Chapter 6: Forms of Market & Price Determination Under Perfect Competition

Question: 1

Fill in the blank with appropriate alternative given below

Under perfect competition commodities are _________________ in nature.

Options

- homogeneous
- classified
- heterogeneous
- supplementary

Solution

Under perfect competition commodities are **<u>homogeneous</u>** in nature.

Under perfect competition, commodities are homogeneous in nature. In other words, the product of each and every firm in the market is a perfect substitute to others' products in terms of quantity, quality, colour, size, features, etc.

Question: 2

Fill in the blank with appropriate alternative given below

______________ appears in a monopoly market.

Options

- product differentiation
- price discrimination
- individual differentiation
- packing differentiation

Solution

Price discrimination appears in a monopoly market.

Price discrimination implies charging different prices for the same product from different buyers at the same time. Because a monopolist is a single seller of a good in the market, he enjoys the freedom to exercise price discrimination.

Question: 3

Fill in the blank with appropriate alternative given below

The price at which demand and supply equate to each other is called ________ price.

Options

- general
- equilibrium
- short-run
- reserve

Solution

The price at which demand and supply equate to each other is called **equilibrium** price.

Equilibrium price is the price at which the demand for a good equals the supply of that good. Graphically, it is obtained at the intersection of the demand and supply curves.

Question: 4

Fill in the blank with appropriate alternative given below

In _________ market, seller creates products differentiation.

Options

- competition
- perfect
- pure
- monopolistic competition

Solution

In **monopolistic competition** market, seller creates products differentiation.

Product differentiation is an important feature of monopolistic competition. It means that the producers in a monopolistic market sell goods that are different from each other; that is, the goods of no two producers will be the same. They may be differentiated in terms of colour, size, fragrance, etc.

Question: 5

Fill in the blank with appropriate alternative given below

Monopolist means ___________ competitive.

Options

- single seller
- several seller
- single buyer
- several buyer

Solution

Monopolist means **single seller** competitive.

Monopolist means single seller. In other words, monopolists is the sole seller of a commodity in the market with a large number of buyers.

Question: 6

Match the following:

Group A	Group B
Monopoly	Public monopoly
Product differentiation	Abnormal profit
Railway	Monopolistic Competition
Perfect Competition	Prof. Chamberlin
Pure Competition	Homogenous product
	Cartel
	Selling cost

Solution

Group A	Group B
Monopoly	Abnormal profit
Product differentiation	Monopolistic Competition
Railway	Public monopoly
Perfect Competition	Homogenous product

Pure Competition	Prof. Chamberlin

1. A monopolist has complete control on the price of the good. This means that a monopolist can make high profits by selling at high prices. He can even increase profits by controlling the supply of the good. Thus, we can say that a monopolist can make abnormal profits.

2. In monopolistic competition, the products sold by the producers are highly differentiated from each other; i.e., they are not the same or homogeneous in nature. Product differentiation is an important feature of the monopolistic type of market.

3. The Indian railways are regarded as the public monopoly because the railways in India are solely owned and controlled by the government. No other private party provides railways services in India. Hence, we can say that the Indian Railways enjoys the monopoly in the railways sector.

4. Under perfect competition, there are a large number of buyers and sellers. The commodities sold by the sellers in a perfectly competitive market are homogeneous in nature. In other words, the product of each and every firm in the market is a perfect substitute to others' products in terms of quantity, quality, colour, size, features, etc.

5. The concept of a pure competition market was initially suggested by Professor Chamberlin. He listed four conditions necessary for a pure competition market structure:
i. Large number of buyers and sellers,
ii. Homogeneous product
iii. Free entry and exit for firms
iv. Independent decision making.

Question: 7

State whether the following statement is TRUE and FALSE.

There is no price discrimination under Monopolistic competition.

Options

- True
- False

Solution

True

In a monopolistic market there exists a large number of sellers selling differentiated products that are close substitutes of each other. Due to the presence of large number of sellers in the market none of them can follow price discrimination. This is because demand curve faced by the sellers is highly elastic. Even a slight change in the price brings about a large change in the quantity demanded. Thus, price discrimination cannot be followed.

Question: 8

State whether the following statement is TRUE and FALSE.

In a monopoly market, firm and industry are the same.

Options

- True
- False

Solution

True
A monopoly market consists of only one seller or firm. This single firm caters to the needs of a large number of buyers. Because there is only firm in the market, the firm is regarded as the industry.

