

SECONDARY SCHOOL IMPROVEMENT PROGRAMME (SSIP) 2021



GAUTENG PROVINCE
EDUCATION
REPUBLIC OF SOUTH AFRICA

GRADE 12



SUBJECT: ECONOMICS SATURDAY CLASSES
TERM 2

LEARNER SOLUTIONS

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SESSION 13: MICROECONOMICS – PERFECT MARKET-PART 2**SECTION A: TYPICAL EXAM QUESTIONS****PERFECT MARKETS****QUESTION 1: Section A – Short Questions****(Taken from various sources)**

1.1 Various options are provided as possible answers to the following questions. Choose the answer and write only the letter (A–D) next to the question number.

- 1.1.1. C ✓✓ (average variable)
- 1.1.2. A ✓✓ (MR=AR)
- 1.1.3. C ✓✓ (Horizontal)
- 1.1.4. B ✓✓ (price)
- 1.1.5. C ✓✓ (TR>TC)
- 1.1.6. C ✓✓ (Only fixed)
- 1.1.7. C ✓✓ (variable cost)
- 1.1.8. A ✓✓ (supernormal profit)
- 1.1.9. B ✓✓ (collusion)
- 1.1.10. D ✓✓ (consumers can anticipate price changes)

1.2 Choose a description from COLUMN B that matches the item in COLUMN A. Write only the letter (A – I) next to the question number (1.2.1 – 1.2.8) in the ANSWER BOOK, for example 1.2.9 J.

1.2.

- 1.2.1. B ✓ (international commodity is exchanged in this market)
- 1.2.2. A ✓ (at all points where TC is above TR)
- 1.2.3. E ✓ (is a price taker and sells goods at the market price)
- 1.2.4. F ✓ (Promote efficiency of the economy)
- 1.2.5. C ✓ (long equilibrium is achieved when individual earn firms earn a normal profit)
- 1.2.6. D ✓ (additional unit of output which is produced as one more unit of the variable)

1.3.

- 1.3.1. Normal profit ✓
- 1.3.2. Competition appeal court ✓
- 1.3.3. Perfect competition ✓
- 1.3.4. Normal profits ✓
- 1.3.5. Shutdown point ✓
- 1.3.6. Restrictive trade practices ✓
- 1.3.7. Merges and acquisitions ✓
- 1.3.8. Loss minimising ✓

SECTION B

QUESTION 2: Section B

HINT: When the question requires you to “list” or “name”, you need not write a sentence but merely one or two words. This MUST be done in bullet form. This types of questions are applicable for 2.1.1, 3.1.1 and 4.1.1

- 2.1.1 Name any TWO objectives of anti-monopoly policies. (2x1) 2**
- There should be no restrictions on entry✓
 - Curb the economic power✓
 - Businesses had to become competitive✓
 - New trade agreements ✓
- (accept any other correct relevant response)
- 2.1.2. Give any TWO examples of variable costs of production. (2x1) 2**
- Labour ✓
 - Raw materials ✓
 - Electricity ✓
- (Accept any other correct relevant example) 2 x 1)
- 2.1.3. Name any TWO goals of competition policy (2x1) 2**
- To prevent monopolies and other powerful business from abusing their power ✓
 - To regulate the formation of mergers and acquisitions who wish to exercise market power✓
 - To stop firms from using restrictive practices ✓
- 2.1.4. Name TWO actual shut-down point should take place (2x1) 2**
- $TR < TVC$ ✓
 - $AR > AVC$ ✓
- 2.1.5. List any TWO profits associated with individual business(2x1) 2**
- Economic profits ✓
 - Economic losses✓
 - Normal profits✓
- 2.1.6. Name any TWO features of demand curve for an individual producer in a perfect market. (2x1) 2**
- Marginal revenue✓
 - Average revenue✓

QUESTION 3:

(Taken from various sources)

HINT: This types of questions are applicable for 2.1.2, 3.1.2 and 4.1.2

- 3.1.1. How would perfect markets disadvantage consumers? (1x2) 2**
- By limiting the variety of consumer goods ✓✓
 - By exposing consumers to lower the quality of goods ✓✓
- 3.1.2. Why are individual market participants in a perfect market insignificant to the market as a whole? (1x2) 2**
- They don't have control over prices ✓✓
 - Large amount of competition exists ✓✓
- 3.1.3. How can economic profit increase in a perfect market? (1x2) 2**
- Revenue can be increased by rising prices or selling additional goods and services. ✓✓
 - It is also possible for a firm to offset capital costs by choosing investments that earn more than their associated capital charges ✓✓
 - Capital costs can be minimized in several ways, including increasing economies of scale ✓✓
- 3.1.4 How does the Competition Commission policy regulate competition in South Africa? (1x2) 2**
- The Commission is empowered by the Competition Act to investigate, control and evaluate restrictive business practices, abuse of dominant positions and mergers in order to achieve equity and efficiency in the South African economy ✓✓
- 3.1.5 What is the relationship between short run and long run costs? (1x2) 2**
- Short Run and Long Run Costs. Long run costs have no fixed factors of production, while short run costs have fixed factors and variables that impact production. ✓✓

Data Response

HINT: All section B questions have TWO data interpretation questions – each total 10 marks. Section B consist of Questions 2-4 not as numbered in this document

QUESTION 4:

Study the graph below and answer the questions that follow

- 4.1 Identify the shutdown point from the graph above. (1)
- Point B ✓
- 4.2 Mention ONE feature which shows that the above graph is of a single firm? (1)
- Horizontal demand curve ✓
- 4.3 Briefly describe the term *marginal cost*. (2)
- Marginal cost is the amount by which total costs increases when one extra product is produced. ✓✓
- 4.4 Explain the reason for a perfect market to make normal profit in the long run? (2)
- Firms make a normal profit in a long-run because many new businesses enter the market which results in the decrease in the market price, thus decreasing profits. ✓✓
- 4.5 Why is the rising part of the MC above point B is the supply curve? (2x2) (4)
- The price of the product is determined using demand and supply curves. ✓✓
 - The MC curve is used to determine the quantity of goods the supplier is willing to produce. ✓✓

QUESTION 5:

Study the graph below and answer the questions that follow.

- 5.1 Identify the market structure represented by the graph above. (1)
- Perfect market ✓
- 5.2 What is the area labelled (A) on the graph above called? (1)
- Economic loss ✓
- 5.3 Briefly describe the term *economic loss*. (2)
- If the price is below the AC per unit and TR is less than TC, then the firm makes an **economic loss** ✓✓
- 5.4 Why do businesses in the perfect market structure only make economic profits in the short term? (2)

- In the long run, new firms/businesses would enter the market and competition rises and profits would therefore as a result shrink/ reduce ✓✓

5.5 Calculate the total economic loss competition by the business above. (SHOW ALL YOUR CALCULATIONS) (4)

Total costs: Cost per unit x Total unit sold
 $R25 \times 10$ (units)
 Cost = R250 ✓
 Total Income = Price per unit x Total units sold
 $= R20 \times 10$ (units)
 Revenue = R200 ✓
 Therefore Total economic Loss = R200 – R250
 $= -R50 / R50$ (loss) ✓✓

(Accept any other correct method used to calculate the total economic loss)

QUESTION 6:

Study the extract below and answer the questions that follow.

6.1 Name the institution that investigates anti-competitive behaviour of companies in South Africa. (1)

- Competition commission ✓

6.2 Which anti-competitive conduct was investigated (1)

- Cartel ✓
- Price leadership ✓
- Collusive activities ✓

6.3 Briefly describe the term *patent right* (2)

- Gives the patent holder the exclusive right to produce a product for as long as the patent rights are valid ✓✓

6.4 What corrective measures can be instituted against companies if they were found guilty of collusion (2)

- Companies can be fined large sums of money ✓✓
- A firm can be warned not to repeat an offence ✓✓

6.5 How can the collusive behaviour of these glass companies affect the economy? (2x2) (4)

- Lead to reduction of competition ✓✓
- Higher prices will be paid by the consumer ✓✓
- If market is not competitive firms benefit from higher prices and high profits ✓✓
- If the market is competitive, firms will end up with low prices and low profits ✓✓

QUESTION 7

Study the extract below and answer the questions that follow

- 7.1 In which market do we find “efficiencies in the movement of people and goods” (1)
- Perfect market ✓
- 7.2 Name the product associated with market illustrated in the extract (1)
- Homogenous ✓
- 7.3 Briefly describe the *equilibrium theory* (2)
- a perfect market will reach an equilibrium where the quantity supplied equals the quantity demanded at the market price. ✓✓
- 7.4 Why there is no transportation cost in perfect competition? (2)
- The goods are produced and sold locally, therefore the firms need not to incur any transportation cost to transport the finished product from one part of the market to another. ✓✓
 - All firms have equal access to the market ✓✓
- 7.5 Explain the significance of the factors of production mobility? (4)
(2x2)
- Mobility of factors of production do facilitate the movement of factors production from surplus areas to deficit areas ✓✓
 - Mobility of factors of production enables the benefits of economic growth of a country to spread evenly throughout ✓✓
 - Mobility of factors of production equally enables the transfer of expertise to areas where it is efficient and in demand ✓✓

HINT: All section B questions have TWO 8 marks questions, numbered according to questions not like in this document.

QUESTION 8**Paragraph type questions – Middle Cognitive**

- 8.1 Explain the goals of the South African competition policy. (4x2) 8**
- Prevents the abuse of economic power, e.g. forming of monopolies ✓✓
 - Regulates the growth of market power by means of mergers and takeovers ✓✓
 - Prevents restrictive practices, especially by oligopolists such as fixing of selling prices, collusion and price discrimination
 - Improves the efficiency in the market through legislation ✓✓
 - Promotes healthy competition between businesses ✓✓
 - Protects the consumer against unfair prices and inferior products for example through Competition Act ✓✓
 - Contributes to South Africa's development objectives to ensure that all South Africans have equal opportunities to participate fairly in economic activities ✓✓
 - They also improve equity in the market for example through EEA/enable SMME's ✓✓
- (Accept any other correct relevant response)
- 8.2. Differentiate between the nature of the product and market entry as characteristics of perfect competition. (4x2) 8**
- Nature of the product
- All products sold at a specific market are homogeneous /standardized ✓✓
 - It makes no difference to a buyer where and from whom to buy ✓✓ (2 x 2)
- Market entry**
- There is complete freedom of entry and exit ✓✓
 - The market is fully accessible ✓✓ (2 x 2)
- 8.3 Discuss objectives to promote competition act in South Africa. (4x2) 8**
- Enable SMMEs to participate in the economy ✓✓
 - To allow previously disadvantaged to increase their ownership of business ✓✓
 - Encourage South Africa's to participate in world markets and accept foreign in South Africa ✓✓
 - Provide consumers with competitive prices and a variety of products ✓✓
 - Promote the efficiency of the economy ✓✓

