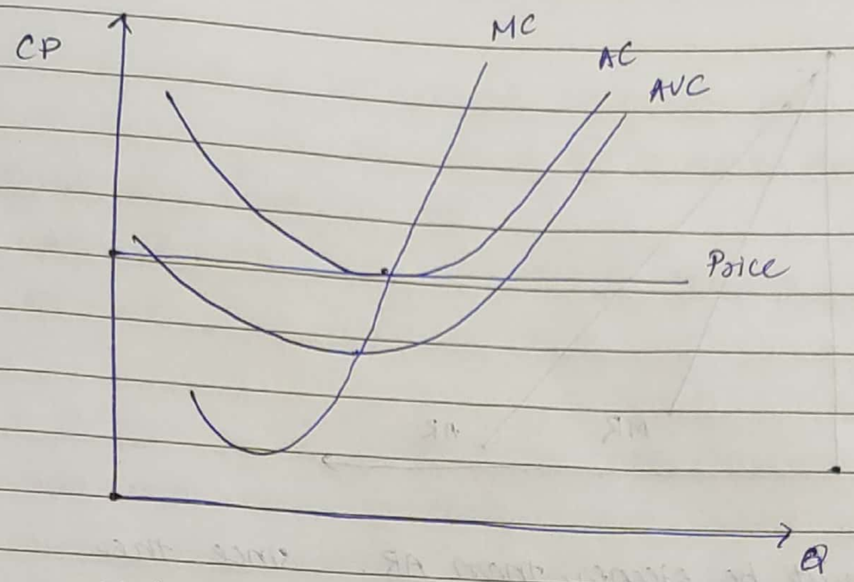
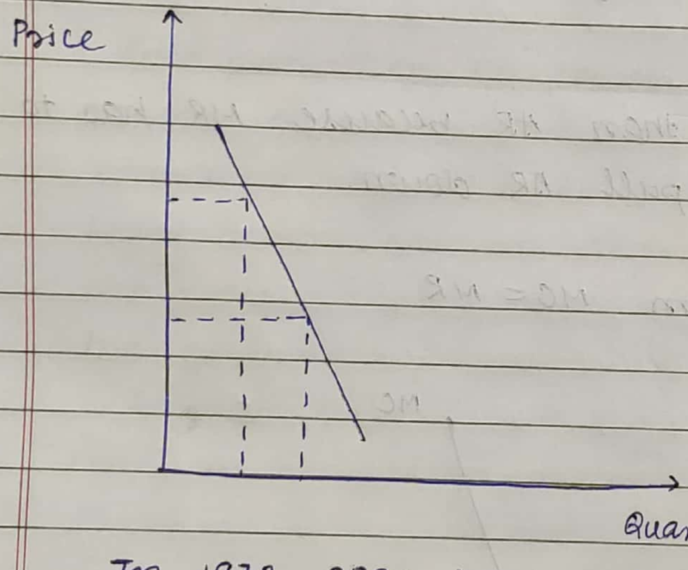


Making Normal Profits

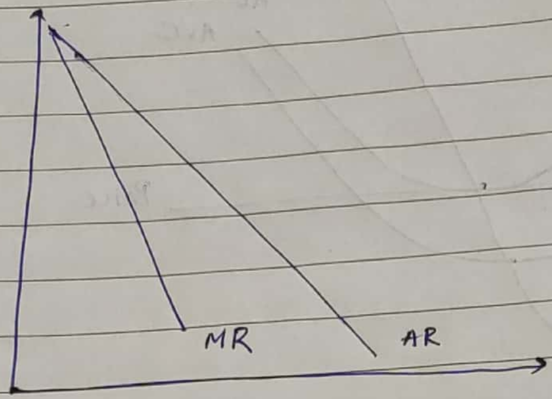
Monopoly :



Monopolist increase the price, but then too the demand wouldn't change a lot. Thus, the demand curve is inelastic for them.

In 1972, OPAC increased the oil prices by 50%. At some time, Bata was the only seller of good shoes.

