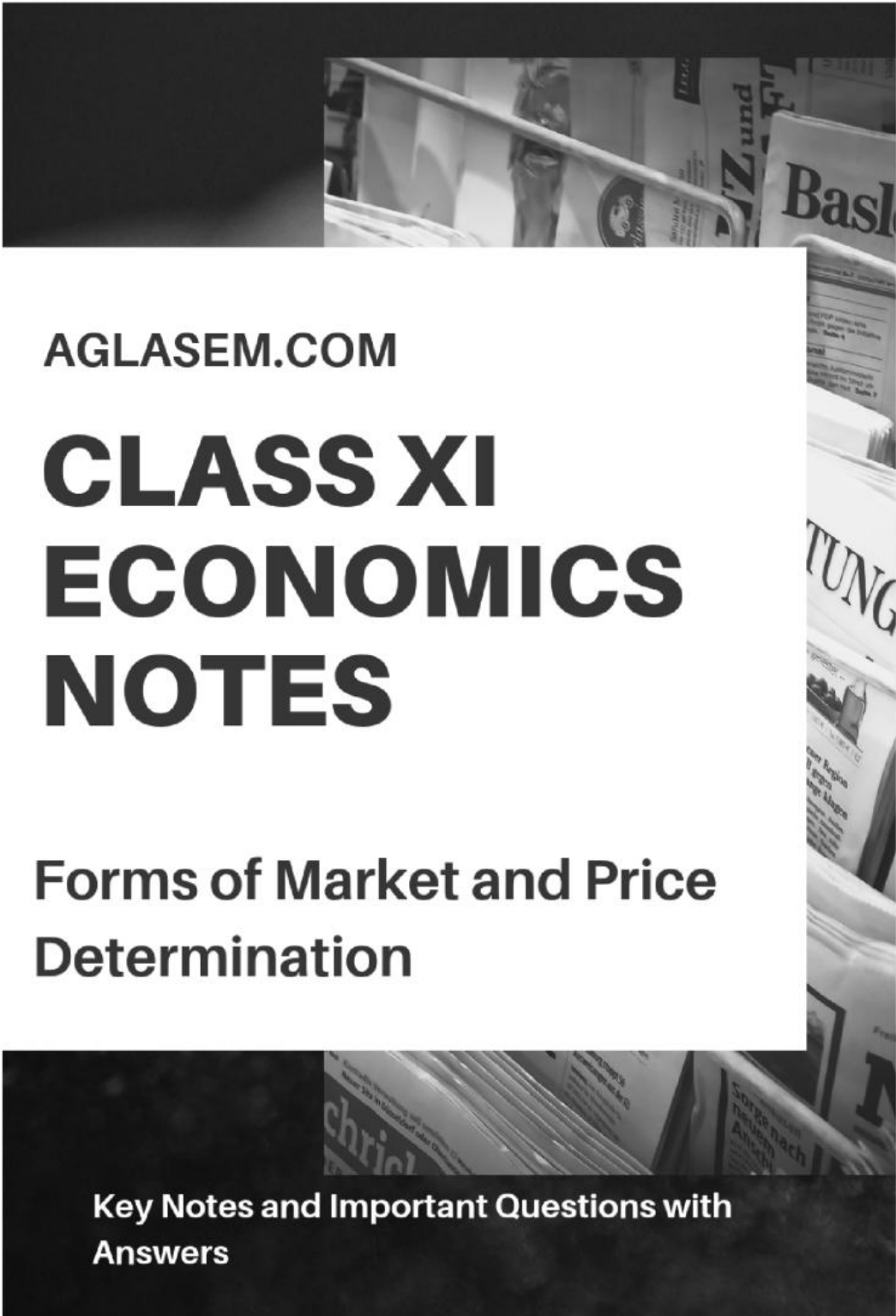




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CLASS XI ECONOMICS NOTES

Forms of Market and Price Determination

**Key Notes and Important Questions with
Answers**

FORMS OF MARKET & PRICE DETERMINATION

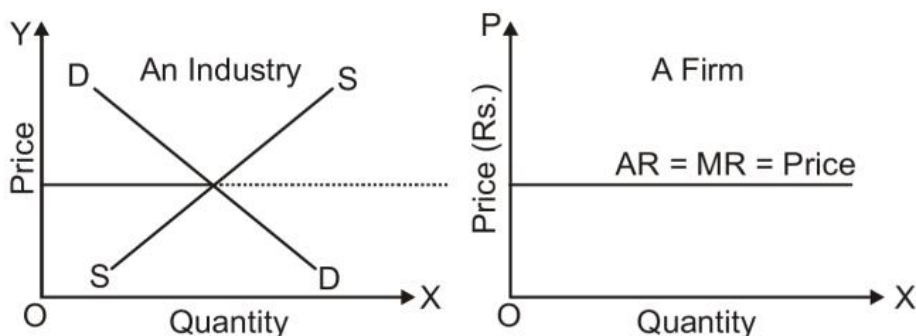
- ❑ Market is a system through which the buyers and sellers of a commodity or service comes in contact of one another for sale and purchase of the commodity or service on specific price.
- ❑ Markets are differentiated on the basis of :
 - (i) Number of buyers & Sellers
 - (ii) Nature of the product
 - (iii) Freedom to entry & exit of firm
 - (iv) Price determination

Types 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.
- ❑ 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 and their implication :