- 8.4 Discuss economic profit and economic loss of a firm in a perfect market (4x2) 8**
- Economic profit is profit that a business makes that is more than the normal profit. ✓✓
 - A business makes economic profit when its revenue is more than all of its costs (explicit and implicit costs). ✓✓
 - Economic profit is also called surplus, extra or excessive profits. ✓✓
 - When an entrepreneur receives economic profits, he actually receives more than necessary, because his remuneration is already included in the normal profit. ✓✓
 - Economic profits don't last long under perfect competition, because these profits will attract more businesses into the industry. ✓✓
 - When the AC curve is **under** $AR = MR = P$, an **economic profit** is made
- Economic losses**
- If the market price falls below the average cost of the individual producer, he will make an economic loss. ✓✓
 - Whether or not a firm will continue producing depends on the level of average revenue (price) relative to the average variable cost of the firm. ✓✓
 - At any price lower than variable cost it will be in the best interest of the firm to shut down. ✓✓
 - Shutdown point occurs at the point where price is equal to average variable cost. ✓✓
 - It is only possible for a business to make a loss in the short run. In the long run, no firm will stay in the industry – there is freedom of exit – they will leave the industry to make an investment somewhere else. ✓✓
- 8.5 Discuss long term equilibrium for the industry and the individual business (4x2) 8**
- The long term equilibrium in the perfect market will be influenced by the entry or exit of individual businesses. ✓✓
 - If the individual business is making a normal profit (breaking even), there is no reason for new businesses to enter the market. ✓✓
 - If the individual businesses are earning economic profits over all costs, new businesses may enter the market, thereby increasing the supply of goods. ✓✓
 - If the individual businesses are making economic losses, some businesses may leave the market. ✓✓
 - Profits are therefore a signal for the entry of new capital (new businesses). The industry will expand, forcing the price down until the profits earned falls to zero. This will be a sign for capital to leave the industry. ✓✓

QUESTION 9 Paragraph type questions – Higher cognitive**9.1 How can government achieve the objectives of the competition act of South Africa (4x2) 8**

The government could achieve competition policy goals by:

- Promoting employment through skills development and training. ✓✓
 - Encouraging local businesses to participate in international competition through tax rebates and subsidies. ✓✓
 - Enabling small businesses to participate in the economy by providing them with financial aid and support. ✓✓
 - Allowing the previously disadvantaged to participate in the economy by implementing policies that promotes their participation. ✓✓
 - Promoting economic efficiency through provision of basic infrastructure to provide basis for economic activities. ✓✓
- (Accept any relevant and correct answer)

9.2 Examine the conditions under which perfect competition successfully operates (4x2) 8

- No firm can influence the market price (price takers) due to a large number of buyers and sellers ✓✓
- Products are identical (homogeneous) ✓✓
- There are no barriers of entry, meaning that there is freedom of entry and exit ✓✓
- Buyers and sellers act independently - no collusion between sellers ✓✓
- No government interference to influence the market – the market is unregulated ✓✓
- Free movement between markets - all factors of production are completely mobile ✓✓
- Both buyers and sellers have full knowledge of all the prevailing market conditions (perfect information) ✓✓

If any of the above conditions are not met, the market is regarded as an imperfect market. ✓✓

9.3 Why it would be in the interest of the firm to continue production even if it makes a loss? (4x2) 8

- The costs that remain constant regardless of the level of output that is produced ✓✓
- Even if there is no production, there will still be fixed cost ✓✓
- As the firm increases production, the fixed costs do not increase they remain the same ✓✓
- These costs can be avoided if the firm shuts down its operations ✓✓
- The level of variable costs will increase. If there is no production variable cost will be ✓✓

(Learners response should be based on the difference between fixed and variable costs)

- 9.4 Explain the derivation of supply curve from cost curves.(4x2) 8**
- An individual businesses' MC curve and AVC curve determine its supply. ✓✓
 - The individual firm's supply curve is the upward-sloping portion of the MC curve that is above the AVC intersection. ✓✓
 - MC always intersects AVC at its lowest point. ✓✓
 - The reason for this is that an individual business will only produce when the price lies above the minimum point on the AVC curve (point S). ✓✓
 - If a business cannot cover its variable costs, it will shut down. ✓✓

SECTION C

HINT: All section C questions have TWO questions 5 & 6 NOT 9 & 10 like in this document. In the examination you will need to answer only one.

QUESTION 10

- **Compare, without graphs, the market structure of a monopolistic competition with that of a perfect market focussing on the following:**
 - nature of the product (8)
 - market information (8)
 - price determination and demand curve (8) (26 marks)
- **Evaluate the importance of the south African competition policy in the operation of marks. (10 marks)**

INTRODUCTION

- a market is an institution/mechanism that brings together the buyers and sellers of a good or service to negotiate about prices and quantities to be traded. ✓✓
- market structure refers to the way markets are organised.
(accept any other correct relevant response) max. (2)

MAIN PART

Nature of the Product

perfect market:

- products sold are homogenous or identical ✓✓
- there is no difference in the products, they are exactly the same in terms of quality and appearance ✓✓
- it makes no difference to a buyer where or from whom to buy the product in a perfect market ✓✓

monopolistic competition:

- products sold are differentiated ✓✓
 - products may be similar but not identical as there may be differences in packaging and ingredients ✓✓
 - the differentiation in products creates a scope for brand loyalty ✓✓
- (accept any other correct relevant response) max. (8)

Market Information

perfect market:

- buyers and sellers have full knowledge of the market conditions ✓✓
- all buyers know what the specific characteristics of the good are, how much to pay, the quality and market opportunities ✓✓
- sellers know the preferences of consumers ✓✓

monopolistic competition:

- market information is incomplete for both buyers and sellers ✓✓
- many brands, enormous variety of products, multiple outlets, diverse location and marginal differences in prices cause a lack of complete information for sellers and buyers ✓✓

(accept any other correct relevant response) max. (8)

Price Determination and Demand Curve

perfect market:

- a perfect competitor cannot determine its prices; it takes the price determined by the market ✓✓
- the price in the market is determined by the intersection of demand and supply, ✓✓ i.e. equilibrium price
- it is therefore a price taker – it takes the price as it is from the market and only changes when the market changes ✓✓
- since it can sell any quantity at the prevailing market price, then the demand curve is perfectly elastic or horizontal ✓✓
- the demand curve is also the price of the products ✓✓

monopolistic competition:

- there is considerable control over the prices of goods and services ✓✓
- it can produce less and charge a higher price ✓✓
- demand curve is downward sloping (negative) moving from left to right ✓✓
- demand curve is relatively elastic and represents the average revenue ✓✓

(accept any other correct relevant response) max. 10

ADDITIONAL PART

competition policy is important in:

- providing consumers with competitive prices and product choice ✓✓
- regulating markets and monopolies in the country thereby preventing monopoly growth ✓✓
- balancing the act of economic transformation that will benefit all South Africans through ownership, participation of SMMEs and employment ✓✓
- declaring practices such as resale price maintenance and horizontal collusion to be unlawful ✓✓
- forcing firms to compete vigorously in terms of prices and quality ✓✓
- fostering restructuring in sectors that have lost competitiveness ✓✓

(accept any other correct relevant response) (5 x 2)(10)

Conclusion

- perfect competition and monopolistic competition are relatively comparable as they have similar characteristics. ✓✓

(accept any other correct relevant higher order conclusion)

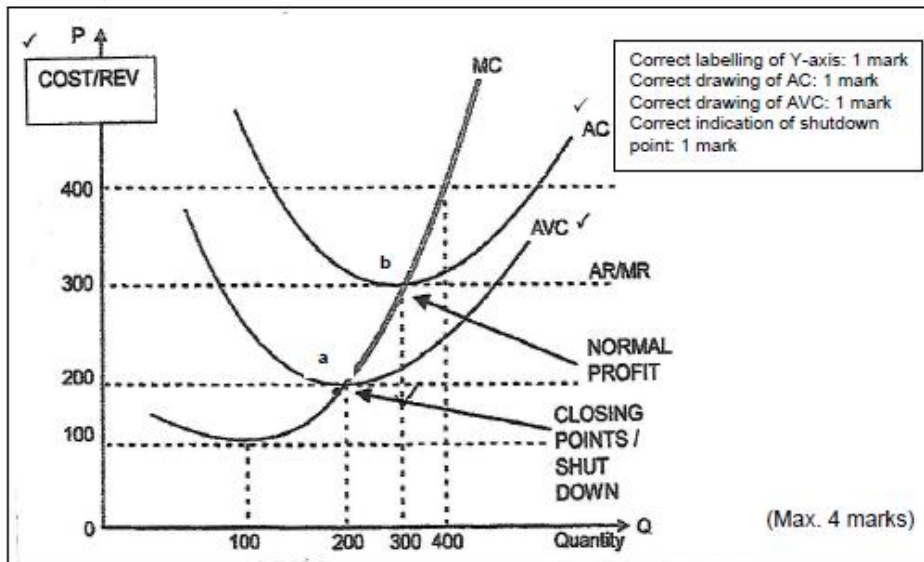
QUESTION 11

- Discuss, with aid of a graph, the shutdown point of a firm under perfect market conditions
- Why is competition in the marketplace good for the economy?

INTRODUCTION

A market is an institution or mechanism that brings together the buyers and sellers of goods or services. ✓✓

MAIN PART



- In determining whether to shut down, a firm should compare total revenue to average AVC variable costs rather than total costs (FC + VC). ✓✓
- If the revenue that the firm is receiving is greater than its average variable cost ($TR > AVC$) then the firm is covering all variable costs, plus there is additional revenue ("contribution"), which can be applied to fixed costs. ✓✓
- (The size of the fixed costs is irrelevant as it is a sunk cost). ✓✓
- The same consideration is used whether fixed costs are R1 or R1 000 000. ✓✓
- On the other hand, if $AVC > TR$ then the firm is not even covering its production costs and it should shut down immediately. ✓✓

The Shut-down Rule

- In the short run, a firm that is operating at a loss (where the revenue is less than the total cost or the price is less than the unit cost) it must decide to operate or temporarily shut-down. ✓✓
- The dark part of the marginal cost curve represents the supply curve of the business. ✓✓
- The supply curve starts at point (a) (shutdown-point) and slopes upward from there due to the marginal cost (MC) which increases as output increases. ✓✓
- At a market price of R200 the business is only able to pay its variable costs (VC). ✓✓
- If the market price drops below R200 the business will be forced to close down and this point (a) is known as the shutdown-point. ✓✓
- At point (b) (output 300), the firm is making a normal profit because $AR = AC$. ✓✓
 - However, the loss is minimised because the firm produces where $MR = MC$. ✓✓ (Max. 26 marks)

ADDITIONAL PART

Competition in the marketplace is good for the economy, because:

- If firms compete with each other, consumers get the best possible prices, quantity and quality of goods and services. ✓✓
- Low prices and good quality products will lead to an increase in aggregate demand. ✓✓
- As a result, firms will expand and produce more goods and services and boost the economy in general. ✓✓
- Competition encourages firms to invent low cost manufacturing processes, which can increase their profits and help them to compete internationally. ✓✓
- It can also encourage business opportunities and improve a country's performance. ✓✓
- Competition can also lead to higher productivity and efficiency in the market. ✓✓

(Accept any other correct relevant response.) (10 marks)

CONCLUSION

- The individual firm maximises profit where the marginal revenue (MR) equals marginal cost (MC), provided that the average revenue (AR) is sufficient to cover the average variable costs (AVC). ✓✓

(Accept any higher order conclusion.) (2 marks) [40]

QUESTION 12

- **Compare the market structure of monopolistic competition with that of a perfect competitor. (26 marks)**
- **with a well labelled graph, explain why the business will stop producing output at the shut-down point. (10 marks)**

INTRODUCTION


- A market structure is a framework of how a market is organized ✓✓
 - Monopolistic is a market structure with many buyers and sellers where entry is relatively easy but the product is differentiated ✓✓
 - Perfect competition is a market structure with many buyers and seller ✓✓
- (Accept any other correct relevant introduction) (Max. 2)

BODY

MAIN PART

CRITERIA	Perfect Competitor	Monopolistic Competition
Number of businesses	The number of seller is so large that individual participants are insignificant in relation to the market as a whole ✓✓, e.g. securities exchange or fresh produce market. ✓	A large number of sellers are active in the monopolistic competitive market ✓✓, e.g. producers of cleaning materials, toothpaste, soap, cold drinks, etc. ✓
Output	The demand curve for the perfect competitor is horizontal. ✓✓	The demand curve is downward sloping. ✓✓

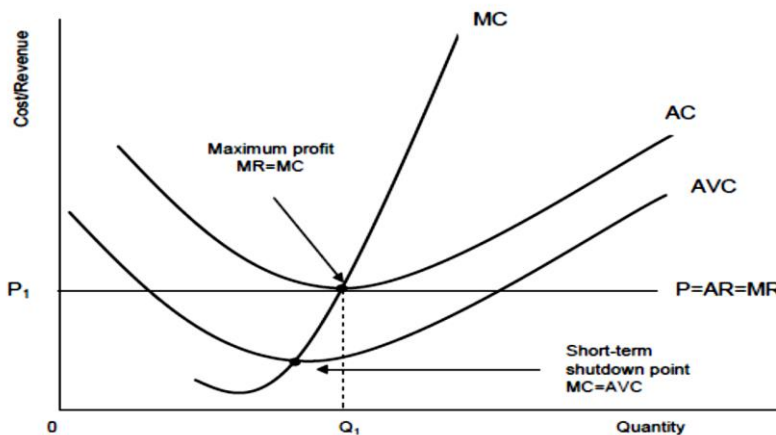
CRITERIA	Perfect Competitor	Monopolistic Competition
Profit	The firm can realise economic profits in the short-term but only normal profit in the long term under conditions of perfect market. ✓✓	The firm can realise economic profit in the short-term as well as in the long term in the monopolistic competitive market. ✓✓
Marketing	There is no need for marketing strategy due to perfect market knowledge. ✓✓	Marketing strategy is applied in the monopolistic competitive market. ✓✓ Deliberate advertising campaign is launched to create brand loyalty. ✓✓
Nature of the product	Homogeneous e.g. maize ✓	Products are heterogeneous. E.g. they differ slightly in terms of appearance, shape, size and taste. ✓✓
Market knowledge	Both buyers and sellers have complete knowledge about prevailing market conditions. ✓✓ It is assumed that buyers and sellers instinctively know, e.g. quantities, price at which the product is sold. ✓✓	Market information is not complete. The many brands, variety of products or marginal differences cause a lack of information for sellers and buyers. ✓✓
Entry	Completely free ✓ Entry into the market is completely free ✓✓	Easy and free. There are no barriers such as licenses, or permits. ✓✓

(Accept any other relevant fact)  (Maximum of 8 marks for mere listing or phrases, and examples) Learners must be encouraged to write in full sentences (Max. 26)

HINT: LEARNERS MUST WRITE IN FULL SENTENCES, EVEN IF IT IS IN TABLE FORM

ADDITIONAL PART

ADDITIONAL PART



Mark allocation	
Axes	1 mark
Correct intersection of MC and AVC	1 mark
Cost curves	1 mark
P=AR=MR	1 mark
Indication MR=MC	1 mark
Indication of shut-down point	1 mark
	6 marks

- A firm will shut down if it cannot meet its average or total variable costs ✓✓
- The firm will not produce here because $AR < AVC$ ✓✓
- The firm will not keep on producing from the shut-down point down because the firm cannot meet its operational cost ✓✓
- Below the shut-down point, the firm will not sell any goods. A firm will sell goods if the price is above the shutdown price level (supply curve) ✓✓

Any (2 x 2)
(Max. 10)

CONCLUSION

While perfect does not exist, it serves as a standard that imperfect markets such as monopolistic competition should strive to achieve. ✓✓

(Accept any other relevant conclusion)

(Max. 2)

[40]

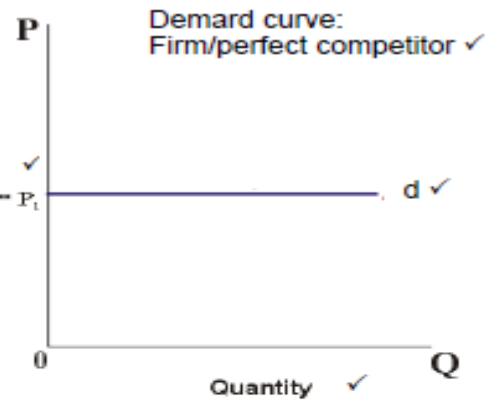
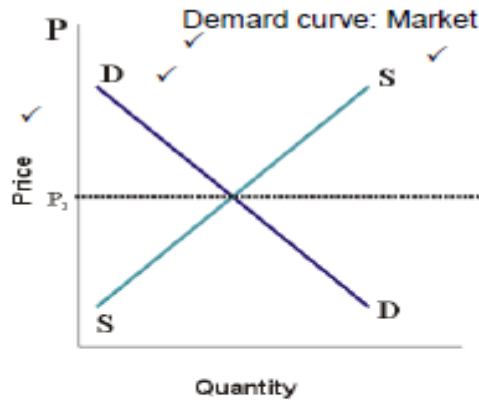
QUESTION 13

- **Make use of graphs to discuss perfect competition under the following heading:**
- **a comparison of the demand curve of the individual producer and industry**
- **Explain why an individual business will not increase its price in a perfect market**

INTRODUCTION

An industry consists of all the firms that produce the same product where the output of an industry is the sum of the output of its individual firms. ✓✓

BODY: MAIN PART



Mark allocation	
Labelling of axes	1 mark
Drawing and labelling of demand curve	1 mark
Drawing and labelling of supply curve	1 mark
Indication of P ₁	1 mark
Heading	1 mark
Max. 5	

Mark allocation	
Labelling of axes	1 mark
Drawing and labelling of demand curve	1 mark
Heading	1 mark
Max. 3	

The industry/market	The firm/perfect competitor
<ul style="list-style-type: none"> Industry refers to the different businesses together that produce or supply the same product. ✓✓ For example, all farmers who produce milk will then form part of the milk industry. ✓ The industry is also called the market. ✓✓ The price is not determined by individual businesses but by the forces of demand and supply. ✓✓ The demand curve for an industry has a negative slope that slopes from top left to bottom right. ✓✓ DD is the original demand curve. ✓✓ At a price of P₁, demand and supply are equal. This is the market price which should be charged by the individual businesses. ✓✓ The industry has a downward-sloping demand curve. ✓✓ 	<ul style="list-style-type: none"> An individual business is a single producer of a specific product such as milk, clothing or furniture. ✓✓ The alternative term for an individual business is a firm. ✓✓ The firm depend on the industry for the price that it will charge. ✓✓ The individual business has a horizontal demand curve ✓✓ Under conditions of perfect market it is true to say that Price = AR =MR. ✓✓ The individual business sells its product at the market price that is determined through the interaction of demand and supply. ✓✓ The individual business is a price-taker in a perfectly competitive market. ✓✓

[Graphs Maximum of 8 marks explanation 18 marks)

(Max. 26)

ADDITIONAL PART

Explain why an individual businesses will not increase its price.

- Therefore, the demand curve of the individual business is completely elastic. ✓✓
- There will be a demand as long as the business charges the market price for its products. ✓✓
- If the business tries to sell its products at a price above the market price there will be no demand since all participants have perfect knowledge. ✓✓
- Consumers know the existing market price and make their decisions according to that. ✓✓
- The business will not attempt to sell its products at a price lower than the market price since the business will not be able to maximise its profits. ✓✓
- The consumer will buy products from another firm. ✓✓
- Consumers go to where they can find the best price. ✓✓ **(Max. 10)**

CONCLUSION

In a perfect market price are determined by forces of demand and supply
On the long run the individual firm will generate normal profit ✓✓



SESSION 15: MONOPOLY- PART 2

SECTION A: TYPICAL EXAM QUESTIONS

MONOPOLIES

QUESTION 1: Section A – Short Questions

(Taken from various sources)

1.1 Various options are provided as possible answers to the following questions. Choose the answer and write only the letter (A–D) next to the question number.

- 1.1.1. C✓✓ (The price that maximizes profit)
- 1.1.2. A ✓✓ (Supernormal profits)
- 1.1.3. C✓✓ (there are extremely large economies of scale)
- 1.1.4. D✓✓ (downward sloping long run average cost curve)
- 1.1.5. B ✓✓ (OB)
- 1.1.6. C✓✓ (AFG)
- 1.1.7. A ✓✓ (equilibrium price is not equal to marginal cost)
- 1.1.8. B ✓✓ (Demand sloping DD curve)

1.2.

- 1.2.1. C✓ (No close substitutes)
- 1.2.2. A ✓ (legal right of a holder to exclusively manufacture a product)
- 1.2.3. E✓ (faces a downward sloping demand curve)
- 1.2.4. D✓ (electricity in South Africa is provided by the government enterprise)
- 1.2.5. G ✓ (cannot be recovered should the firm leave the market)
- 1.2.6. F ✓ (Reduction in economic welfare caused by a reduction in both consumer and producer surplus)

1.3.