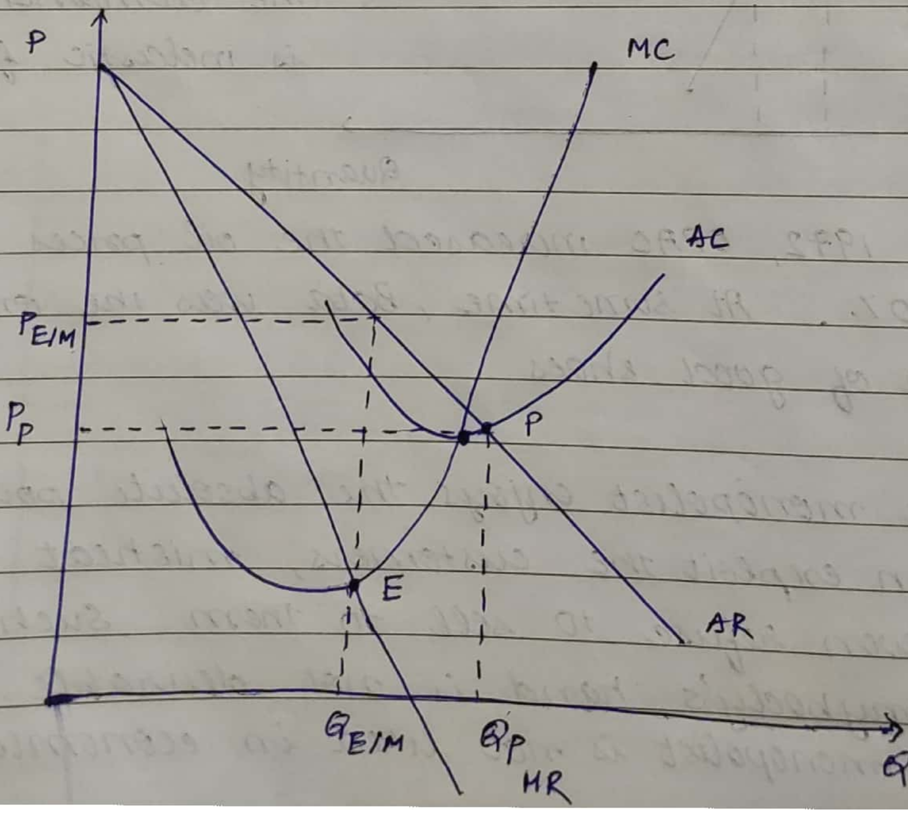
The monopolist enjoys the absolute power. He can exploit the customers, mistreat them or even refuse to sell to them. Such power in anybody's hand is not desirable. That is why monopolist is not liked in economics.



MR must be steeper than AR. since the monopolist produces for the entire market, he faces the negatively sloping demand curve because market demand curve will always be negatively sloping as per the law of demand.

MR is steeper than AR because MR has to decline faster to pull AR down.

For equilibrium MC = MR



Lowest point of AC is near AR or on AR. MC passes through minimum of AC. MC's minimum must pass through MR.
AC = AR (Perfectly competitive Market).
MC = MR (Equilibrium)

As the curve shows, the equilibrium is attained in monopoly at a point where prices are higher than the perfectly competitive market (where AC=AR) and the quantity supplied is also lesser. Thus, the consumer gets less at higher price. That's why monopoly is not desirable.

Each nation has the power to restrict the actions of a monopolist. Monopolies are controlled by law in almost all countries. Legal action can be taken against people who try to gain monopoly powers. At times the government encourages competition by ~~Gujarati~~ either entering the market itself or by giving subsidies to other companies to enter the market.

Monopsony: one consumer and many sellers.
Gujarati products were highly demanded all over the world. The traders bought from artisans and sold for huge profits. Thus, government started Gurjary and so as to purchase products directly from artisans at proper rates.

Solving problem of Monopoly:
- Restrict through legal actions
- Auction Natural Monopoly.

Natural Monopoly:

There are certain products where the investment is very large and duplication is uneconomical. For eg, railways, electricity supply / transmission lines, water supply lines. For such monopolies, usually the ~~Government~~ government becomes the owner.

Problems:
1. Corruption
2. Inefficiency

To solve the problem of natural monopoly, we auction the services according to geographical area. The government also sets up the maximum price ~~that~~ at which the services are provided to the customer.

