, quickly and efficiently (perfect information). Also, the internet has made barriers to entry lower. For example, selling a popular good on the internet through a service like e-bay is close to perfect competition. It is easy

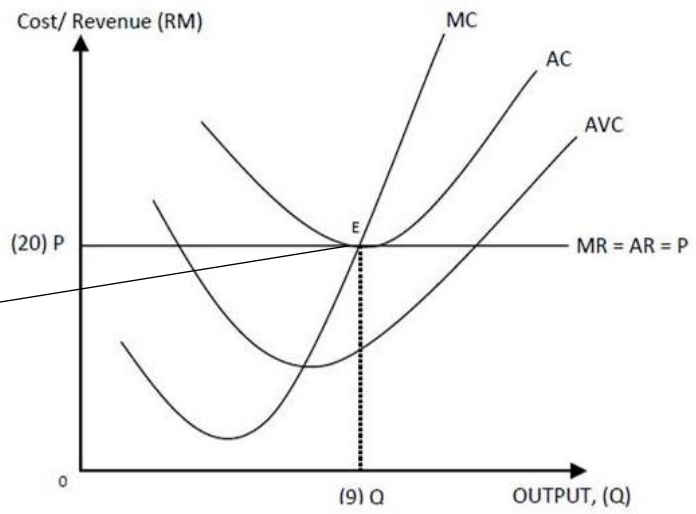
Strand: (2) Microeconomics **Lesson 31**
Sub Strand: (2.4) Market Structures
L/Outcome: - Explain the Profit situations in Short Run and Long Run

Profit situations under Perfect Competition

1. Normal Profit

- Demand curve is at AR (average revenue) which is horizontal and perfectly elastic. (because firms have a elastic demand curve at
  P = MR = D = AR
- The long run situation for a perfect completion is always Normal Profit
- Normal profit occurs at the *Breakeven point* i.e.
  where MC = MR = AC
- Profit is TR = TC