- 1.3.1. Copyright ✓
- 1.3.2. Natural monopoly ✓
- 1.3.3. Patent✓
- 1.3.4. Predatory pricing ✓
- 1.3.5. Deregulation ✓
- 1.3.6. Barriers to entry✓

SECTION B

QUESTION 2:

HINT: When the question requires you to “list” or “name”, you need not write a sentence but merely one or two words. This MUST be done in bullet form. This types of questions are applicable for 2.1.1, 3.1.1 and 4.1.1

- 2.1.1 Name TWO main groups of monopolies. (2x1) 2**
- Natural monopolies ✓
 - Artificial ✓
- 2.1.2 List any TWO characteristics of monopolies (2x1) 2**
- They are no close substitutes ✓
 - Products are differentiated and unique ✓
 - Large amounts of starting capital ✓
 - Monopolies have legal considerations ✓
 - Price maker ✓
 - There are barriers to entry ✓
- 2.1.3 Name any TWO barriers to entry of monopolies (2x1) 2**
- High start-up cost ✓
 - Patents ✓
 - Government licences ✓
 - Sunk costs ✓
- 2.1.4 Give any TWO examples of variable cost of production (2x1) 2**
- Labour ✓
 - Raw materials ✓
 - Electricity ✓
- 2.1.5 Name any TWO examples of monopoly in South Africa (2x1) 2**
- Eskom ✓
 - Transnet ✓
 - Denel ✓



QUESTION 3:

(Taken from various sources)

HINT: This types of questions are applicable for 2.1.2, 3.1.2 and 4.1.2

- 3.1.1 How do monopolies affect consumers? (1x2) 2**
- Monopolies face inelastic demand and so can increase prices – giving consumers no alternative ✓✓
- 3.1.2 Why are generic pharmaceuticals significantly cheaper than name brand one's economics? (1x2) 2**
- are not protected by patent law, so the lack of barriers to entry and increased competition keep prices down. ✓✓
- 3.1.3 Why the AR and MR curves are two different curves (2x1) 2**
- A monopoly is confronted with a normal market demand curve which slopes downwards from left to right $D = AR$.
 - The percentage increase in quantity demanded is greater than the % decrease
 - in price at all points; therefore, the MR will always lower than AR

- 3.1.4 What determines the optimum production level in a monopoly market? (1x2) 2
- The position of MC and MR where MC=MR
- 3.1.5 How does profit maximisation occur? (1x2) 2
- Profit maximisation occurs when marginal revenue (MR) is equal to marginal cost (MC). ✓✓

Data Response

HINT: All section B questions have TWO data interpretation questions – each total 10 marks. Section B consist of Questions 2-4 not as numbered in this document

QUESTION 4:

Study the picture below and answer the questions that follow

- 4.1 Which market structure is illustrated above (1)
- Monopoly ✓
- 4.2 Name ONE non-price competition which SABC use to generate revenue. (1)
- Advertising ✓
- 4.3 Briefly describe the term *price maker*. (2)
- A producer who has enough market power to influence prices ✓✓
- 4.4 Why state-owned enterprises above are inefficient (2)
- The monopoly pricing creates a deadweight loss because the firm forgoes transactions with the consumers. ✓✓
 - Monopolies can become inefficient and less innovative over time because they do not have to compete with other producers in a marketplace ✓✓
 - In the case of monopolies, abuse of power can lead to market failure. ✓✓
- 4.5 Differentiate characteristic A and B of the market illustrated above (2x2) (4)

ARTIFICIAL MONOPOLY (A)	NATURAL MONOPOLY (B)
<ul style="list-style-type: none"> • Here the barriers to entry are not economic in nature. ✓✓ • An example of a barrier is a patent. ✓ • A patent is a legal and exclusive right to manufacture a product, ✓✓e.g. Denel Land Systems manufacturing Casspirs. ✓ • Licensing is another way in which an artificial monopoly is applied. ✓✓ • In South Africa licenses are required for radios, TV broadcasters, etc. ✓✓ • Licenses protects operators against entry of competitors. ✓✓ 	<ul style="list-style-type: none"> • High development costs prevent others from entering the market and therefore the government supplies the product. ✓✓ • E.g. Electricity in South Africa is provided by the government enterprise, Eskom. ✓✓ • It costs billions of rands to build and maintain power stations and therefore there are no other suppliers. ✓✓ • A single business (Eskom) can serve the whole market at a lower price than two or more businesses together. ✓✓ • Such a business is frequently owned or regulated by the government. ✓✓

QUESTION 5:

Study the table below and answer the questions that follow.

- 5.1 Give formula for calculating total revenue (1)
- $TR = \text{Price} \times \text{Quantity}$ ✓
- 5.2 At which level of output is the firm maximizing revenue? (1)
- Unit 6 ✓
- 5.3 Briefly describe the term *marginal revenue*. (2)
- Extra revenue received for every additional unit sold ✓✓
- 5.4 Explain how monopolists determine the production level (2)
- The monopolist first determines the price and then the quantity it wants to sell ✓✓
 - By reducing the price, monopolists will sell more units of the product and vice versa ✓✓
- 5.5 Use the information above and calculate average revenue for unit 3. (4)
- $AR = TR / \text{Units}$ ✓
 $= 24 / 3$ ✓✓
 $= R8$ ✓

QUESTION 6:

Study the graph below and answer the questions that follow.

- 6.1 Identify the market price of the monopoly depicted above. (1)**
- R20✓
- 6.2 Name ONE characteristic of marginal revenue. (1)**
- The extra unit sold provides an additional revenue✓✓
 - The change in income, divided by the change in quantity thus income decreases✓✓
- 6.3 Briefly describe the term *price discrimination* (2)**
- The practice of charging different prices to different consumers for the same goods and services✓✓
- 6.4 How can monopolies advance technology? (2)**
- Investing in the latest/update technology for more cost efficiency ✓✓
 - To implement more efficient production systems, such as robots in factories/mechanisation ✓✓
 - Public entities must invest in modern equipment such as more efficient power stations✓✓
- 6.5 Why does the graph above depict a profit situation? (4)**
- The LAC curve (point B) is situated lower than the average revenue (point C) on the graph. ✓✓
 - The revenue of the monopoly (R 20) is more than the cost (R 10) ✓✓
 - The monopoly makes an economic profit between B/C/R 10/R 20)/Shaded area. ✓✓
- (Accept any other correct relevant response.)

QUESTION 7

Study the cartoon below and answer the questions that follow

- 7.1 Which commission was established to ensure that the level of competition in the economy is not eroded but enhanced? (1)**
- Competition commission ✓
 - Competition Appeals Court ✓
 - Competition tribunal ✓
- 7.2 Mention any ONE advantage of competition (1)**
- Lower prices ✓
 - Higher output with a greater variety of goods ✓
 - Increased quality of goods ✓
- (Accept any other correct relevant response)

- 7.3 Briefly describe the term *monopoly* (2)
- A market structure where there is only one supplier of a product or service with no close substitutes ✓✓
- 7.4 Why are the monopolists, being the only suppliers of their products not always making an economic profit? (2)
- The profitability of a monopolist depends on the demand of the product ✓✓ **OR** the cost of production incurred in the production of their products ✓✓
- 7.5 What economic benefits would the destruction of the anti-competition practices have on the entire economy? (2x2) (4)
- Improvement in innovation, research and development by businesses ✓✓
 - Increased use of technology to improve and outcompete rival businesses producing similar products ✓✓
 - Improved marketing and advertising strategies to outclass competing companies ✓✓
- (Accept any other correct relevant response)

QUESTION 8

Study the graph below and answer the questions that follow.

- 8.1 Identify the quantity where the optimum production level will take place (1)
- 50 ✓
- 8.2 What type of market is illustrated above? (1)
- Monopoly ✓
- 8.3 Briefly describe the term *natural monopoly* (2)
- High development costs prevents others from entering the market e.g. electricity provision(Eskom) ✓✓
- 8.4 Explain why the marginal revenue (MR) curve will always lie below the demand curve (DD) in this type of market. (2)
- The negative sloping demand curve means that more goods are sold at low prices, hence additional revenue will decrease as more goods are sold. ✓✓
- (Accept ant other correct relevant response)
- 8.5 Calculate the profit or loss of this market. Show ALL calculations. (2x2) (4)

Unit profit: $150 - 100 = R50$ ✓
 Total profit: 50×50 ✓
 = R2 500 ✓✓
 OR

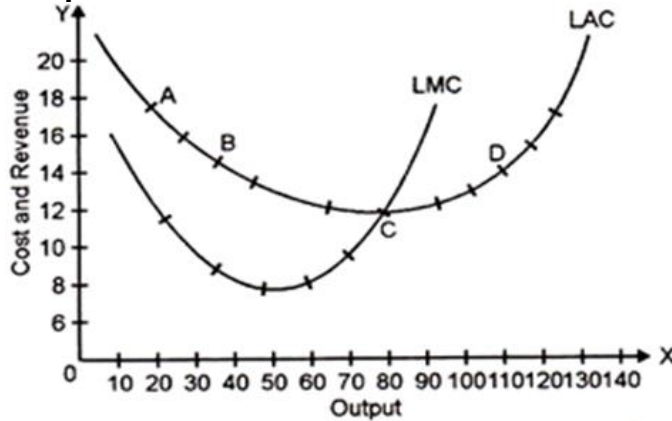
TR-TC
 (150×50) ✓ - (100×50) ✓
 R7 500 - R5 00 ✓
 R2 500 Profit ✓

HINT: All section B questions have TWO 8 marks questions, numbered according to questions not like in this document.

QUESTION 9

Paragraph type questions – Middle Cognitive

9.1 Illustrate with aid of diagram why Average Cost Curve is “U” Shaped? (4x2) **8**



- The Average Costs are high at low levels of output because both the Average Fixed Costs and Average Variable Costs are more as the level of output increases. ✓✓
- The Average Costs fall more sharply due to the combined effect of the declining average fixed and Average Variable Costs. ✓✓
- This results from the use of indivisible factors and the reaping of internal economies of labour, technical, managerial, marketing etc. ✓✓
- The Average Cost will continue to fall till they reach the minimum point which is the optimum point level of output. Once the optimum level of output is reached, Average Costs starts rising as more are produced beyond this level. ✓✓
- The rise in Average Variable Cost is more than off set by the small fall in Average Fixed Costs and hence the Average Costs rises quickly. This is due to the change of economies into dis-economies. This gives the short-run as well as long-run Average Cost Curve of the firm IP shaped. ✓✓
- The nature ‘U’ shaped short-run Average Cost curve can be attributed to the law of variable proportions. ✓✓ This law tells that when the quantity of one variable factor is changed while keeping the quantities of other factors fixed, the total output increases with an increasing rate and then declines with more than proportionate. ✓✓

- Thus, the Average Costs of the firms continue to fall as output increases because it operates under the increasing returns due to various internal economies. ✓✓ Due to the operation of the law of increasing returns the firm is able to work with the machines to their optimum capacity and as a consequence the Average Cost is minimum. ✓✓

9.2 Explain the revenues of a monopoly (4x2) 8

- Any point on the demand curve (D) represents the amount of the unique product that will be sold and at what price it will be sold. ✓✓
- Therefore, the monopolist's demand curve is also his average revenue curve (AR). ✓✓
- Total revenue (TR) is calculated by repeatedly multiplying the price (P) by the amount (Q). ✓✓
- Marginal revenue (MR) reflects the changes in total revenue that result from selling one additional unit of the product. ✓✓