The problem has been solved now as follows: The services are divided into geographical units. Each of this unit is contracted out to private companies. This way there is competition generated and the conditions for pricing are clearly laid out by the government. Thus, monopoly becomes efficient.

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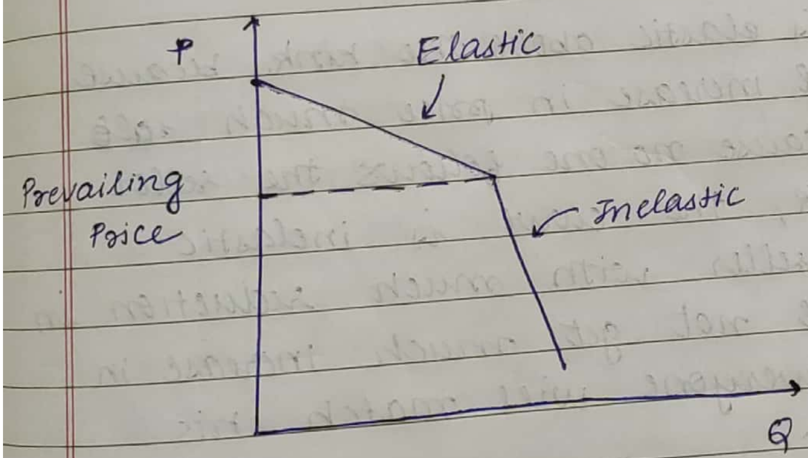
Oligopoly :

Characteristics :

1. Less than 20 sellers . 4. Kink demand curve
2. Large no. of buyers . 5. Homogeneous or Heterogeneous
3. Restricted Entry and Exit (Not so much restricted).

Oligopolist knows their competitor completely well. They want most of the market coming to them. Usually there are 6-7 competitors .

1. Price Wars .
Jet Airways did not understand the pricing and thus vanished .



Kinked Demand curve .
The Kink represents the prevailing price .

If there is increase in cost of inputs, if you increase in the prevailing price then no. of customers would decrease as other sellers would advertise about their product . If you decrease than the prevailing price so as to attract more customers. Then other seller would also decrease their price.

The oligopolist face a kinked demand curve where the kink represents the prevailing prices. If a seller tries to increase his price all his competitors would try to take away his customers by maintaining their low price. Thus, the seller would not gain more revenue but would lose many customers. Thus, it is not advisable to increase the price.

When a seller decides to decrease the price to get more customers, all his competitors will also decrease the price to maintain their customer base. This way the seller would get lesser price but not more customers.

The curve is elastic above the kink because with ~~sa~~ small increase in price much sale will be lost because no one follows the seller. Below the kink, the curve is inelastic because the seller with much reduction in price also will not get much increase in sale because everyone will match his price reduction.

Oligopoly leads to price wars which leads to sick industries. If the industries are a necessity then we wouldn't want them to make losses and they finally vanish. Thus, then government enters to stop the price wars.

Price wars are very common in oligopoly where in all the companies would try to outplay each other by reducing prices further and further. After certain point, such price war results into loses for everybody. The entire industry become sick. To save the nation from this problem, government intervenes and commands the companies to follow certain base rules.

Government only intervenes in those markets that are needed for the smooth functioning the country such as airlines but not in things such as softdrinks.

Some industries have a leader company in their oligopolist, there won't be any price wars. eg steal industries has the leader TATA. If other industries are undergoing through loses then they ask for the leader to increase the prices so that they can also increase. If somebody decreases the price then others won't be affected. Thus, there are no price wars or losses due to increased cost.

If the companies want to increase the prices, if they don't have a leader then they try to contact each other through mediums and increase prices accordingly.

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Price Leadership:

There are some oligopolist industries where there are leaders who exist, they either have large share in the market or have a very reputed name. When the costs increase the "leader" is requested to increase the price first and everyone follows. Thus, the presence of a leader in an oligopolistic market can save the industry from price wars or losses due to increased costs.