S.No.	Feature	Implication
1.	Very large number of buyers and sellers.	No firm can effect/ change the price, all firm are price taker because insignificant share of firm in market supply
2.	Homogeneous product	Uniform price prevails in the market
3.	Free entry and exit of firms in the market.	All firm earn normal profit in long run.
4.	Perfect knowledge	Uniform price prevails in market.

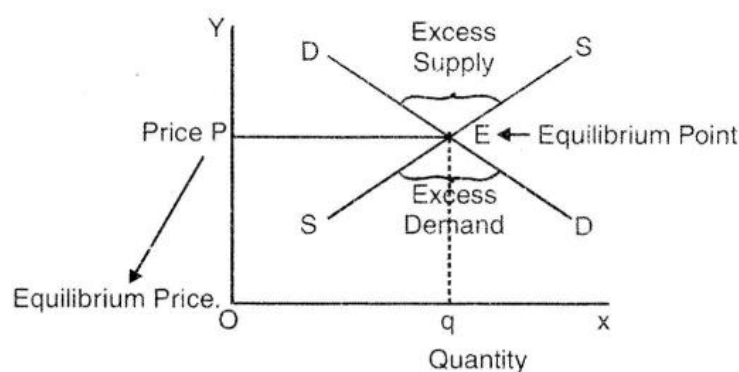
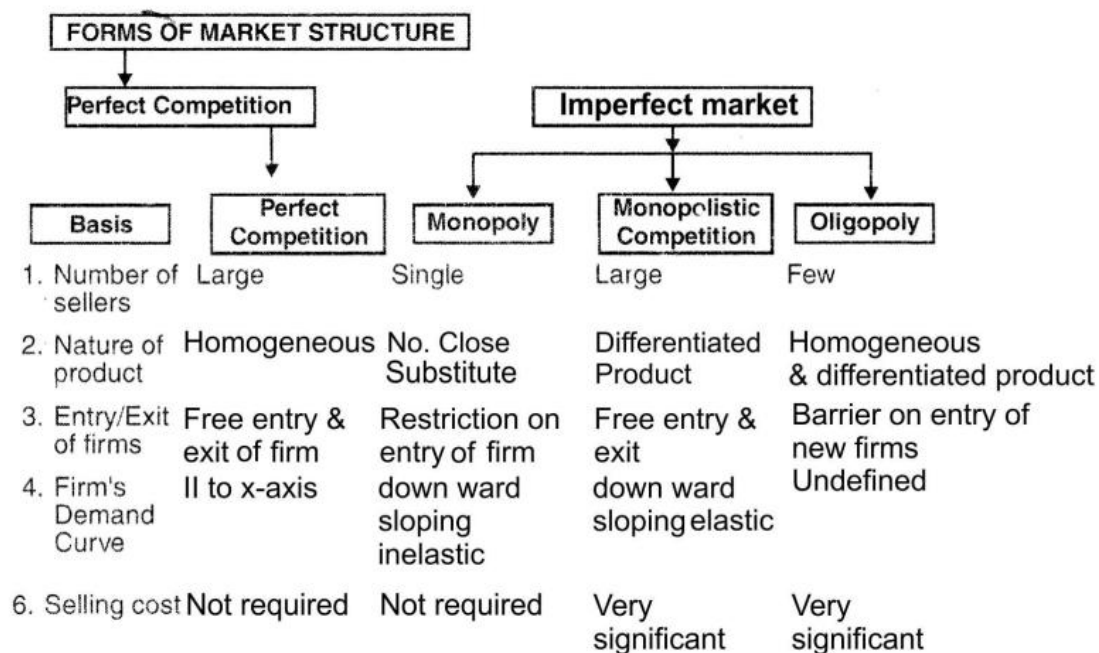
MONOPOLY MARKET

- ❑ Monopoly is that type of market where there is a single seller, selling a product which does not have close substitutes and there are restrictions/barriers to enter into the industry. The monopoly firm is itself an industry and can set the price to its maximum advantage.