9.3 Distinguish between short-run profits and long run equilibrium. (4x2) 8

Short-run profits and losses

- If a monopolist wants to sell more goods, he would have to lower his prices. ✓✓
- In the short-run, the monopoly firm can make economic profits, normal profits or economic losses. It is possible but unlikely that a monopoly makes an economic loss. ✓✓

Long-run equilibrium

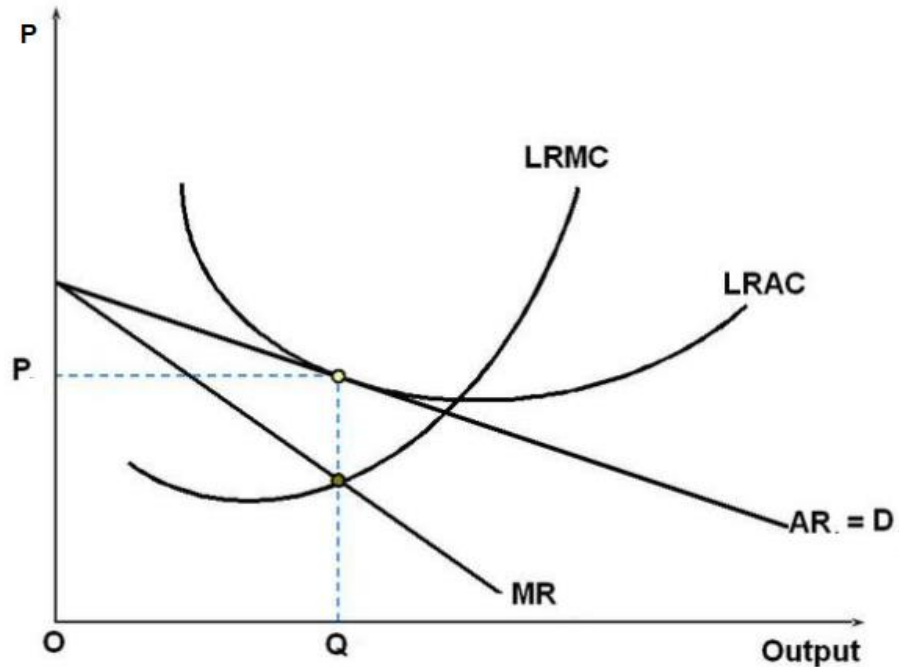
- The monopolist strives to make a maximum profit, like any other business, and will therefore increase his output until $MR = MC$. It will charge the highest price per unit at which this quantity of output can be sold. ✓✓
- In the long-run, a monopoly can make economic or normal profits only. ✓✓

9.4 Discuss types of monopolies in South Africa. (4x2) 8

- Legal monopoly✓ – It is based on laws preventing other companies from competing (State monopoly). ✓✓
- Local monopoly✓ – A local monopoly will control the market in a particular area or town, e.g. if there is only one petrol station. ✓✓
- Natural monopoly – This arises in industries where economies of scale are so large that a single business can supply the entire market, ✓✓ e.g. electricity. ✓
- Horizontal monopoly✓ – This occurs when a parent company takes control over several smaller companies, e.g. Naspers in the printing business. ✓✓
- Vertical monopoly – This occurs when 1 firm will supply and produce the product, e.g. Eskom.

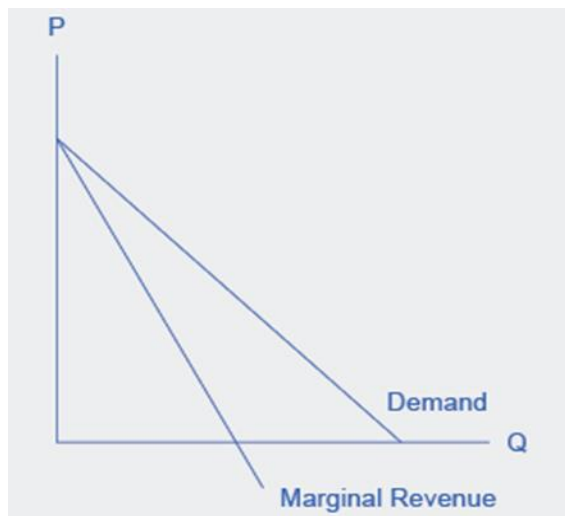
- Coercive monopoly ✓ – This occurs as a result of any activity that violates the principles of a market economy. ✓✓

9.5 Explain the long-run equilibrium position with the aid of a graph. (4x2) 8



- In the long run, a firm in a monopolistic competitive market will produce the amount of goods where the long run marginal cost (LRMC) curve intersects marginal revenue (MR). ✓✓
- The price will be set where the quantity produced falls on the average revenue (AR) curve. ✓✓
- The result is that in the long-term the firm will break even. ✓✓

9.6 With aid of graph explain the marginal revenue curve of the monopoly. (4x2) 8



- As output increases, marginal revenue decreases twice as fast as demand, so that the horizontal intercept of MR is halfway to the horizontal intercept of demand. ✓✓
- Because the market demand curve is conditional, the marginal revenue curve for a monopolist lies beneath the demand curve. ✓✓

QUESTION 10 Paragraph type questions – Higher cognitive

10.1 How is equilibrium under monopoly different from equilibrium under perfect competition? (4x2) 8

- under perfect competition, equilibrium is possible only when marginal cost is rising at the point of equilibrium, but monopoly equilibrium can be reached whether marginal cost is rising, remaining constant or falling at the equilibrium output. ✓✓
- Under perfect competition average revenue curve is a horizontal straight line and therefore marginal revenue curve coincides with average revenue curve and as a result marginal revenue and average revenue are equal to each other at all levels of output ✓✓
- a perfectly competitive firm tends to be of optimum size in the long run, a monopolist firm stops short of the optimum size. ✓✓
- This is so because it pays a competitive firm to expand production so long as average cost is falling since average revenue and marginal revenue remain constant but it does not pay a monopolist firm to expand production to the minimum point of the average cost curve because it is often not worthwhile for it to do so. ✓✓

- 10.2 How does inefficiency occur in a monopoly? (4x2) 8**
- the firm will set a specific price for a good that is available to all consumers. ✓✓
 - The quantity of the good will be less and the price will be higher (this is what makes the good a commodity). ✓✓
 - The monopoly pricing creates a deadweight loss because the firm forgoes transactions with the consumers. ✓✓
 - The deadweight loss is the potential gains that did not go to the producer or the consumer. ✓✓
 - As a result of the deadweight loss, the combined surplus (wealth) of the monopoly and the consumers is less than that obtained by consumers in a competitive market.
 - A monopoly is less efficient in total gains from trade than a competitive market. ✓✓
 - Monopolies can become inefficient and less innovative over time because they do not have to compete with other producers in a marketplace. ✓✓
- 10.4 Evaluate the existence of natural monopoly in any economy. (4x2) 8**
- Natural monopoly will occur only because of either specific market conditions or because of a unique product. It generally occurs without any unfair play or business practices that might stifle rivalry. ✓✓
- Successful**
- It helps to avoid wastage as there cannot be duplication of products or services ✓✓
 - The firm with a natural monopoly is in a good space as it earns substantial amounts as revenues and profits ✓✓
 - Higher profit margins help the company to set up research and development departments that will ultimately prove advantageous to both the firm and the consumers in terms of better products at lower costs. ✓✓
 - A natural monopoly is a source of revenue for a government as the firms have to pay tax to them ✓✓
- Unsuccessful**
- The start-up cost of natural monopoly firms is very high ✓✓
 - Unregulated natural monopolies prove a bad bargain for the customers as they tend to be expensive and often provide poor services like a cable company. ✓✓
 - Lack of rivalry can also lead to outdated and low-quality goods and services ✓✓
- 10.5 Analyse the impact of an economic loss of a monopoly 8**
- Revenue declines which lead to retrenchment of workers in a monopoly company ✓✓
 - The product supplied by the monopoly firm will be at a high demand which will lead to an increase in prices ✓✓

- There are no alternative for the product, therefore some people will be excluded from use of the product ✓✓
- Black markets will appear, and try to satisfy the demand for the product, such as illegal connections for electricity ✓✓
- Due to the limited supply of electricity other companies might suffer, such as SMMEs. Expansion of these SMMEs will not be possible since most of them will be depending with a monopoly ✓✓
- Monopoly firm will increase prices to avoid a completely shut down. ✓✓

QUESTION 11 – ESSAY QUESTION - SOLUTION TO QUESTION 11 MONOPOLY

- With the aid of graphs, discuss how economic profit and economic loss is determined in a monopoly market. (26 marks)
- Why does the performance of natural monopolies contradict (deny) the long-run equilibrium position of a monopoly? (10 marks)
- [40]

INTRODUCTION

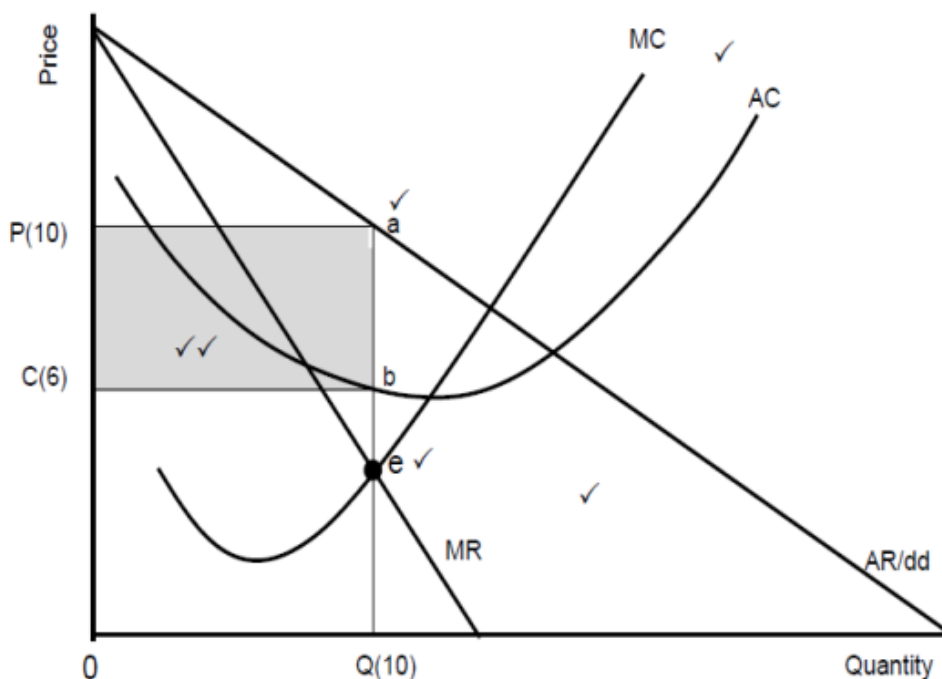
A monopoly is a market structure where only one seller operates. Entry is blocked and the product has no close substitutes ✓✓

