Market Structure – Lesson 5.1

**Question 1**

Explain what is meant by productive efficiency and allocative efficiency, and assess whether, it is in consumers' interest when firms are both productive efficient and allocative efficient. [25]

**Question 2**

Explain why less market competition might lead to higher and more stable prices. [10]

(a) Explain why less market competition might lead to higher and more stable prices. [10]

**To explain why the industry with less market competition produce higher and stable price, there is a need to understand how price and output decision is influenced by the profit maximizing rule based and the impact of barriers to entry on the market.**

**Analysis of the question:**

Areas of writing:

1. Explain the meaning of less market competition (refers to the oligopoly and monopoly)
* Firms can set price and output
* Firms have high degree of market power and thus, the value of PED is price inelastic
1. Explain how the price and output is set based on the notion of profit maximization which is based on MR = MC.
2. Explain why the price is high as the firms in these two market structures as the Price inelastic MR and AR influences the price and output determination to be set higher.
3. Explain how price is stable under different conditions with greater market power, allowing firms to practice different price to be stable.

**Structure of Development:**

Introduction – how price and output decision based on profit max will lead to higher and stable price as explained by the concept of profit maximization ( set the requirements of the question and the economic principles to be applied)

main body

1. Explain the features of firms in the less market competition and how their MR and AR will be (Oligopoly and Monopoly) – higher BTEs – High degree of market power
2. how price and output is set based on profit max.
3. how less market comp will influence price and out decision (draw diagram and describe the diagram)
4. why it will be higher price – high degree of market power – set price and output – steep MR and AR – price inelastic profit maximization level is at a low output level and the price will be high – based on law of demand – reflective of the condition of market power – price setting power to raise price to maximize profit
5. why it will be stable price –

monopoly set the price and no other firm can change it

price rigidity – no advantage to increase or decrease price – mutual interdependency (must explain why the firms in oligopoly will not change price)

price collusion – abide the price set by the market – reduce market unpredictability to set price by abiding to price leadership - raise their power to set higher price and gain more revenue to praise profit

1. analysis – significance of the factor – high degree of market power – why ? – it determines the slope of MR and AR.

conclusion

**In sum, the profit maximizing will explain how price and output are set and it can be observed that the degree of market competition will explain why price is set high and will be stable. This understanding will help government to derive policies to regulate the firms in the oligopolistic and monopolistic market in the interests of the society,**