

4. Taxation and subsidy policy:

The government can impose higher taxes and collect more revenue if the demand for the commodity on which a tax is to be levied is inelastic. On the other hand, in case of a commodity with elastic demand high tax rates may fail to bring in the required revenue for the government.

5. Importance in international trade:

The concept of elasticity of demand is of crucial importance in many aspects of international trade. The success of the policy of devaluation to correct the adverse balance of payment depends upon the elasticity of demand for exports and imports of the country.

6. Importance in the determination of factors prices:

Factor with an inelastic demand can always command a higher price as compared to a factor with relatively elastic demand.

7. Determination of sale policy for super markets:

Super Markets is a market where in a variety of goods are sold by a single organization. These items are generally of mass consumption.

8. Pricing of joint supply products:

The goods that are produced by a single production process are joint supply products. The cost of production of these goods is also joint.

9. Public utilities:

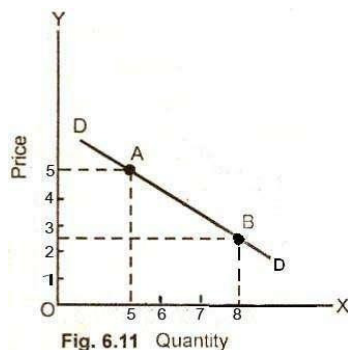
The nationalization of public utility services can also be justified with the help of elasticity of demand. Demand for public utilities such as electricity, water supply, post and telegraph, public transportation etc. is generally inelastic in nature.

10. Output decisions:

The elasticity of demand helps the businessman to decide about production. A businessman chooses the optimum product- mix on the basis of elasticity of demand for various products.

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28. Price elasticity of demand when the price per unit of a product falls from taka 5 to taka 3, and the quantity purchased rises from 5 to 8 units as a result.



It is shown that when the price of the product was tk.5, than the quantity of purchased product demand was 5 unit, but when its price falls from taka 5 to taka 3, than the quantity of purchased product demand increases from 5 unit to 8 unit. So the elasticity of demand is $\frac{Q2-Q1}{Q2+Q1} \div 2$

$\frac{P2-p1}{P2+P1} \div 2$

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29. The distinguishing features of perfect competition and monopolistic competition. Give at least one example of a firm in each of this market?

Features of Perfect Competition

1. Large number:

perfect competition, there must be large number of buyers and sellers. Each buyer buys a small quantity of the total amount. Each seller is so large that no single buyer or seller can influence the price and affect the market.

2. Homogeneous product:

Under perfect competition, the product offered for sale by all the seller must be identical in every respect. The goods offered for sale are perfect substitutes of one another. Buyers have no special preference for the product of a particular seller. No seller can raise the price above the prevailing price or lower the price below the prevailing price.

3. Free entry and exit:

Under perfect competition, there will be no restriction on the entry and exit of both buyers and sellers. If the existing sellers start making abnormal profits, new sellers should be able to enter the market freely. This will bring down the abnormal profits to the normal level.

4. Perfect knowledge:

Perfect competition implies perfect knowledge on the part of buyers and sellers regarding the market conditions. As a result, no buyer will be prepared to pay a price higher than the prevailing price. Sellers will not charge a price higher or lower than the prevailing price.

5. Perfect mobility of factors of production:

The second perfection mobility of factors of production from one use to another use. This feature ensures that all sellers or firms get equal advantages so far as services of factors of production are concerned.

6. Absence of transport cost:

Under perfect competition transport, cost does not exist. Since commodities have, the same price it logically follows that there will be no transport cost.

7. No attachment:

There is no attachment between the buyers and sellers under perfect competition. Since products of all sellers are identical and their prices are the same a buyer is free to buy the commodity from any seller he likes.

Examples of Perfect Competition

Agricultural markets: are the closest representations of perfectly competitive markets. These are marketplaces which have a large number of vendors selling fruit, vegetables, and poultry - namely, identical produce. The prices of goods are competitive, and no single seller can yield an influence over the pricing. Consumers are free to pick any seller, depending upon their choice.

Important features of monopolistic competition

1. Existence of large number of firms:

The first important feature of monopolistic competition is that there is a large number of firms satisfying the market demand for the product. As there are a large number of firms under monopolistic competition

(2) Product differentiations:

The various firms under monopolistic competition bring out differentiated products which are relatively close substitutes for each other. So their prices cannot be very much different from each other.

(3) Some influence over the price:

As the products are close substitutes of others any reduction of price of a commodity by a seller will attract some customers of other products. Thus with a fall in price quantity demanded increases. It therefore, implies that the demand curve of a firm under monopolistic competition slopes downward and marginal revenue curve lies below it.

(4) Absence of firm's interdependence:

Under oligopoly, the firms are dependent upon each other and can't fix up price independently. But under monopolistic competition the case is not so. Under monopolistic competition each firm acts more or less independently

(5) Non-price competition:

Firms under monopolistic competition incur a considerable expenditure on advertisement and selling costs so as to win over customers. In order to promote sale firms follow definite -methods of competing rivals other than price. Advertisement is a prominent example of non-price competition.