(Accept any other correct relevant response)

Max (2)

BODY: MAIN PART

Economic profit



Mark allocation

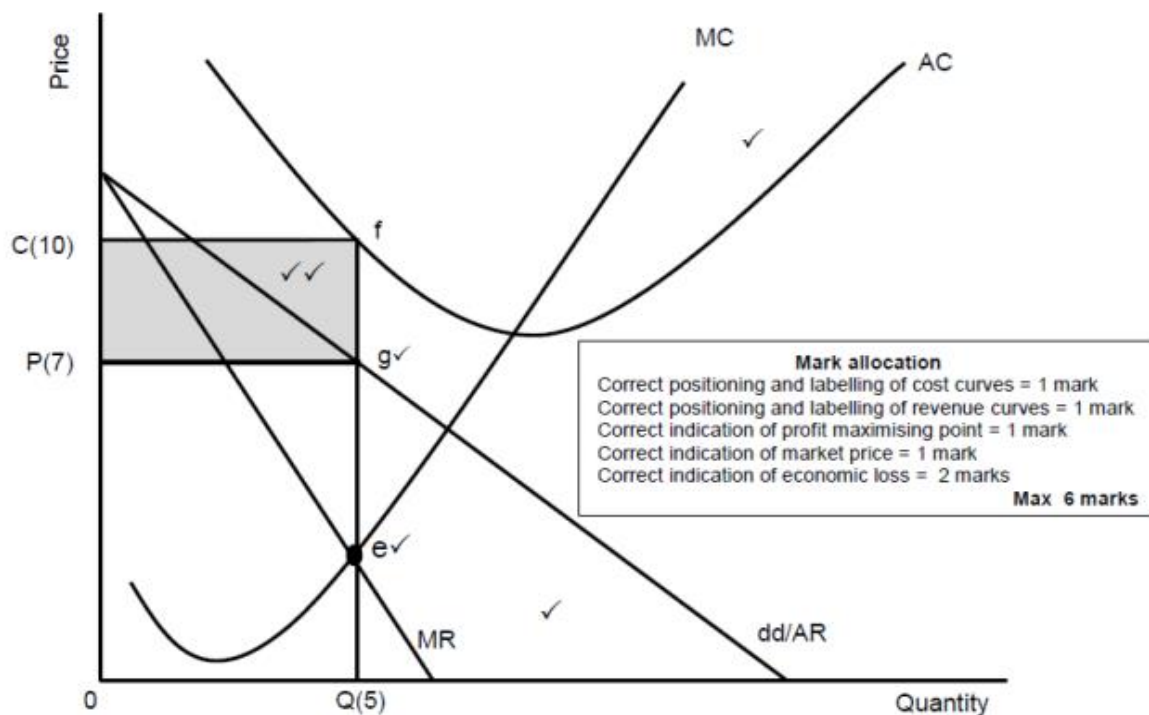
Correct positioning and labelling of cost curves = 1 mark
 Correct positioning and labelling of revenue curves = 1 mark
 Correct indication of profit maximising point = 1 mark
 Correct indication of market price = 1 mark
 Correct indication of economic profit = 2 marks
 Max 6 marks

- Monopoly is subject to same technological and cost constraints as other market structures ✓✓
- The cost structure of the monopoly is the same than that of competitive businesses where the monopolist will try to maximize both short and long-term profit ✓✓
- Location of SAC in relation to market price determines profit or loss ✓✓
- The MR curve lies below the AR curve, halfway between the AR and the origin ✓✓
- The MC curve intersects the AC curve at its minimum point ✓✓
- Determine point where $SMC = MR$ – point where production cost of last unit is equal to revenue it earns (point e) – profit-maximising production quantity of Q on horizontal axis ✓✓
- The monopolist will produce at the output (Q[10]) where $MR=MC$, because it can maximise profit at this level ✓✓
- Point a represents the average revenue at selling price (P[10]) while point b represents the average cost at the cost price (C[6]) ✓✓
- When the average revenue is more than the average cost, it results in an economic profit for the business / When the TR is more than TC it will result in an economic profit for the business ✓✓
- The monopoly makes economic profit when AC curve is below market price (AR) ✓✓
- The monopoly blocks new entries so that competing businesses cannot reduce short run economic profit ✓✓

Total income = Price x Quantity = $OP(10) \times OQ(10) = OPaQ (100)$	} ✓✓
Total cost = Cost x Quantity = $Oc(6) \times OQ(10) = OCbQ (60)$	
Economics profit = Income – Cost = $100 - 60 = CPab (40)$ ✓✓	

(Max 10)

Economic losses



- The minimum point of SAC is higher than market price ✓✓
- A monopoly makes an economic loss when its revenue is less than its costs ✓✓
- The monopoly will produce at the output level where $MR=MC$, because it can minimise losses at this level ✓✓
- Point g represents the average revenue at selling price (P[7]) while point f represents the average cost at the cost price (C[10]) ✓✓
- The average cost is more than the average revenue, resulting in an economic loss for the business / When the TC is more than TR it will result in an economic loss for the business ✓✓
- The shaded area PCfg shows the economic loss ✓✓
- The monopoly suffers an economic loss in the short run when the AC curve is above the market price (g) ✓✓

$$\left. \begin{aligned} \text{Total income} &= \text{Price} \times \text{Quantity} = OP(7) \times OQ(5) = OPgQ (35) \\ \text{Total cost} &= \text{Cost} \times \text{Quantity} = OC(10) \times OQ(5) = OCfQ (50) \\ \text{Economic loss} &= (PCfg)15 \end{aligned} \right\} \checkmark\checkmark$$

(Max 10)
(Max 26)

ADDITIONAL PART

Why does the performance of natural monopolies contradict the long-run equilibrium position of a monopoly? (10 marks)

Natural monopolies' performances are not always in line with the long-run equilibrium position of a monopoly because:

- compared to a typical monopoly where economic profit always prevails over the long run, natural monopolies do not enjoy the benefits experienced by other monopolies ✓✓

- natural monopolies require high development cost which prevent others from entering the market ✓✓
- natural monopolies supply goods and services to the nation as a whole and therefore it is difficult to set very high prices ✓✓
- Eskom is subjected to the National Energy Regulator in South Africa (NERSA) that determines the selling price of electricity in South Africa ✓✓
- a natural monopoly has experienced high maintenance cost compared to artificial monopolies, that compromises profits ✓✓
- natural monopolies cannot manipulate its quantities to increase prices ✓✓
- revenue seems to be less than cost due to corruption, non-payment by a large number of electricity users ✓✓
- under normal circumstances, a monopoly will shut down if average cost exceeds average revenue in the long run, but natural monopolies like SAA are often bailed out by the government due to its strategic position in the country ✓✓
- the internal (private cost) structure of natural monopolies have increased, but the private benefits (revenue of sales) stagnated due to poor maintenance of infrastructure ✓✓

(Accept any other correct relevant response)

(Max 10)

CONCLUSION

The monopoly can continue to earn economic profit for as long as the demand for its product continues and its production costs stay the same ✓✓

(Accept any other higher order conclusion)

Max (2) [40]



SESSION 17: OLIGOPOLY-PART 2**SECTION A: TYPICAL EXAM QUESTIONS****OLIGOPOLY****QUESTION 1: Section A – Short Questions****(Taken from various sources)**

HINT: When answering Section A – short question, it is important not to rush but to read the questions carefully and to make sure you understand what the question is asking. Always remember one alternative is completely wrong, one is nearly correct and one is totally correct. It is easy to eliminate the completely wrong answer, but if you do not read the question carefully the nearly correct answer will also appear correct. The answer will **NEVER** be two options. Only **ONE** option is correct. Your answer will immediately be marked incorrect if you write **TWO** options.

1.2 Various options are provided as possible answers to the following questions.**Choose the answer and write only the letter (A–D) next to the question number.**

- 1.1.1. C✓✓ (Paul Sweezy)
- 1.1.2. B✓✓ (Oligopoly)
- 1.1.3. C✓✓ (the market for aluminium)
- 1.1.4. A✓✓ (Oligopoly)
- 1.1.5. D✓✓ (kinked demand)
- 1.1.6. A✓✓ (price leadership)
- 1.1.7. D✓✓ (neither a change in output level nor a change in price)
- 1.1.8. B✓✓ (it equals market demand minus demand facing fringe firms)

- 1.2 Choose a description from COLUMN B that matches the item in COLUMN A. Write only the letter (A – I) next to the question number (1.2.1 – 1.2.8) in the ANSWER BOOK, for example 1.2.9 J.

1.2.

- 1.2.1. E✓ (one firm fixes the price and other accept as a market price)
- 1.2.2. C✓ (two firms dominate the market)
- 1.2.3. B✓ (a change in price causes a smaller percentage change in the quantity demanded)
- 1.2.4. A ✓ (collusion that is open and oligopolies meet formally to decide on prices and production)
- 1.2.5. D✓ (doing business over the internet)

1.3.

- 1.3.1. Duopoly✓
- 1.3.2. Oligopoly✓
- 1.3.3. Tacit collusion ✓
- 1.3.4. Kinked demand curve

SECTION B

QUESTION 2:

HINT: When the question requires you to “list” or “name”, you need not write a sentence but merely one or two words. This **MUST** be done in bullet form. This types of questions are applicable for 2.1.1, 3.1.1 and 4.1.1

- | | | | |
|--------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|----------|
| 2.1.1 | Name any TWO forms of non-price competition | (2x1) | 2 |
| | <ul style="list-style-type: none"> • Extended shopping and business hours✓ • Doing business over the internet✓ • After-sales services✓ • Offering additional services✓ • Loyalty rewards for customers✓ • Door-to-door deliveries ✓ | | |
| 2.1.2 | List any TWO well know cartels | (2x1) | 2 |
| | <ul style="list-style-type: none"> • Organisation of Petroleum Exporting Countries (OPEC) ✓ • De Beers diamonds✓ | | |
| 2.1.3 | Name TWO segments of the kinked demand curve | (2x1) | 2 |
| | <ul style="list-style-type: none"> • Elastic slope✓ • Inelastic slope✓ | | |
| 2.1.4 | Name any TWO characteristics of oligopolies | (2x1) | 2 |
| | <ul style="list-style-type: none"> • Homogenous products✓ • Limited competition ✓ • Mutual dependence ✓ • Abnormal high profits✓ • Absolute cost advantage ✓ | | |
| 2.1.5 | Name any TWO types of collusion | (2x1) | 2 |
| | <ul style="list-style-type: none"> • Overformal collusion✓ • Price leadership (tacit collusion) ✓ | | |

QUESTION 3:

(Taken from various sources)

