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CLASS XII ECONOMICS NOTES

FORMS OF MARKET & PRICE DETERMINATION

Key Notes and Important Questions with Answers

UNIT IV

FORMS OF MARKET & PRICE DETERMINATION

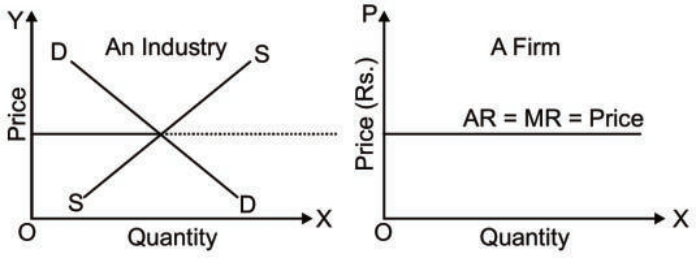
Points to Remember

- Market is a system through which the buyers and sellers of a commodity or service comes in contact of each other for sale and purchase of the commodity or service on specific price.
- **Forms of Market**

1. Perfect Competition
2. Monopoly
3. Monopolistic competition
4. Oligopoly

PERFECT COMPETITION

- Perfect competition is that type of market in which there are very large no. of buyers and sellers selling homogenous product at same price and possessing perfect to knowledge at a time.
- Under perfect competition, per unit price remains constant therefore, average and marginal revenue curves coincide each other and becomes parallel to X-axis.



- Under perfect competition price is determined by the market forces of demand and supply in an industry. No individual firm or buyer can influence the price of the product. So industry is price maker and firm is price taker.

- **Features of Perfect Competition :**

(a) Very large no. of buyers and sellers.

(b) Homogeneous product.

(c) Free entry and exit of firms in the market.

(d) Perfect knowledge.

(e) Firm is a Price Taker

(f) Perfectly elastic demand curve

MONOPOLY MARKET

- Monopoly is that type of market where there is a single seller, selling a unique product which does not have close substitutes.

- **Features of Monopoly**

(a) Single Seller

(b) Bannedor prohibted entry and exit of new firms.

(c) Unique product which have no close substitute

(d) Firm is a Price Maker

(e) Price discrimination may be exist

(f) Inelastic demand curve

- AR (Demand) curve is left to right downward sloping curve and less elastic than that of monopolistic competition.

MONOPOLISTIC COMPETITION

Monopolistic competition is that type of market under which there are large number of buyers and sellers, Selling differentiated product to the consumer who have imperfect knowledge about the product.

Features :

(a) Large number of buyer & large group model of sellers or firms

(b) **Product Differentiation :** In this feature every firms make its product different on the basis of colour, taste, packing, size and shape.

(c) **Selling Cost :** Cost on advertisement and sales promotion.

(d) Controled Freedom of entry and exit of new firm into the large group.

(e) Lack of perfect knowledge.

(f) Elastic demand curve

OLIGOPOLY

- Oligopoly is the form of market in which there are few large firms, mutually dependent for taking price and output decisions.

Features of Oligopoly

(a) Few firms or sellers

(b) All the firms under oligopoly produce homogeneous or differentiated product.

(c) Under oligopoly demand curve is undefined/indeterminate.

(d) Barriers under certain limitations & conditions to the entry and exit of firm into industry.

(e) All the firms are interdependent in respect of price and output determination under oligopoly market.

(f) Non-price competition may be exist.

- Oligopoly can be categorised in two categories following ways.

  (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.

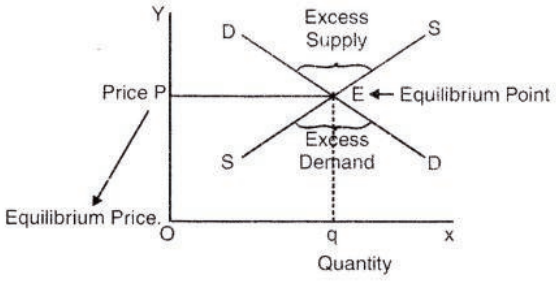
(iii) **Perfect Oligopoly :** If firms produce homogeneous product then it is called perfect oligopoly.

(iv) **Imperfect Oligopoly :** If firms produce heterogeneous product it is called imperfect Oligopoly.