Features :

- (a) Single Seller
- (b) Restrictions on the entry and exit of new firms.
- (c) No close substitute of product available.

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- (b) All the firms under oligopoly produce homogeneous or differentiated product.
 - (c) Under oligopoly demand curve is undefined/indeterminate.
 - (d) Economic Barriers to the entry of firm into industry. e.g., huge investment requirements, economies of scale etc.
 - (e) All the firms are interdependent in respect of price and output determination under oligopoly market. Any action of a firm in terms of change in price, gets reaction from other firms.
- Oligopoly can be categorised in two categories in the following ways.
- Collusive oligopoly and Non-collusive oligopoly :
 - (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 other firms.
 - Perfect oligopoly and Imperfect oligopoly
 - (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.



MULTIPLE CHOICE QUESTIONS (1 MARK)

1. In which market $MR = \text{Price}$
 - (a) Monopoly
 - (b) Perfect Market
 - (c) Monopolistic Market
 - (d) Oligopoly
2. In which market, restrictions on entry of new firms
 - (a) Perfect Competition
 - (b) Monopolistic competition
 - (c) Monopoly
 - (d) None of the above.
3. Under which market, firm is a price taker
 - (a) Perfect Competition
 - (b) Monopoly
 - (c) Monopolistic Competition
 - (d) Oligopoly
4. Under Oligopoly
 - (a) Large no. of sellers
 - (b) Few sellers
 - (c) Single seller
 - (d) None of above
5. A price at which a consumer is willing to buy and a seller is willing to sell the commodity is called.
 - (a) Minimum Price
 - (b) Maximum Price
 - (c) equilibrium price
 - (d) None of the above.
6. When a monopoly firm charges different prices from different consumers for the same product is called
 - (a) Quantity discrimination
 - (b) Product differential
 - (c) Price discrimination
 - (d) Consumer differentiation.
7. Quantity of a commodity which is bought and sold at the equilibrium price is called?
 - (a) Maximum quantity
 - (b) Minimum quantity
 - (c) Both (a) and (b)
 - (d) Equilibrium quantity

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8. At a given price, when demand for commodity is more than supply of the commodity then it is called excess demand. Here given price is :
- (a) less than equilibrium price
 - (b) more than equilibrium price
 - (c) less than or equal to equilibrium price
 - (d) More than or equal to equilibrium price
9. Price ceiling refers to :
- (a) Max. retail price
 - (b) Max. price the buyer is willing to pay
 - (c) Max. price at which seller is willing to sell.
 - (d) Max. price the producer is legally allowed to charge.
10. Fixation of minimum wage below the equilibrium wage rate leads to :
- (a) Unemployment
 - (b) Over employment
 - (c) Neither (a) nor (b)
 - (d) Either (a) or (b)
11. Which feature distinguished oligopoly from other market forms
- (a) Interdependence among firms.
 - (b) Homogenous product
 - (c) Perfect knowledge
 - (d) Large number of buyers
12. Which market form does not exist in real life.
- (a) Perfect competition
 - (b) Monopoly
 - (c) Oligopoly
 - (d) Monopolistic competition

Answers

1. (b); 2. (c); 3. (a); 4. (b); 5. (c); 6. (c); 7. (d); 8. (a); 9. (d); 10. (c); 11. (a); 12. (a).

