

Market Structures

There are a range of market structures from monopoly to perfect competition. This determines the type of industry the firm is in. Market structure depends on:

- **Number of firms** – (Monopoly = 1, competitive = many firms)
- **Degree of product differentiation**
- **Barriers to entry and exit.** – Can new firms enter the market?

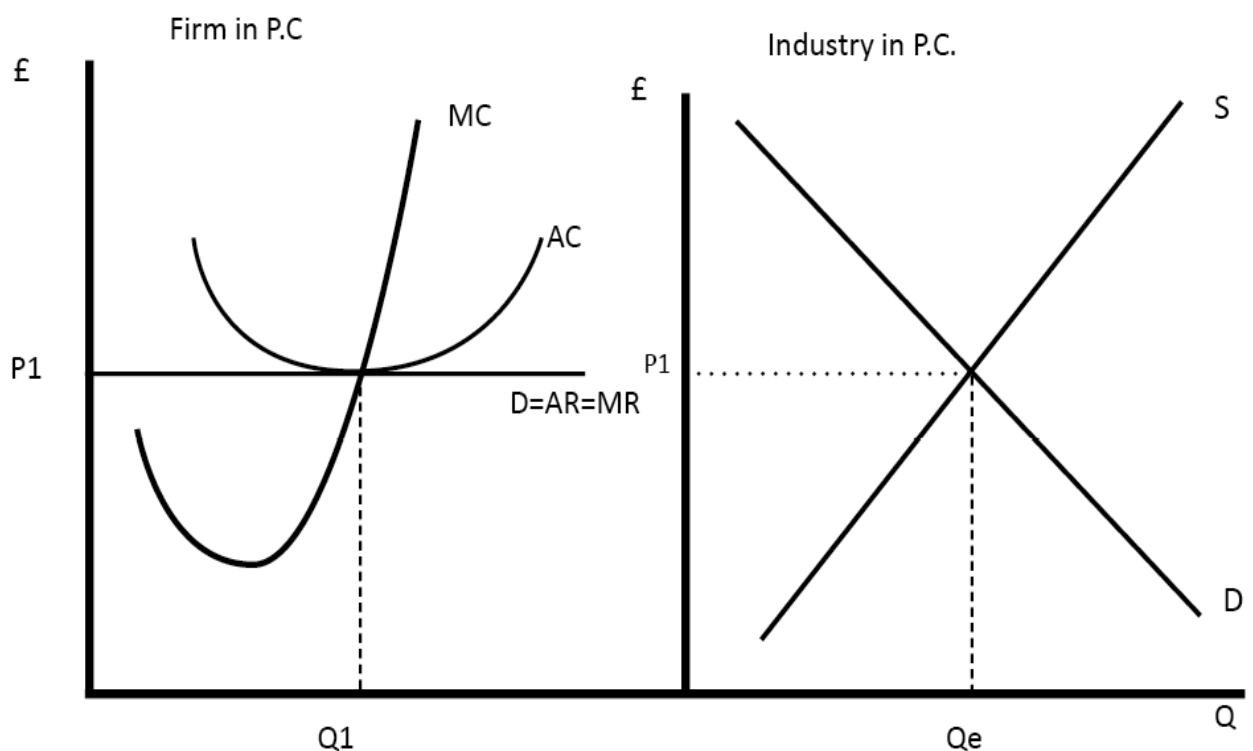
Perfect competition

Perfect competition is a market structure where there are many firms and competitive prices. Features of perfect competition include:

1. **Many small firms.**
2. **Freedom of entry and exit;** this will require low sunk costs.
3. **Homogenous product** All firms produce an identical product which is the same wherever you buy it.
4. **All firms are price takers;** therefore a firm's demand curve is perfectly elastic.
5. **There is perfect information and knowledge** for both consumers and producers.

Examples of perfect competition include foreign exchange markets, many agricultural markets and walking tourist guides around cities.

Diagram for perfect competition long run



Market Failure

Market failure occurs when there is an inefficient allocation of resources in a free market.

Reasons for market failure

- **Externalities.** A cost or benefit imposed on a third party, leading to under or over-consumption.
- **Lack of information** Lack of complete knowledge by one party. E.g. people may under-estimate the benefits of education (merit good) or underestimate the costs of smoking (demerit good).
- **Monopoly.** When a firm has market power and can set higher prices. Monopolies may also be more inefficient because they face less competitive pressures.
- **Immobilities.** Geographical immobilities occur when it is difficult for people or firms to move to another area.
- **Public goods.** Goods that are non-rival and non-excludable. These may be underprovided in free market
- **Merit goods** – goods like education where people may underestimate the benefits, leading to underconsumption.
- **Demerit goods** – goods like alcohol where people may underestimate the costs, leading to overconsumption.
- **Inequality.** When income and wealth are unevenly distributed leaving some part of society in relative poverty.