HINT: This types of questions are applicable for 2.1.2, 3.1.2 and 4.1.2

- | | | | |
|--------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|----------|
| 3.1.1 | How does the kinked demand curve explain price rigidity in oligopoly? | (1x2) | 2 |
| | <ul style="list-style-type: none"> • firms fear that any downward revision in price may trigger a price war. This results in significant price rigidity in an oligopoly✓✓ | | |
| 3.1.2 | Why is it difficult to determine a unique demand curve under oligopoly? | (1x2) | 2 |
| | <ul style="list-style-type: none"> • there is a huge interdependence among rivals. ✓✓ | | |

- The rivals can react in different ways when a firm changes its price and that makes the demand curve indeterminate ✓✓
- 3.1.3 Why is collusion desirable to oligopolistic firms? (1x2) 2**
- When there are few firms in the market, they may collude to set a price or output level for the market in order to maximize industry profits. ✓✓
 - As a result, price will be higher than the market-clearing price, and output is likely to be lower ✓✓
- 3.1.4 How do firms compete in the oligopoly market? (1x2) 2**
- Increasing brand recognition and brand loyalty through advertising ✓✓
 - Anticipating trends in markets by developing new products ✓✓
 - Giving some discounts to give impression of good value ✓✓
- 3.1.5 What is the importance of after sale service (1x2) 2**
- It generates loyal customers and increase a brand value ✓✓
 - Customer satisfaction and customer retention ✓✓

Data Response

HINT: All section B questions have TWO data interpretation questions – each total 10 marks. Section B consist of Questions 2-4 not as numbered in this document

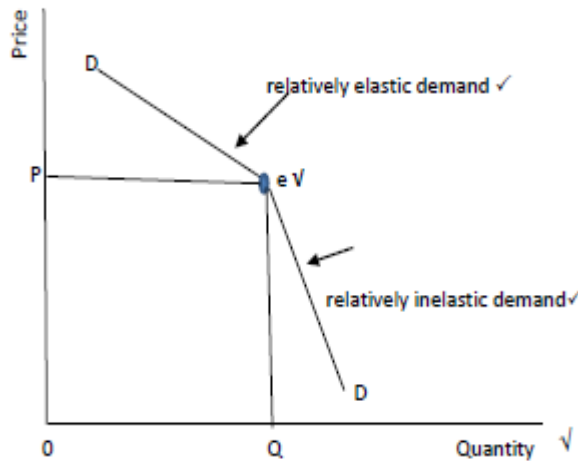
QUESTION 4:

Study the extract below and answer the questions that follow

- 4.1 Name ONE example of barriers to entry in an oligopoly (1)**
- High start-up capital ✓
 - Economies of scale ✓
 - Ownership of raw materials ✓
 - Patents ✓
 - Licences ✓
- 4.2 Give any non-price competition strategy used by oligopolists. (1)**
- Advertising ✓
 - After sales service ✓
 - Efficient service ✓
 - Door to door services ✓
 - Loyalty rewards ✓
- 4.3 Briefly describe the term *oligopolies*. (2)**
- Oligopoly is a market structure where only few sellers operate and sell differentiated products. ✓✓

- 4.4 Explain the tacit collusion by oligopolies (2)
- Oligopolies collude without communicating formally or concluding formal agreements ✓✓
 - A dominant firm (price leader) will increase the price of a product in the hope that its rivals will see this as a signal and do the same ✓✓

- 4.5 With aid of a graph, explain the demand curve of an oligopolist (2x2) (4)



QUESTION 5:

Study pictures below and answer the questions that follow.

- 5.1 Identify a non-price competition strategy above (1)
- Door to door delivery ✓
- 5.2 Which market structure practices non-price competition? (1)
- Oligopoly ✓
- 5.3 Briefly describe the term *non-price competition*. (2)
- Competing on the basis of product differentiation, efficient service and by using advertisements rather on the basis of prices ✓✓
- 5.4 Why are oligopolists reluctant to compete with each other on price in order to get a greater share of the market? (2)
- They act on behaviour of others: if one business increases its price it loses its market share ✓✓
 - When the firm decrease their price, others will follow, and a price war might arise ✓✓

- 5.5 How do restaurants use non-price competition to make their products or service more price inelastic? (4)**
- Extensive use of advertising to provide information, remind consumers and to persuade the consumers to use their services✓✓
 - Offers such as bonus points for use of certain shopping cards, birthday vouchers✓✓
 - Online ordering services ✓✓
 - Extended business hours

QUESTION 6:

Study the graph below and answer the questions that follow.

- 6.1 Name any segment of the kinked demand curve (1)**
- Demand elastic✓
 - Demand inelastic ✓
- 6.2 What is the impact of price rise on kinked demand curve (1)**
- Fall in demand ✓
 - Firms will lose revenue✓
 - Consumers will switch to its rivals ✓
- 6.3 Briefly describe the concept *kinked demand curve* (2)**
- Occurs when the demand curve is not a straight line but has a different elasticity for higher and lower prices✓✓
- 6.4 Why does the kink in the demand curve occur? (2)**
- Because rival firms will behave differently to price cuts and price increases✓✓
- 6.5 How realistic is the kinked demand curve in practice? (4)**
- Petrol stations may increase price and not see elastic demand because they have the best location✓✓
 - Firms may not want to defend market share. Rather than getting pulled into a price war✓✓
 - Mobile phone companies can increase the price but consumers are willing to pay because the price is not dominant factor✓✓

QUESTION 7

Study pictures below and answer the questions that follow

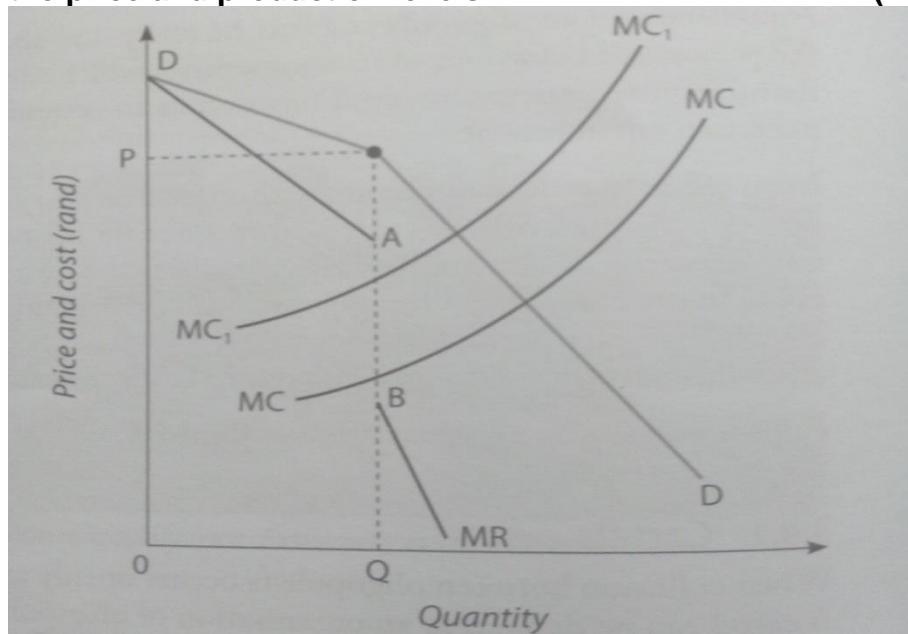
- 7.1 Identify ONE example of firms that use non-price strategies (1)**
- Capitec bank ✓
 - Shell ✓
- 7.2 What type of profit is made with oligopoly in the long run? (1)**
- Economic profit ✓
- 7.3 Briefly describe the concept *price leadership* (2)**
- A situation where one firm fixes a price and the others accept it as the market price. ✓✓
- 7.4 Explain “doing business over the internet” as a form of non-price competition important for firms (2)**
- The internet helps the business to connect with customers communication channels and build a strong network. ✓✓
 - Internet platforms helps the business to get new customers and retain existing customers ✓✓
- 7.5 Why is mutual interdependence important under oligopoly, but not so important under perfect competition and monopoly? (4)**
- The number of oligopoly firms is small, change in price or output by one firm can have direct effect on another firm. Therefore firms will consider the reactions of it competitor in decision making ✓✓
 - In perfectly competitive market, firm are selling homogenous goods and they are price taker. Hence there have so many firm, therefore no one can influence the others
 - Monopoly has only one firm, so there is no opportunities for mutual interdependence ✓✓

HINT: All section B questions have TWO 8 marks questions, numbered according to questions not like in this document.

QUESTION 8

Paragraph type questions – Middle Cognitive

- 8.1 Illustrate the demand curve of the oligopoly clearly showing the price and production levels. (4x2) 8



- This model is based on the assumption that each business believes that if it raises its price others will not follow but if it cuts its price other business will cut theirs. ✓✓
- At prices above P , a small price rise brings a big decrease in the quantity sold. ✓✓
- The other business holds their current price and the business has the highest price for good, so it losses market shares. ✓✓
- At Prices below P , even a large price cut brings only a small increase in the quantity sold. ✓✓
- To maximize profit the business produces the quantity at which marginal cost equals marginal revenue. ✓✓
- If marginal cost fluctuates between A and B like the marginal cost curves MC and MC_1 , the business does not change its price or output. ✓✓
- Only if marginal cost fluctuates outside the range AB does the change its price and output. ✓✓
- Kinked demanded curve model predicts that price and quantity are insensitive to small cost changes. ✓✓

- 8.2 With reference to an oligopoly graph, explain the two elasticity segments of the demand curve (4x2) 8**
- The upper segment of the oligopoly graph is more elastic in nature. ✓✓
 - Any price increases in this segment above the market price will have a large decrease in the quantity demanded (law of demand). ✓✓
 - An oligopoly competitor will lose many sales for any small increase in price. ✓✓
 - If a firm decreases its price, while other firms do not follow, it will face a more inelastic demand curve, which will allow it to increase sales. ✓✓
 - The large price decrease will cause a small increase in the quantity demanded in this inelastic segment. ✓✓
 - The profit obtained by any price decrease is actually less than at the original market price. ✓✓
- (Accept any other correct relevant response.)
- 8.3 Discuss the characteristics of oligopolies (4x2) 8**
- There is limited competition. Only few suppliers manufacture the same product ✓✓
 - Products may be homogenous or differentiated ✓✓
 - This market is characterised by mutual dependence. The decision of one company will influence and will be influenced by the decisions of the other companies ✓✓
 - Oligopolies can frequently change their prices in order to increase their market share ✓✓
 - Extensive use is made non-price measures to increase market share e.g. advertising, efficient service or product differentiation ✓✓
 - Entry is not easy in an oligopolistic market. This is due to brand loyalty and it also requires a large capital outlay ✓✓
- 8.4 Discuss non-price competition strategies for oligopolies. (4x2) 8**
- Non-price competition involves firms distinguishing their products from competing products on the basis of attributes other than price ✓✓
 - Non-price competition involves promotional expenditures ✓✓
 - Trying to improve quality and after sales servicing, such as offering extended guarantees ✓✓
 - Spending on advertising, sponsorship and product placement ✓✓
 - Sales promotion ✓✓
 - Firms will engage in non-price competition, in spite of the additional costs involved, ✓✓
 - because it is usually more profitable than selling for a lower price and avoids the risk of price wars ✓✓