A \ B	Confess	Not Confess
Confess	15, 15	1, 15
Not Confess	15, 15	0, 0

If A confesses,

$$P(\text{Confess}(A)) = 0.5(15) + 0.5(1) = 8$$

Game Theory is applied to oligopolist market. They look for a sub-optimal solution. They thus think that he should decrease the price but others would also decrease the price but the initiator would have some additional profits. Or else they could co-operate with each other and maintain the same prices or change according to their competitors.

Nash Equilibrium:

Nash said that in any oligopoly market, decreasing the price can win over the customers but eventually leads to everyone making loses. Still the attraction to get more customers is high. So each oligopolist has the choice to either decrease the price or maintain it. If they all co-operate with each other, they would maintain the price and each one would make good profits. But if one person decreases the price for a short period, he will get more customers till others follow. Thus, there is always a suspesion that somebody will decrease the price and get away with more customers. Because of this each oligopolist tries to be the first one to decrease the price and thus leading to losses for everyone. Thus, Nash shows that due to mistrust the industry always attains a sub-optimal equilibrium where everyone makes less profits.

'A'

	Confess	Not Confess
'B' Confess	10, 10	15, 1
Not confess	1, 15	0, 0

Confess: $0.5(10) + 0.5(1) = 5.5$

Not confess: $0.5(15) + 0.5(0) = 7.5$

Thus, the best strategy is to confess as less loss. But if they have faith in each other and do not confess then both would get away without punishment. But people don't trust each other and take the sub-optimal solution.

Monopolistic Competition.

- Light competition.
- Brand names.
- Large no. of buyers.
- Many sellers.
- Don't know their competitors.
- Don't care about what your competitors are doing, as their share won't be affected.
- Seller does not consider reactions of their rivals while choosing their product prices.
- Product differentiation.

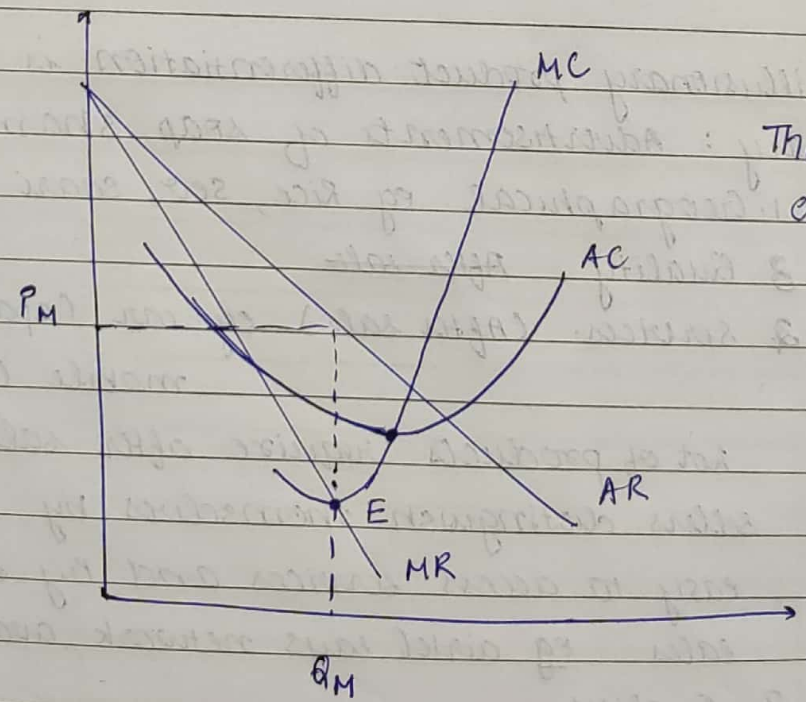
Game Theory (Real Example):
Hunters Dilemma is also like game theory but is a practical and real scenario.

- Real or illusionary product differentiation is made.
  Illusionary: Advertisements of soap, shampoo, etc.
  Real: 1. Geographical eg Rice, sev, saari
  ~~3~~ Quality ~~After sale~~
  ~~3~~2. Services. (After sale) eg car (spare parts).
  mobile (cover, spare parts)
  Lot of products require after sales services, sellers distinguish themselves by providing easy to access services and try to get more sales. eg airtel says network available every-where.
  3. Quality
  Some names gaurantee quality.
  eg sony, toyota, etc.
  Godrej made a name because of quality, but then too they are overtaken by others.