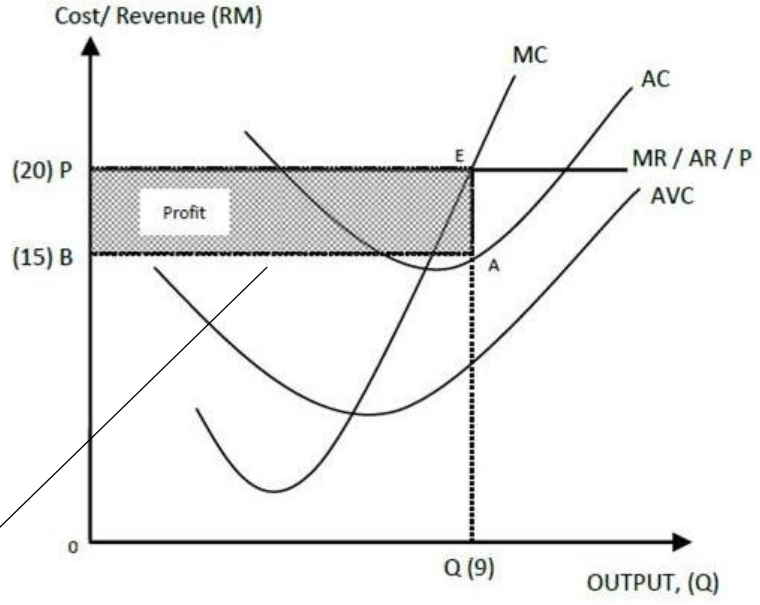
Normal Profit

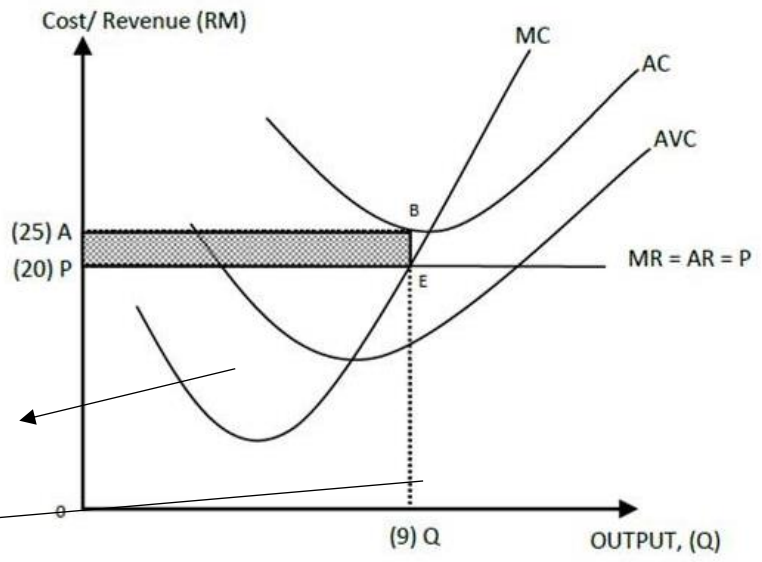


2. Supernormal Profit

- Supernormal profit can only be earned in the short term
- Supernormal profit is also known as economic or abnormal profit
- Defined as the profit-maximising level of output where Total Revenue (TR) is greater than Total Cost (TC) and the Price is greater than the Average Total Cost. (AC)
- Price is constant. i.e.
  - ✓ (P = AR = MR = D)
  - ✓ Pe is where MR = MC
- Pe > Pc which means TR > TC which is *supernormal profit*
- Profit is TR > TC

Supernormal Profit



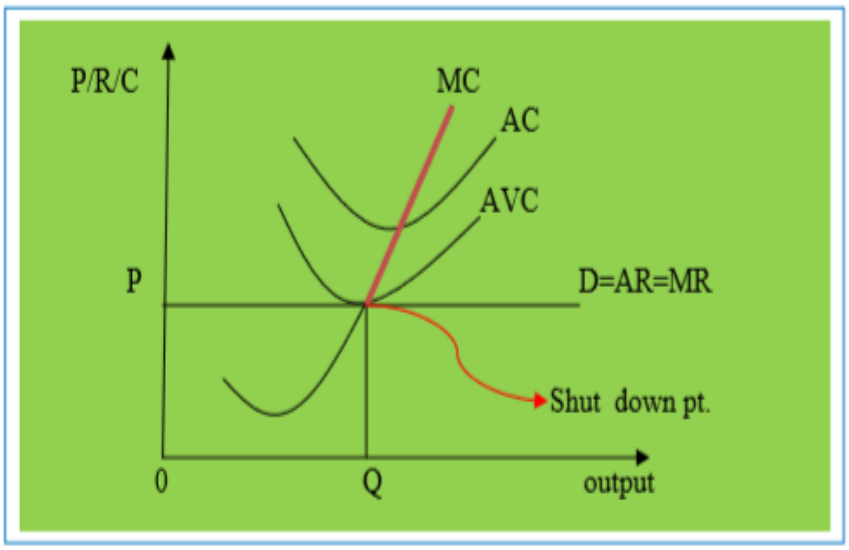
3. **Subnormal Profit**	**Subnormal Profit**
• The firm is making a profit, but not enough to cover all economic costs, including opportunity costs so it's making a sub normal profit. • Firm is making an economic loss • Pe is where MR = MC, which is below the AC curve • When Pc > Pe it's a *subnormal profit* • Profit is TR < TC • *Shut down point*	

Note

- ✓ Profit maximising point is where MR = MC or MC = MR
- ✓ Pe and Qe is where MR = MC
- ✓ Pc is where MR = MC = AC
- ✓ TR = Pe × Qe
- ✓ TC = Pc × Qe
- ✓ Profit = TR – TC

Supply Curve of a Perfect Competition

- Firm's Supply Curve is MC above the shutdown point.



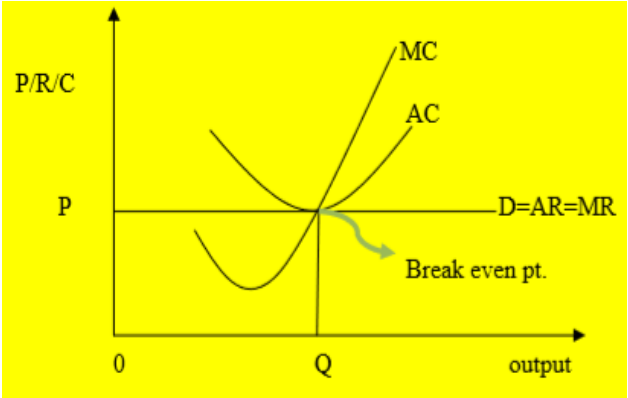
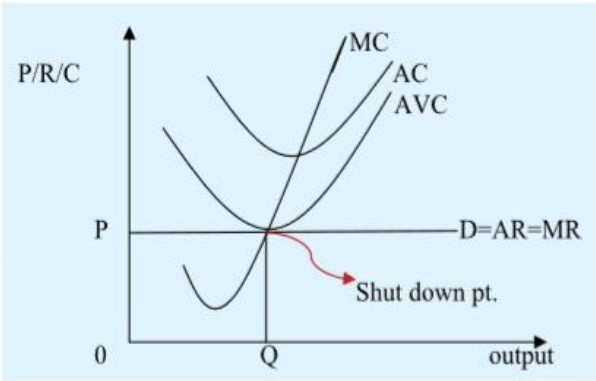
Strand: (2) Microeconomics **Lesson 32**