Question: 9

State whether the following statement is TRUE and FALSE.

Product differentiation is not possible under perfect competition.

Options

- True
- False

Solution

True

Under perfect competition, the sellers sell goods that are homogeneous in nature. In other words, the product of each and every firm in a perfectly competitive market is a perfect substitute to others' products in terms of quantity, quality, colour, size, features, etc. Therefore, product differentiation is not possible under perfect competition.

Question: 10

State whether the following statement is TRUE and FALSE.

Under perfect competition, price is determined by equilibrium of demand and supply.

Options

- True
- False

Solution

True

Under perfect competition, each firm is a price taker, while the industry is a price maker. In the industry, the market price is determined by the intersection of the supply and demand curves.

Question: 11

Define or explain the following concept:

Market

Solution

The market acts as a platform where buyers and sellers come into contact in order to exchange (buy and sell) goods and services. It refers to a situation where buyers and sellers meet. The market need not be a physical place. Nowadays, buyers and sellers meet over the internet and engage in trade.

Question: 12

Define or explain the following concept:

Price discrimination

Solution

Price discrimination implies charging different prices for the same product from different buyers at the same time. Such discrimination is generally enjoyed by a monopolist. In other words, he can sell the same product to different buyers at different prices at same or different time periods. Possibility of following Price discrimination is one of the important features of monopoly.

Question: 13

Define or explain the following concept:

Monopolistic Competition

Solution

Monopolistic market structure is defined as the market structure where a large number of buyers and sellers engage in the exchange of differentiated products, i.e., products that are close substitutes of each other. Differentiated product is one of the unique features of the monopolistic market structure. For example, in the market of toilet soap, differentiated products are available under different brand names, which are close substitutes of each other but are not identical, such as Lux, Rexona, Cinthol, Lifebouy and Pears.

Question: 14

Define or explain the following concept:

Selling cost

Solution

Selling cost refers to the total expenditure incurred by a monopolistically competitive firm in order to differentiate its product from the product of its competitors. For instance, advertisement expenses incurred by a firm are a part of the selling cost of the product.

Question: 15

Define or explain the following concept:

Equilibrium price

Solution

Equilibrium price is the price at which the demand for a good is equal to its supply. This price is determined by the intersection of the demand and supply curves. Thus, it is a state where the demand and supply of goods balance.

Question: 16

Give reason or explain:

Single price prevails in perfect competition.

Solution

Under perfect competition, each firm is a price taker and the industry is a price maker. This is because there are a large number of firms selling homogeneous goods, i.e., similar goods. If any firm increases its price, the buyer will shift to another producer. If the firm reduces the price, it will not be able to cater to the demand that will be shifted to it on reducing the price. The market price in the industry is determined by the intersection of the market supply and market demand curves. Therefore, individual firms take the market price, so determined, as fixed and adjust their supply accordingly.

Question: 17

Give reason or explain:

Price discrimination is possible under monopoly.

Solution

Price discrimination implies charging different prices for the same product from different buyers at the same time. Since a monopoly firm is the single seller in the market it enjoys complete control over the price. In this regard he can follow price discrimination in order to gain maximum profits.

Question: 18

Give reason or explain:

Selling cost is incurred by a firm in Monopolistic competition.

Solution

The products sold under monopolistic competition are differentiated from each other. The products of the monopolistic firm is differentiated on the basis of certain characteristics as colour, shape size, etc. Such product differentiation further leads to selling costs by the firms. Through such expenses as advertisement, a particular monopolistic firm tries to convince the consumers by distinguishing its product on qualitative basis from its substitutes and thereby, attract greater number of customers to it.

Question: 19

Give reason or explain:

A monopolist can control the supply of goods.

Solution

Being a single seller, a monopolist has sole control over the production. The supply of output rests on the monopolist’s decision. Therefore, we can say that a monopolist has complete control over the market supply.

Question: 20

Give reason or explain:

Sellers and the buyers are price takers in perfect competition.

Solution

There exist a large number of buyers and sellers in a perfect competitive market. The number of sellers is so large that no individual firm owns control over the market price of the commodity. Due to the existence of a large number of sellers in the market, there exists perfect and free competition in the market. The firm acts as a price taker and the price is determined by the ‘invisible hands of the market’, i.e., by the demand and supply of commodities.