FORMS OF MARKET STRUCTURE

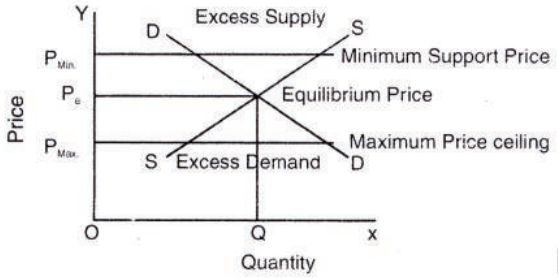
Basis	Perfect Competition	Monopoly	Monopolistic Competition	Oligopoly
1. Number of sellers	Very Large	Only one	Large	Few
2. Nature of product	Homogeneous	Unique and having no. close substitute	Differentiated Product with close substitutes	Homogeneous & differentiated product
3. Entry/Exit of firms	Free entry exit of firm	Banned Entry	Controlled entry & exit	Controlled
4. Firm's Demand Curve	Parallel to X-axis	Down ward sloping In elastic	Elastic	Undefined
5. Perfect Knowledge	Perfect knowledge of market	No-requirement of knowledge	Lack of knowledge	Lack of knowledge
6. Selling cost	No-requirment	Not required	Very significant	Less significant

- **Equilibrium Price :** Refers to the price at which market demand and market supply of a commodity are equal.
- **Market Equilibrium :** Market equilibrium is a state in which market demand is equal to market supply. There is no excess demand or excess supply in the market.



Application of Demand and Supply

(a) **Maximum Price Ceiling :** It mean the maximum price the producers of goods or service are allowed to charge. Government imposes such a ceiling below the equilibrium price when it finds that the demand for necessary goods exceeds its supply. That is, when consumers are facing shortages and equilibrium price is too high. Government does it in the interest of consumers.



(b) **Minimum Price Ceiling :** Government imposes lower limit on the price, which is higher than the equilibrium price to safe guard the interest of producers. The price is also called minimum support price.

Exam. Oriented Questions with Answer

VERY SHORT ANSWER QUESTION (1 MARK)

Q. 1. Define equilibrium price.

Ans. Equilibrium price refers to that price which equates market demand for a commodity with its market supply.

Q. 2. Define perfect competition.

Ans. Perfect competition refers to a market situation in which (i) there are very large number of buyers and sellers (ii) products are homogeneous and (iii) there is free entry and exit.

Q. 3. What is Cartel?

Ans. A Cartel is a group of firms which jointly set output and price of its product in such a way so as to keep benefit of monopoly.

Q. 4. Define Price Ceiling.

Ans. Price Ceiling refers to the maximum price of a commodity lower than equilibrium price at which the seller can legally sell their product.

Q. 5. What is meant by excess demand for a product.

Ans. Excess demand refers to the situation in which market demand is more than market supply of a commodity at a given price.

SHORT ANSWER TYPE QUESTIONS (3-4 MARKS)

Q. 1. Explain the implication of large number of buyers in a perfect competitive market.

Ans. The implication is that no single buyer is in a position to influence market price on its own because an individual buyer's purchase for negligible proportion of the total purchase of the good in the market.

Q. 2. Explain why are firms mutually interdependent in an oligopoly market.

Ans. Firms are mutually interdependent because an individual firms take decision about price and output after considering the possible reactions by the rival firms.

Q. 3. Explain the implication of 'freedom of entry and exit of the firms' under perfect competition.

Ans. The firms enter the industry when they find that the existing firm earning super normal profits. Their entry raises output of the industry brings down the market price and thus reduce profits. The entry continue till profits are reduced to normal (or zero).On the other hand the firms start leaving industry when they are facing losses. This reduces output of the industry raises market price and reduces losses. The exit continues till the losses are wiped out. Hence in the long run, firms earn only normal profit.

Q. 4. Explain the implication of 'perfect knowledge about market' under perfect competition.

Ans. Perfect knowledge means that both buyers and sellers are fully informed about the market price. Therefore no firm is in a position

to charge different price and no buyer will pay a higher price. As a result uniform price prevails in the market.

Q. 5. Why is the demand curve more elastic under monopolistic competition than under monopoly.

Ans. The elasticity of demand is high when the product has close substitutes and elasticity of demand tends to be low when the products have no close substitutes. As we know in monopolistic competition large number of close substitutes are present and in monopoly there is no close substitutes. Hence the demand curve under monopolistic competition is more elastic than that under monopoly.

Q. 6. Why is a firm under perfect competition a price taker while under monopoly a price maker Explain in brief.

Ans. A firm under perfect competition a price taker by the following reasons :

1. **Number of Firms :** The number of firms under perfect competition is so large that no individual firm by changing sale, can cause any meaningful change in the total market supply. Hence, market price remains unaffected.
2. **Homogeneous Product :** All firms in a perfectly competitive industry product homogeneous product. Hence, price remains same.
3. **Perfect Knowledge :** All the buyers and sellers have perfect knowledge about market price so no firm charge a different price than market price. Hence a uniform price prevails in the market.