Sub Strand: (2.4) Market Structures

L/Outcome: - Discuss about Breakeven point and shutdown point

- Explain the Advantages and disadvantages of Perfect Competition

Breakeven point and Shutdown Point

Breakeven Point	Shutdown Point
 • This is the point where price is equal to average cost, P = AC • At this price the firm is covering all of its economic costs • Breakeven point is earning normal profit.	 • Shutdown Point – is a point at which only variable costs are covered. • Where P = AVC

Efficiency of perfect competition

- Firms will be allocatively efficient at P=MC
- Firms will be productively efficient at lowest point on AC curve.
  - Firms have to remain efficient otherwise they will go out of business.

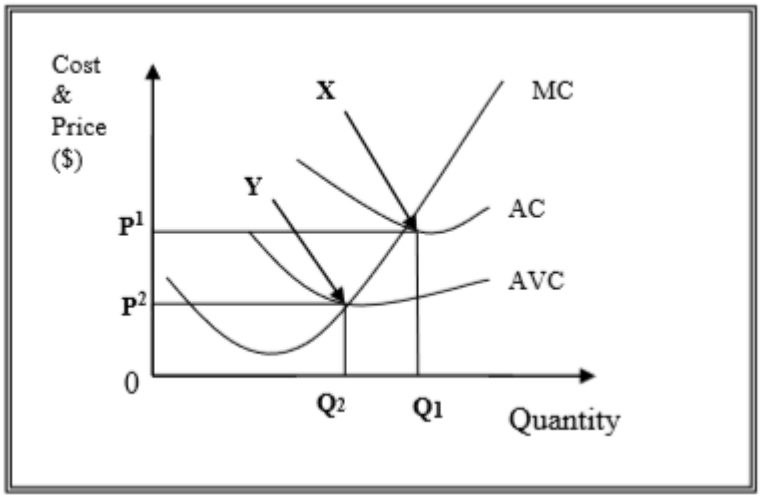
Advantages of Perfect Competition	The disadvantages of Perfect Competition
1. They allocate resources in the most efficient way- both productively (P=MC) and allocative efficient (P> MC) in the long run. 2. There is no information failure as all knowledge is spread out evenly 3. Only normal profits made just cover their opportunity cost 4. Maximum consumer surplus and economic welfare	1. No Scope for economies of scale because of the high number of firms in there 2. Undifferentiated products- all homogeneous. Important in industries like clothes and cars 3. Lack of supernormal profits may mean the investment of Research and Development (R&D) is unlikely. Important for industries like pharmaceuticals. 4. With perfect knowledge there is no incentive to develop new technology because of the ability to share information. FREE RIDERS of information.

Strand: (2) Microeconomics **Lesson 33**
Sub Strand: (2.4) Market Structures
L/Outcome: - Discuss about Perfect Competition

Worksheet

1. Ref: 2019

(a) Study the graph below on perfect competition and answer questions (i) to (iv).