Similarly, the number of buyers is so large that no single buyer can influence the price in the market. He accepts the price at which the firms sell the commodity.

Question: 21

Distinguish between the following:

Perfect competition and Pure competition

Solution

Perfect Competition	Pure Competition
Factors of production are **perfectly mobile**.	Factors of production are **immobile** and **cannot move** from one industry to another.
Buyers and sellers have **perfect knowledge** about the prevailing market conditions.	Buyers and sellers have **imperfect knowledge** about the prevailing market conditions.
The characteristics of perfect competition are quite stringent, hence the existence of this market structure is a myth.	The characteristics of this market structure are comparatively liberal, hence, can be found in the real world.

Question: 22

Distinguish between the following:

Perfect competition and Monopoly

Solution

Perfect Competition	Monopoly
There are a large number of buyers and sellers.	There are a large number of buyers but only one seller.
Price discrimination is not possible.	Price discrimination is possible.
There is free entry and exit of firms.	The entry and exit of firms is restricted.

Question: 23

Distinguish between the following:

Natural monopoly and Social monopoly

Solution

Natural Monopoly	Social Monopoly

It is created due to the ownership of some natural resources.	It is created due to sole ownership and management by the government.
It arises because of factors such as good location, old establishment, goodwill of the firm and ownership of a natural resource.	It is created deliberately for welfare motive.

Question: 24

Distinguish between the following:

Natural monopoly and legal monopoly

Solution

Natural Monopoly	Legal Monopoly
It is created due to the ownership of some natural resources.	It is created by the law.
It arises because of factors such as good location, old establishment, goodwill of the firm and ownership of natural resources.	It arises due to such provision as patents, copy rights, trade marks, etc.

Question: 25

Distinguish between the following:

Perfect competition and Monopolistic competition

Solution

Perfect Competition	Monopolistic Competition
Products sold are homogenous in nature.	Products sold are differentiated in nature.
There is no selling cost involved.	Huge selling cost is involved.
Prices are determined by the forces of demand and supply. The firm is the price taker.	Every firm has its own pricing policy.

Question: 26

Write short note on the following:

Types of monopoly

Solution

The following are the seven types of monopolies:

i. **Natural monopoly** - It emerges due to the availability of natural resources at a particular location. The benefit of these natural resources is enjoyed by one particular firm or industry.
ii. **Public monopoly** - It is a government-created monopoly; it is created when an entity is solely owned by the government.
iii. **Private monopoly** - It occurs when a private firm sells a particular product in the entire market. The private firm solely owns and manages the production of goods.
iv. **Legal monopoly** - It refers to the monopoly created by law by granting copyrights, patents, etc.
v. **Simple monopoly** - In this type of monopoly, all customers are charged a single price for the same product. In other words, there is no price discrimination under this monopoly.
vi. **Discriminating monopoly** - It refers to a monopoly that charges different prices from its customers for the same product or service.
vii. **Voluntary monopoly** - It refers to the monopoly jointly created by big business firms.

Question: 27

Write short note on the following:

Features of pure competition

Solution

Some of the features of pure competition are:

i. **Large number of buyers and sellers:** There exist large number of buyers and sellers in this kind of market.
ii. **Homogeneous product:** The products sold under pure competition is homogeneous which means they are same in respect of quality, colour, size etc.
iii. **Free entry and exit of firms:** The firms under pure competition are free to enter or exit the market. There is no legal restriction as such.
iv. **Single price of the product:** Under pure competition products are sold at a unified price i.e. there is no price discrimination.

Question: 28

Answer the following question
What are the features of Perfect Competition?

Solution

The following are the features of perfect competition are as follows:

i. **Large number of buyers and sellers** - Under perfect competition, there are a large number of buyers and sellers. The number of sellers is so large that no individual firm has control over the market price of the commodity.

ii. **Free entry and exit of firms** - There is no restriction on the entry and exit of firms. This free entry and exit of the firms ensure that no firm earns either abnormal losses or abnormal profits in the long run.

iii. **Homogeneous product** - The product of each and every firm in the perfectly competitive market is a perfect substitute to others' products in terms of quantity, quality, colour, size, features, etc.

iv. **Perfect knowledge** - In a perfectly competitive market, the buyers are aware of the prevailing market price of the product at different places and the sellers are aware of the prices at which the buyers are willing to buy the product.

v. **Perfect mobility of factors of productions:** In a perfect competition the factors of production are perfectly mobile. Such mobility implies that there is optimum utilisation of the factors of production.

vi. **Absence of transport cost:** In a perfect competition it is assumed that there is no transport cost. This further ensures that there is uniform price in the market.