Short Answer Type Questions (3-4 Marks)

1. How is the demand curve under monopolistic competition different from demand curve of a firm under perfect competition?
2. How does 'Free entry and exit' feature of Perfect competition market affect the profit of a firm.
3. What will happen if the price prevailing in the market is above the equilibrium price.
4. Explain the concept of excess demand with the help of diagram.
5. Differentiate between :
 - (a) Collusive and Non-collusive oligopoly.
 - (b) Perfect and Imperfect oligopoly.
6. Explain the determination of equilibrium price under perfect competition with the help of schedule.
7. Explain why is the equilibrium price determined only at the output level at which market demand and market supply are equal.
8. In perfect competition $AR = MR$ but in monopoly and monopolistic competition $AR > MR$, why?
9. In which condition decrease in demand can not change the price of commodity?
10. Explain how firms are interdependent in an oligopoly market.
11. In which competition the availability of close substitutes is present? How does it effect the price?
12. 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 'increase' in supply of that good. Explain the chain of effects of this change. Use a numerical example.
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 and their implication of perfect competition.
 - (i) Large number of firms or Sellers and Buyers.
 - (ii) Homogeneous Product.
6. Explain features of Oligopoly.
7. With the help of a diagram explain the effect of 'decrease' in demand of a commodity on its equilibrium price and quantity.
8. 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.
9. Suppose under a competitive market equilibrium price is too high for an average consumer in case of essential items. Give suggestion to bring down the equilibrium price upto affordable level for a common man.
10. Suppose government reduces the rate of excise duty and raise subsidies. What is the likely impact of these on the market of a product. Explain with diagram.

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.

3-4 MARKS QUESTIONS

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. 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 produce 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/services. |

- | | |
|------------------------------------|---|
| 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.	<i>Monopoly</i>	<i>Monopolistic competition</i>
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.	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

6 MARKS QUESTIONS

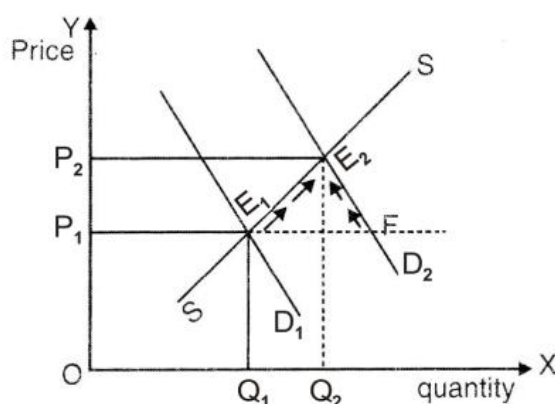
Q. 1. Distinguish between collusive and non-collusive oligopoly. Explain how the oligopoly firms are interdependent in taking price and output decisions.

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.

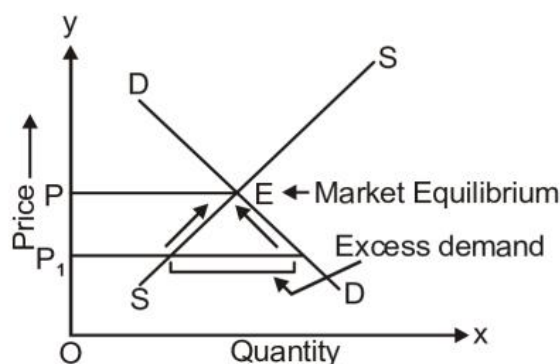
- Q. 4.** Explain why the equilibrium price of commodity is determined at that level of output at which its demand equals its supply.

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 an 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. If demand is less than supply. Since the sellers will not be able to sell all what they want, there will be competition 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.

- Q. 5.** With the help of diagram, show the situation of excess demand. Explain in steps how excess demand reaches to equilibrium.

Ans.



Excess demand is a situation when price of a good is less than the equilibrium price. It leads to competition among buyers which push the price upwards which leads to contraction in market demand and expansion in market supply. Due to it price rise, excess demand wiped out.

Q. 6. Define price floor. Explain the implications of price floor.

Ans. "Price Floor" is the minimum price fixed by the government below which seller cannot sell their product.

Since this price is normally above equilibrium price, there is excess supply in the market. As the seller may not be able to sell all the he wants to sell, he may illegally attempt to sell the product at a price below the floor price. Most well known example of imposition of price floors are agricultural price support programme or MSP (Minimum Support Price) and minimum wage legislation.

Q. 7. Define price ceiling. Explain the implications of price ceiling.

Ans. 'Price ceiling' is the maximum price fixed by the government that sellers can legally charge for a product or a service.

Since this price is below equilibrium price, there is excess demand in the market. As the buyer may not be able to buy all that he wants to buy, he may illegally attempt to buy the product at a price above the ceiling price and it lead to black marketing'.

Most well known examples of imposition of price ceiling are dengue test and pricing of stent that is used in the heart surgery.