A firm under monopoly a price maker by the following reasons :

1. A monopolist is a single seller of the product in the market. Hence it has full control over supply.
2. There are no close substitutes of the monopoly product hence the demand is less elastic or 'inelastic.'
3. There are legal, technical and natural barriers to the entry of new firms so that there is no fear of increase in market supply.

Q. 7. Differentiate between price discrimination and product differentiation.

Ans. **Price Discrimination :** Price discrimination is a situation when a monopolist charges different price from different buyers of the same product. This is generally done to maximise profits.

Product Differentiation : Product differentiation is a situation when different producers under monopolistic competition, try to differentiate their product in terms of its shape, size, packaging, trade mark or brand name. This is done to attract buyers from the rival firms in the market.

Q. 8. Distinguish between perfect competition and monopoly.

Ans.

	Perfect Competition		***Monopoly***
1.	Large number of buyers and sellers.	1.	One seller & large no. of buyers.
2.	Products are homogeneous.	2.	There is no close substitutes of goods.
3.	Free Entry and exit.	3.	Barriers to entry
4.	There is no control over price.	4.	There is full control over market price.

Q. 9. Differentiate between Monopoly and Monopolistic Competition.

Ans.

	Monopoly		*Monopolistic competition*
1.	Single seller and large number of buyers	1.	Large number of buyers and sellers.
2.	No close substitutes	2.	There is product differentiation.
3.	Product Barriers to entry.	3.	Free entry and exit.
4.	Selling cost is zero.	4.	Heavy selling costs are incurred.

Q. 10. What is oligopoly? State its main properties/features.

Ans. **Oligopoly :** It is a form of the market in which there are a few big sellers of a commodity and a large number of buyers. There is a high degree of interdependence among the sellers regarding their price and output policy.

Following are some principal features of oligopoly :

1. A few firms
2. High degree of interdependence
3. Non-price competition
4. Entry barriers
5. Formation of cartels
6. High selling cost

LONG ANSWER TYPE QUESTIONS (6 MARKS)

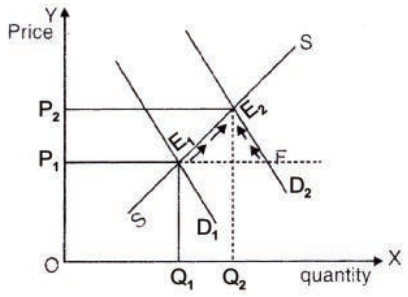
Q. 1. Distinguish between collusive and non-collusive oligopoly. Explain how the oligopoly firms are interdependent in taking price and output decisions.

Ans. Collusive oligopoly is one in which the firms cooperate with each other in deciding price and output where as, noncollusive oligopoly is one in which the firms compete with each other.

The firms are interdependent because each firm takes into consideration the likely reactions of its rival firms when deciding its output and price policy.

It makes a firm dependent on other firms. The firm may have to reconsider the change in the light of the likely reactions.

Q. 2. Market for a good is in equilibrium. There is an 'increase' in demand for this good. Explain the chain of effects of this change. Use diagram.



Ans. Increase in demand shifts the demand curve from D_1 to D_2 to the right leading to excess demand E_1 F at the given price OP_1.

Since the consumers will not be able to buy all they want to buy at this price, there will be competition among buyers leading rise in price.

As price rises, demand starts falling (along D_2) and supply, starts rising (along S) as shows by arrows in the diagram.

The quantity rises to OQ_2 and price to OP_2.

Q. 3. Market for a good is in equilibrium. There is simultaneous 'decrease' both in demand and supply of the good. Explain its effect on market price.

Ans. There are three possibilities :

1. If the relative (percentage) decrease in demand is greater than the decrease in supply, price will fall. The price will fall because of excess supply in the market.
2. If the relative (percentage) decrease in demand is less than the decrease in supply price will rise. The price will rise because of excess demand in the market.
3. If the relative (percentage) decrease in demand is equal to the decrease in supply price will remain unchanged.

   The price will remain unchanged because there is neither excess demand nor excess supply in the market.

Q. 4. Explain why the equilibrium price of commodity is determined at that level of output at which its demand equals its supply.

Ans. Suppose demand is greater than supply. Since the buyers will not be able to buy all what they want, there will be competition among the buyers. It will have on upward influence on the price. As a result demand will start falling and supply rising. It will go on till demand is equal to supply again. It demand is less than supply. Since the sellers will not able to sell all what they want, there will be comeptition among the sellers. It will have a downward influence on the price. As a result demand will start rising and supply falling. It will go on till demand is equal to supply again.

Hence, the equilibrium price of a commodity is determined at that level of output at which its demand equals its supply.