Question: 29

Answer the following question
What are the features of monopoly?

Solution

The following are the features of a monopoly:

i. **Single seller/firm/industry** - In a monopoly, there exists only one seller or a group of individuals owning a single firm.

ii. **Price maker** - Since a monopolistic firm is the only firm in the market, it has total freedom to fix the price level that can maximise its profit. Therefore, it can be said that a monopolist firm is a price maker.

iii. **Perfect knowledge** - It is assumed that a monopolist has perfect knowledge about the different conditions prevailing in the market. He is well informed about the types of demand prevailing in different markets segments and determines the price of his product accordingly.

iv. **Price discrimination** - A monopolistic firm enjoys the freedom to engage in price discrimination. That is, it can sell the same product to different buyers at different prices at different time periods.

v. **Restricted entry of new firms**- The entry into the monopolist market is restricted. In other words, no new firm can enter the monopoly market. There may be various legal barriers such as, patent rights, cartel laws, exclusive rights, etc. to restrict the entry of the new firms.

vi. **Possibility of super normal profits:** A monopolist firm has complete control over his decisions regarding price and output. The decision is taken taking into consideration the profit motive. At times higher price is charged and at times supply is restricted to earn greater profits.

vii. **Firm is the industry:** As the monopoly firm is the single firm in the market there is no distinction between the firm and the industry.

Question: 30

Answer the following question
What are the features of monopolistic competition?

Solution

The following are the features of monopolistic competition:

i. **Large number of buyers and sellers** - There are a large number of buyers and sellers in a monopolistic market.

ii. **Differentiated product** - Products of a firm are slightly different from those of other firms, but they are close substitutes. Product differentiation is achieved through brand name, trade mark and advertisements.

iii. **Selling cost** - The need of the selling cost arises due to the sole aim of differentiating products. It is through the help of advertisements that a monopolistic firm tries to convince the consumers by distinguishing its product from its substitutes on qualitative basis.

iv. **Free entry and exit of firms** - There is no restriction on the entry and exit of firms in this form of market. But at certain times, due to some legal barriers and patent rights, it is not so free for the new firm to enter the market.

v. **Imperfect Knowledge**- Both the buyers and the sellers do not have complete knowledge about the prevailing market conditions. Due to product differentiation, it is very difficult to acquire complete knowledge about prices and quantities of different products.

Question: 31

State with reason whether you agree or disagree with the following statement Perfect Competition means Monopolistic Competition.

Solution

No, the statement given above is not correct. Perfect competition and monopolistic competition are two different market forms. Although in both the markets there exists a large number of buyers and sellers, one of the basic differences between the two is that while in perfect competition, the products sold by different firms are homogenous in nature, as against this is monopolistic competition, the firms sell differentiated products.

Question: 32

State with reason whether you agree or disagree with the following statement A seller is price maker in monopoly.

Solution

Yes, the above statement is correct. This is because in a monopoly, there is only a single seller or a group of individuals owning a single firm. Being a single firm in the market, it has total freedom to fix the price level that maximises its profit. Therefore, it can be said that a monopoly firm is a price maker.

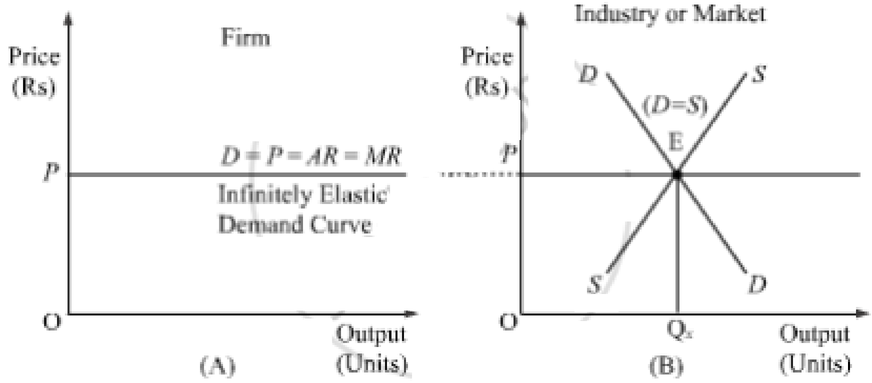
Question: 33

Answer in detail
What is Perfect Competition? Explain price determination under Perfect Competition.