- Advertising :
It is very important in this market structure to make people aware of the brand. However, advertising costs increase the cost of the product. And hence these products are always more expensive than the perfectly competitive markets.

- Entry and Exit is relatively free because there is no possibility to restrict competition.
But an exception is Pantanjali. It entered the market and people did not worry about it. But then too it got great response from consumer. When a strong person enters the ~~compett~~ market it would just affect a little but may affect similar product sellers more.

GRAPH (NOT IN EXAM)



The sellers have excess capacity.

Money used for trading - Dollars.
Before second world war - Pound.
International currency Power must be economically as well as militarily very strong.

More often than not, this market structures producers work at less than full capacity which means that they are generally in the region of increasing returns to scale. It is possible to reduce the cost with more sales but such sales do not happen because of competition.

International Trade:

The international currency is US dollar at present, so the entire world trade gets done in dollars. The nations might at times decide to do trade in local currency (like rupee rubel trade) but for most part of the world trade, the currency is USD. From that each nation decides its exchange rate.

In 2008 recession struck in USA. Thus, interest rates over there decreases. But countries such as BRICS were doing well having higher interest rates than USA. Thus, the rich people of USA who had money decided to invest at higher rates in such countries. Thus, they started buying more foreign currency such as rupee. Thus, the demand for rupee increased while of dollar decreased. Thus, value for money increased.

The foreign exchange rate gets determined by simple forces of demand and supply. The currency whose demand is high will have a higher exchange value and the currency with lesser demand will be a weak currency

But some countries currency don't have much demand. Thus, their exchange rate cannot depend on the demand of currency.

There are two types of exchange rate systems:

1. Fixed Exchange Rate
2. Floating Exchange Rate.

Floating Exchange Rate:

Floating Exchange Rate is determined by demand and supply in the foreign currency market. Their movement can be very volatile. But it gives the real value of the currency because it reflects the actual demand and supply.

If dollar is more powerful, it has more demand, then India's certain amount of capitol would go to USA for investment. Thus, exchange rate decreases. The exchange rate depends on the relationship of those two currencies.

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In fixed exchange rate, we can't get money / foreign currency in open market. The people have no say in foreign exchange. As the nation had to use foreign exchange only on necessities such as petroleum, machinery, etc. People needed to pay 100% custom duty on foreign products. Thus, in turn people started cheating by hiding the foreign products, smuggling, black marketing, etc.

Fixed Exchange Rate :

Many nations decide that their currency will exchange at a certain rate only and that they do not want the market forces to determine the value of their currency. This happens mostly in developing nations who have very limited foreign exchange reserve. They restrict the import of unnecessary items by not allowing open market for ~~forig~~ foreign currency. Only the central Bank has the authority to buy and sell foreign currency. Citizens have to buy the foreign currency from the central Bank. This method allows the country to have proper planning for use of foreign exchange reserve. But it develops black markets and smuggling.

Rupee used to be under fixed exchange rate regime till 1991. After that for almost 20 yrs it was partially convertible (i.e only upto certain amount was allowed, for higher than that needed to go to Central Bank (RBI)) and now it is fully convertible.

What does RBI do to increase the demand of rupee?
RBI ~~gets~~ goes to foreign exchange and buys rupee and sells dollars. Thus, demand for rupee increases. Thus, the value increase.

What does RBI do when the rupee becomes very powerful?
Sometimes the rupee is quite strong. Thus, our export prices would be higher as compared to other countries' exports. Thus, then RBI sells rupee and buys dollars so as to decrease demand of rupee.

Under the floating exchange rate regime RBI intervenes in the market sometimes. When rupee is sinking, RBI buys rupee in the market and sells dollars. Thus, the demand for rupee increases vis-a-vis dollar. Exactly opposite is done when rupee becomes extremely strong.

Barriers to Trade :

They come in 2 forms :
1. Tariff
2. Quota .

Tariff : Customs Duty imposed on both imports and exports. Larger the tariff more restricted the trade .

Quota : Quota decides a certain quantity of imports beyond which no imports are allowed . Its a very strict measure that restricts trade .