Public goods

A public good has two characteristics:

- **Non-rivalry.** When a good is consumed, it doesn't reduce the amount available for others, e.g. street lighting.
- **Non- excludability.** This occurs when it is not possible to provide a good without it being possible for others to enjoy, e.g. national defence.
- **Examples** include law and order, national defence, and street lighting.

Public goods suffer from the **free-rider problem**.

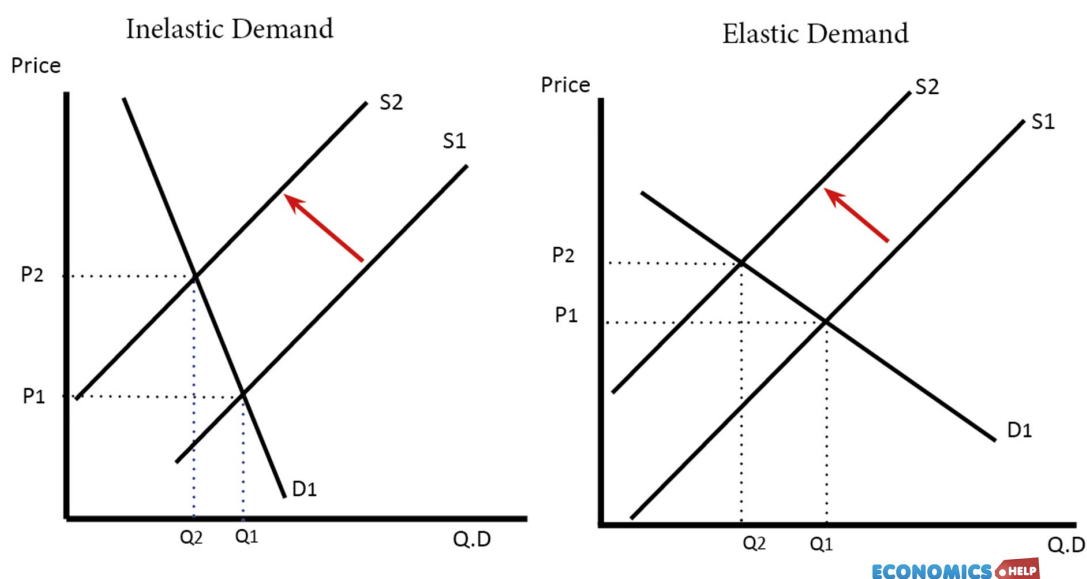
- **The free rider problem** means that people can enjoy the goods without paying for it.
- **Therefore** there is **no incentive for firms** to provide goods because it is difficult to charge consumers for using it.
- Public goods usually require the government to provide the good directly and pay for it out of general taxation.
- **Exam tip:** Be careful - not all goods provided by the *public sector* (government) are *public goods*.

Glossary of terms

Term	Definition
Scarcity	Limited resources but unlimited wants
Opportunity cost	The next best alternative foregone
Economic goods	Goods that are scarce and have an opportunity cost
Free goods	Goods that are not scarce and have no opportunity cost
Factors of production	Resources used to produce goods and services (land, labour, capital, enterprise)
Land	Natural resources used in production
Labour	Human effort used in production
Capital	Man-made goods used to produce other goods
Enterprise	The ability to organise factors of production and take risks
Mobility of factors	The ease with which factors of production can move between uses or locations
Occupational mobility	Ability of labour to change jobs
Geographical mobility	Ability of labour to move location
Production possibility frontier (PPF)	A curve showing the maximum output an economy can produce with given resources
Productive efficiency	Producing maximum output from given resources
Allocative efficiency	Producing goods consumers most want ($P = MC$)
Economic efficiency	Producing at lowest possible cost
Technical efficiency	Producing maximum output with no waste
Demand	The quantity consumers are willing and able to buy at different prices
Quantity demanded	The amount consumers buy at a given price
Effective demand	Demand backed by willingness and ability to pay
Utility	Satisfaction gained from consuming a good
Marginal utility	Extra satisfaction from consuming one more unit
Diminishing marginal utility	Additional units give less extra satisfaction

Evaluation tips

Depends on elasticity



→ The impact of a fall in supply will depend on the price elasticity of demand and supply, as more elastic markets (example on right) will see a larger change in quantity rather than price.

Short run vs long run

→ In the short run, the effect may be limited due to fixed factors, but in the long run firms and consumers can adjust behaviour more fully.

Size of effect

→ The overall impact depends on the magnitude of the change, as small shifts may have only a limited effect on price and quantity.

Time lags

→ There may be significant time lags before the full effects are felt, particularly in markets where adjustment takes time.

Information gaps

→ The outcome may be affected by imperfect information, as consumers and firms may not respond rationally.

Assumptions (*ceteris paribus*)

→ This analysis assumes *ceteris paribus*, but in reality other factors may change and influence the outcome.