(i) Define **perfect competition**. **(1 mark)**

(ii) Name the points marked **X** and **Y** from the graph. **(2 marks)**

(iii) Calculate the following at $\mathbf{P^1}$

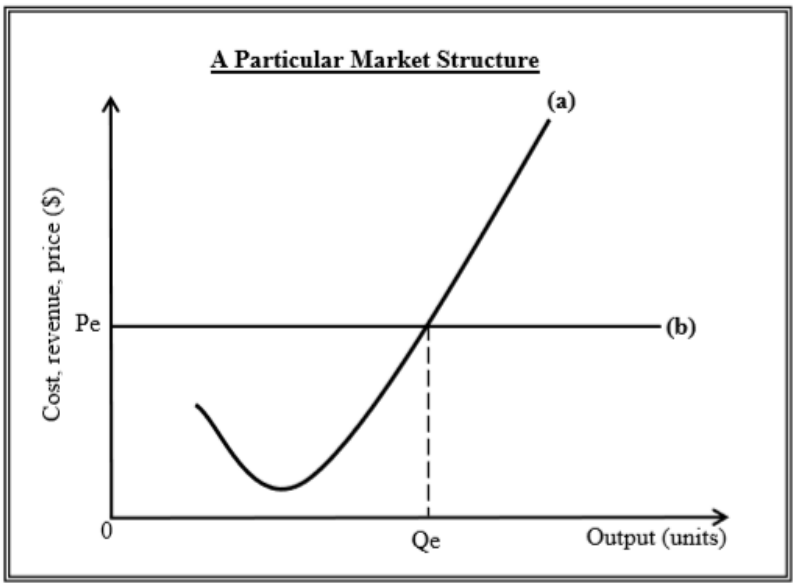
(I) **Total revenue.**

(II) **Total costs.** **(2 marks)**

(iv) Derive the respective **supply curve** of the firm from the graph above.
Illustrate this in the diagram provided in your **answer book**. Label it **S**. **(2 marks)**

2. Ref: 2015

(a) Study the graph below on perfect competition and answer questions



(i) Identify the market structure given above. **(1 mark)**

(ii) Label the curves **(a)** and **(b)**. **(2 marks)**

(iii) Draw the average cost curve to illustrate a **supernormal profit.** **(1 mark)**
(Label the average cost curve as AC.)

3. Ref: Textbook pg 58-59

2. A perfectly competitive firm will shut down in the short run if :

A. At the loss minimizing level of output
B. Fixed cost exceeds total revenue
C. Total variable cost exceeds total revenue
D. Total cost exceeds total revenue

3. Short run supernormal profits in a perfectly competitive market will result in

A. Firms are price takers therefore face by horizontal demand curve
B. Long run subnormal profits as too many new firms enter the market
C. No changes in the long run because of strong barriers to entry
D. Normal profits are earned in long run due to freedom of entry

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Worksheet

4. Ref: Textbook pg 59

4. The marginal cost above the shut down point for a firm is its

A. Demand curve
B. Production curve
C. Supply curve
D. Close down point

5. The reason for long run normal profits under perfect competitive market is

A. Horizontal demand curve
B. Price takers
C. Freedom of entry and exit
D. Homogenous product

Study the information given in the table below and answer the questions that follow;

OUTPUT (Q)	TC ($)
0	300
1	450
2	570
3	670
4	780

Price per unit of output =$100

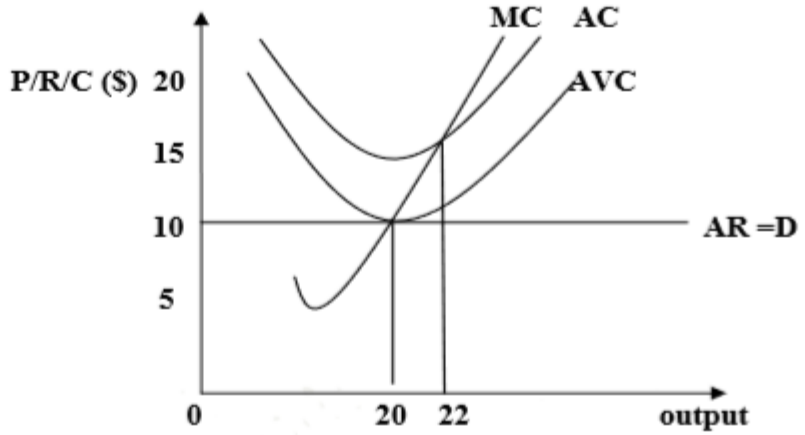
i. Calculate the total fixed cost for the firm. (1mark)

ii. Calculate the total revenue from producing 4th unit of output? (1mark)

iii. Determine the firms profit maximization price and output level. (1mark)

iv. Identify the market structure that is depicted by the information above. (½ mark)

Use the graph given below and answer the questions that follow.



i. Draw the graph and label the profit maximization price and output. (1mark)

ii. Identify the type of profit earned by this firm. (1mark)

iii. Calculate the amount of profit or loss earned by this market shown above. (1mark)

iv. Explain the long run situation of the market. (2marks)

Assume that the growing of the sugar cane is a perfectly competitive industry and the price of sugarcane is determined on the world market. Fiji has many small sugarcane producers.

i. Perfectly competitive firms are faced by horizontal demand curve. Give a reason for horizontal demand curve. (1mark)

ii. A firm in perfectly competitive market is earning supernormal profits in short run. What type of profit will this firm earn in long run? Explain (2marks)