(6) Freedom of entry and exit:

In a monopolistic competition it is easy for new firms to enter into an existing firm or to leave the industry.

Monopolistic Competition Examples

A very nice example for monopolistic competition is farmers: Farmers produce crops for the entire world population, but again they have different characteristics by virtue of things like size and quality.

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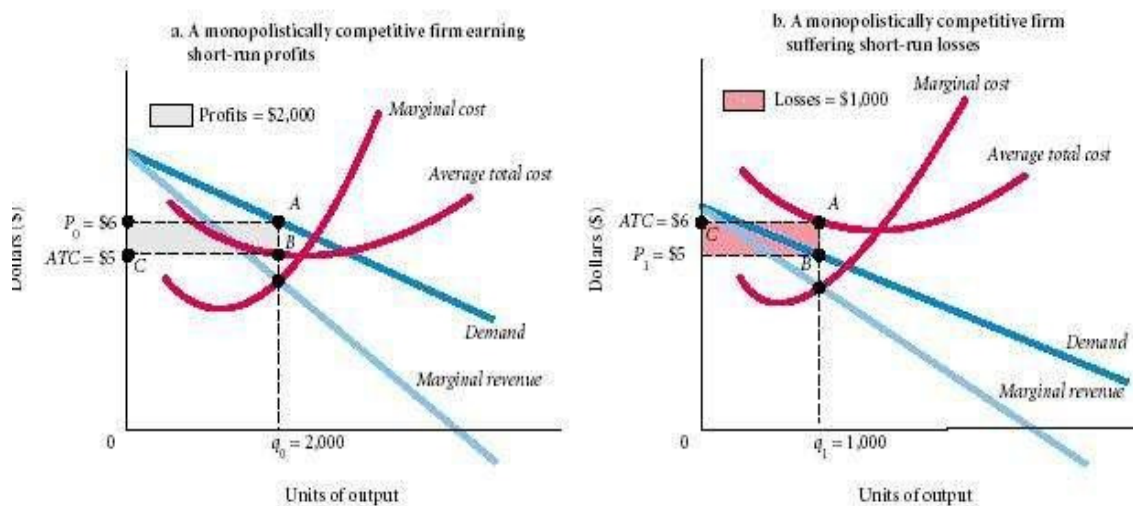
30. How equilibrium price and output are determined by a monopoly firm?

Price and Output Determination in Monopolistic firm

Monopolistically competitive industries are made up of a large number of firms, each small relative to the size of the total market. Thus, no one firm can affect market price by virtue of its size alone. But firms differentiate their products, and by so doing gain some control over price.

Price/Output Determination in the Short Run

Since the firm has a downward-sloping demand curve, it will also have a downward-sloping marginal revenue (MR) curve. A profit-maximizing firm produces where marginal cost (MC) equals marginal revenue (q_0 in the graph below) and charges the price determined by demand (P_0).



In panel (a) of the figure, the monopolistic competitor will make a profit. However, like a monopoly, a monopolistic competitor is not guaranteed to make a profit in the short run. The firm may make a loss in the short run; its profitability will depend on the demand. This is shown in panel (b)

Price/Output Determination in the Long Run

The action in a monopolistically competitive market occurs when the market moves to the long run. Since other competitors selling a similar good can enter the market, two changes will occur:

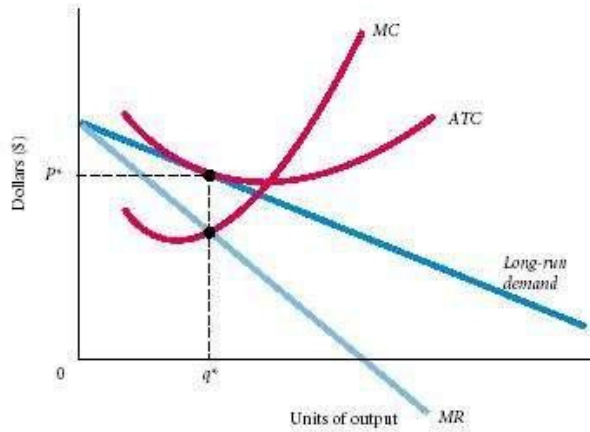
Firm demand will decrease.

Firm demand will become more elastic.

As more firms enter the market, the demand for any one firm will decrease, since the firm is now sharing the market with other firms.

A decrease in demand implies a leftward shift in the demand curve. Since the entering firms are producing substitutes for the existing firm's good, the demand for the existing good will become more elastic. An increase in elasticity implies the demand curve is getting flatter. By combining these effects, as a monopolistically competitive market moves from short-run profits to the long run, the firm's demand curve will move to the left and get flatter. Furthermore, the demand curve will

continue to move until there are no more firms entering the market. Firms will stop entering the market when profits are zero.



This occurs when the demand curve just barely touches (i.e., is tangent to) the ATC curve, as shown in the figure above. Once the demand curve is tangent to the ATC curve, the profit-maximizing price is equal to the average total cost, and thus, profits are zero. In the long run, competition will drive monopolistically competitive markets to make zero profits. The goal of the firm is to try to maintain as much short-run profit as possible by differentiating its product. Eventually, though, in the long run, economic profits will be zero.

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