Solution

Perfect competition is defined as a market structure that consists of a large number of buyers and sellers such that no individual seller can influence the existing market price of the product. All the sellers in a perfect competition market produce homogenous products; that is, the output of all sellers is similar to each other and each firm sells its output at a uniform price.

Price Determination under Perfect Competition
Under perfect competition, the market price, or the equilibrium price, is determined in the industry. Individual firms have no influence on this price. In the industry, the price is determined by the intersection of the market supply and market demand curves. In other words, the price under perfect competition is set at the point where the market supply of the good is equal to the market demand for the good. The individual firms take the market price so determined as fixed and adjust their supply accordingly.



In the figure, part A depicts the infinitely elastic demand curve faced by an individual firm in a perfect competition market. Part B depicts how the market demand and market supply curves interact to determine the market price. The market price OP is determined by the intersection of market (industry) demand curve DD and market (industry) supply curve SS. The market equilibrium is at point E, where OQ_X (amount of output) is supplied at the equilibrium market price OP. The price for the commodity is given to an individual firm and no single firm can influence the market price. The firm faces an infinitely elastic demand curve, which suggests that no matter how many units of output are supplied, the price will remain the same. Hence, we can conclude that under a perfect competition market, an individual firm is a price taker and not a price maker.

Question: 34

Answer in detail
What is monopoly? Explain in detail the features of monopoly?

Solution

A monopoly is defined as a market structure in which there is only one seller or firm. This single firm caters to the needs of a large number of buyers. Because it is the only firm in the market, it is regarded as the industry.
The following are the basic features of the monopoly market structure:

i. Single seller/firm/industry - In a monopoly, there exists only one seller or a group of individuals owning a single firm.

ii. Price maker - Since a monopolistic firm is the only firm in the market, it has total freedom to fix the price level that can maximise its profit. Therefore, it can be said that a monopolistic firm is a price maker.

iii. Perfect knowledge - It is assumed that a monopolist has perfect knowledge about the different conditions prevailing in the market. He is well informed about the types of demand prevailing in different markets segments and determines the price of his product accordingly.

iv. Price discrimination - A monopolist enjoys the freedom to engage in price discrimination. In other words, it can sell the same product to different buyers at different prices at different time periods.

v. Complete control over market supply - Being a single seller, a monopolist has sole control over the production. The supply of output rests on the monopolist's decision.

vi. Possibility of super normal profits- A monopolist firm has complete control over his decisions regarding price and output. The decision is taken taking into consideration the profit motive. At times higher price is charged and at times supply is restricted to earn greater profits.

viii. Firm is the industry- As the monopoly firm is the single firm in the market there is no distinction between the firm and the industry.

Question: 35

Answer in detail
What is Monopolistic Competition? Explain in detail the features of Monopolistic Competition.

Solution

Monopolistic competition is defined as the competition among a large number of sellers. These sellers sell differentiated products that are close substitutes of each other. Dealing in differentiated products is one of the unique features of the monopolistic market structure.

Some of the features of monopolistic competition are as follows:

i. Large number of buyers and sellers - There are a large number of buyers and sellers in a monopolistic market.

ii. Differentiated product - Products of a firm are slightly different from those of other firms, but they are close substitutes. Product differentiation is achieved through brand name, trade mark and advertisements.

iii. Selling cost - The need of the selling cost arises due to the sole aim of differentiating products. It is through the help of advertisements that a monopolistic firm tries to convince the consumers by distinguishing its product from its substitutes on qualitative basis.

iv. Free entry and exit of firms - The firms in the monopolistic market enjoy the freedom of free entry and exit from the market. However, at times, because of legal barriers and patent rights, a new firm cannot enter the market.

v. Restricted entry of new firms- The entry into the monopolist market is restricted. In other words, no new firm can enter the monopoly market. There may be various legal barriers such as, patent rights, cartel laws, exclusive rights, etc. to restrict the entry of the new firms.

vi. Elastic demand curve- The demand curve faced by the firms is highly elastic and slopes downwards. This is because of the availability of a large number of close substitute products.