QUESTION 9 Paragraph type questions – Higher cognitive

- 9.1 Explain how SASOL can compete in an oligopolistic market with other petrol-selling companies in South Africa. (4x2) 8**
- They will engage in non-price competition ✓✓ by focusing on some of the following:
- Advertising and marketing ✓ e.g. television and radio ✓
 - Additional services ✓ e.g. convenience stores ✓
 - Branding ✓ SASOL logo ✓ e.g. fuel for cleaner engine ✓
 - Friendly staff ✓ e.g. offer additional services such as tyre-pressure check ✓
 - Clean sanitary facilities ✓ cleaned regularly / additional services e.g. a baby room ✓
 - Competitions ✓ e.g. win a car ✓
 - Collaborate with businesses ✓ e.g. fast-selling food outlets ✓
 - Loyalty rewards for customers ✓ e.g. fill-up to a certain amount, getting a free engine wash ✓
 - Advertise ✓ with and in conjunction with other businesses ✓
 - Account holders ✓ certain companies filling, only pay month-end ✓
- 9.2 Assess the considerations involved in the oligopolists decision about whether to compete or cooperate (4x2) 8**
- Firms in an oligopoly may collude to set a price or output level for a market in order to maximize industry profits. At an extreme, the colluding firms can act as a monopoly. ✓✓
 - Oligopolists pursuing their individual self-interest would produce a greater quantity than a monopolist, and charge a lower price ✓✓
 - Collusive arrangements are generally illegal. Moreover, it is difficult for firms to coordinate actions, and there is a threat that firms may defect and undermine the others in the arrangement ✓✓
 - Price leadership, which occurs when a dominant competitor sets the industry price and others follow suit, is an informal type of collusion which is generally legal. ✓✓
- 9.3 Explain the role of competition and collusion in the formation of cartels (4x2) 8**
- Cartel members cooperate to set industry price and output. ✓✓
 - Game theory indicates that cartels are inherently unstable. Each individual member has an incentive to cheat in order to make higher profits in the short run. ✓✓

- Cheating may lead to the collapse of a cartel. With the collapse, firms would revert to competing, which would lead to decreased profits. ✓✓
- OPEC, the Organization of Petroleum Exporting Countries, provides an example of a historically effective cartel. ✓✓

9.4 Evaluate the impact of cartels on the consumers (4x2) 8
Negative

- Higher prices – cartel members can all raise prices together, which reduces the elasticity of demand for any single member. ✓✓
- Lack of transparency – members may agree to hide prices or withhold information, such as the hidden charges in credit card transactions. ✓✓
- Restricted output – members may agree to limit output onto the market, as with OPEC and its oil quotas. ✓✓
- Carving up a market – cartel members may collectively agree to break up a market into regions or territories and not compete in each other’s territory. ✓✓

Positive

- Assurance of profits – Higher prices means that the businesses will make some profit ✓✓
- Monopoly power – when companies work together then they set their prices high, meaning the individual oligopolists will have power as if they a monopoly . ✓✓
- Marketing economies. ✓
- Production efficiency. ✓
- Ability to withstand business cycles. ✓✓
- Economies of scale, because producers can make products at a much cheaper rate. ✓✓

SECTION C

QUESTION 10

- **Discuss an oligopoly as a market structure (26 marks)**
 - **How do oligopolists compete without using price to increase their market share? (10 marks)**
- [40]**

INTRODUCTION

- The oligopoly is a type of imperfect market in which only a few large producers dominate the market. ✓✓

(Accept any other relevant and correct response)

MAIN PART

Nature of product

- The product may be homogeneous in a pure oligopoly. ✓✓

- If the product is differentiated, it is known as a differentiated oligopoly. ✓✓

Market information

- There is incomplete information on the product and the prices. ✓✓

Market entry

- Market entry is not easy, it is limited in the sense that huge capital outlay might be necessary. ✓✓

Control over price

- Oligopolists have considerable control over price, it can influence price, but not as much as the monopolist. ✓✓
- Oligopolies can frequently change their prices in order to increase their market share and this result in price wars. ✓✓

Mutual dependence

- The decision of one firm will influence and be influenced by the decisions of the other competitors. ✓✓
- Mutual dependence (interdependence) exists amongst these businesses.
- A change in the price or change in the market share by one firm is reflected in the sales of the others. ✓✓

Non-price competition

- Non - price competition can be through advertising, packaging, after-sales services. ✓✓
- Since price competition can result in destructive price wars, oligopolies prefer to compete on a different basis. ✓✓
- Participants observe one another carefully- when one oligopolist launches an advertising campaign, its competitors soon follow suite. ✓✓
- If oligopolies operate as a cartel, firms have an absolute cost advantage over the rest of the other competitors in the industry. ✓✓

Collusion

- Collusion is a strategy used by firms to eliminate competition amongst each other. ✓✓
- It can be in a form of overt collusion where firms can work together to form a cartel and tacit collusion where a dominating business controls the price. ✓✓

Limited competition

- There are only a few suppliers manufacturing the same product. ✓✓

Economic profit

- Oligopolies can make an economic profit over the long term. ✓✓
- Abnormal profits may result to joint decision-making in an oligopoly. ✓✓

Demand curve

- Slope from left down to the right. ✓✓
- It is known as the kinked demand since it contains the upper relatively elastic slope and the lower relatively inelastic slope. ✓✓

(Accept any other relevant and correct response)

(A maximum of 8 marks for sub-headings and examples)

(Max. 26)

ADDITIONAL PART

Oligopolist may increase their market share using non-price competition strategies by:

- branding their product to create an impression that its product is for a particular age group or income group. ✓✓

- aggressive advertising which inform customers about the business or product it provides. ✓✓
- using appealing packaging to bring out important features of their product.
- improving their customer service in order to ensure that they return to their businesses. ✓✓
- providing relevant and precise information, which is crucial to the customers, since there are competitors in the market, customers will patronize the businesses that provides relevant information. ✓✓
- extending shopping hours to the convenience of customers.
- Offering loyalty rewards to customers which will encourage their return to spend accumulated rewards. ✓✓

(Accept any other relevant response)

(Max.10)

CONCLUSION

- In South Africa, oligopolists have been found to be illegally manipulating prices to their benefit, yet to the detriment of consumers and have been penalized for such action. ✓✓

(Accept any other relevant response)



SESSION 19: MONOPOLISTIC COMPETITION – PART 2

SECTION A: TYPICAL EXAM QUESTIONS

QUESTION 1: Section A – Short Questions

(Taken from various sources)

1.1. Various options are provided as possible answers to the following questions.
Choose the answer and write only the letter (A–D) next to the question number.

- 1.1.1. C ✓✓ (monopolistic competition)
- 1.1.2. A ✓✓ (free entry and exit)
- 1.1.3. c ✓✓ (product diversity)
- 1.1.4. A ✓✓ (face downward sloping demand curves)
- 1.1.5. B ✓✓ (will make zero profit)
- 1.1.6. D ✓✓ (there is freedom of entry and exit in the long run)
- 1.1.7. C ✓✓ (MC<ATC)
- 1.1.8. B ✓✓ (Each firms output level is too small to minimize average cost)

1.2

- 1.2.1 B ✓ (is used to differentiate the firm's product)
- 1.2.2 C ✓ (Occurs when sellers focus on their product's features than on price)
- 1.2.3 D ✓ (Type of competition that occurs often in the retail sector of the economy)
- 1.2.4 A ✓ (Occurs when MC = MR)

1.3

- 1.3.1 Advertising ✓✓
- 1.3.2 Monopolistic competition ✓✓
- 1.3.3 Branding ✓✓
- 1.3.4 Collusion ✓✓

SECTION B

QUESTION 2:

HINT: When the question requires you to “list” or “name”, you need not write a sentence but merely one or two words. This MUST be done in bullet form. This types of questions are applicable for 2.1.1, 3.1.1 and 4.1.1

- 2.1.1 Name any TWO examples of monopolistic competition (2x1) 2
- Hotels and pubs ✓
 - Hairdressing (consumer services) ✓

- General specialist retailing ✓
 - Restaurant business ✓
- 2.1.2 Name any TWO dimensions of product differentiation (2x1) 2**
- Products are identical ✓
 - Difference in imaginary ✓
 - Differences in packaging ✓
- 2.1.3 List any TWO brands of fast-food suppliers in South Africa (2x1) 2**
- KFC ✓
 - Chicken Licken ✓
 - Nando's ✓
 - Steers ✓
 - Wimpy ✓
- 2.1.4 Name any TWO general characteristics of monopolistic competition (2x1) 2**
- Differentiated products ✓
 - A hybrid structures ✓
 - Diverse business ✓

QUESTION 3:

(Taken from various sources)

HINT: This types of questions are applicable for 2.1.2, 3.1.2 and 4.1.2

- 3.1.1 Why do some firms in monopolistic competition not earn losses in the long run? (1x2) 2**
- Free exit implies that any unprofitable firms leave the market in the long run. ✓✓
- 3.1.2 Why is the monopolistic competition inefficient? (1x2) 2**
- The firm's profit maximizing output is less than the output associated with minimum average cost ✓✓
 - the firm charges a price that exceeds marginal costs ✓✓
- 3.1.3 Why is excess capacity said to exist in monopolistic competition in the long run? (1x2) 2**
- the firm is said to have excess capacity because it can easily accommodate an increase in production. This excess capacity is the major social cost of a monopolistically competitive market structure ✓✓

- 3.1.4 Why is a perfectly competitive firm more efficient than a monopolistic firm? (1x2) 2**
- In a perfectly competitive market, price equals marginal cost and firms earn an economic profit of zero. ✓✓
 - In a monopoly, the price is set above marginal cost and the firm earns a positive economic profit. ✓✓
 - Perfect competition produces an equilibrium in which the price and quantity of a good is economically efficient ✓✓

Data Response

HINT: All section B questions have TWO data interpretation questions – each total 10 marks. Section B consist of Questions 2-4 not as numbered in this document

QUESTION 4:

Study the extract below and answer the questions that follow

- 4.1 Name other examples of a monopolistic competition (1)**
- Hairdressers ✓
 - Clothing ✓
 - TV programmes ✓
 - Restaurants ✓
- 4.2 What characteristics does monopolistic competition have in common with a monopoly? (1)**
- Both market structures involve a differentiated product so firms face downward-sloping demand curves, equate MC and MR, and charge a price above MC. ✓
- 4.3 Briefly describe the term “*small cartel*”. (2)**
 an organization of a few independent producers for the purpose of improving the profitability of the firms involved. ✓✓
- 4.4 Why should the government regulate monopolistic competition? (2)**
- Without government regulation, monopolies could put prices above the competitive equilibrium. This would lead to allocative inefficiency and a decline in consumer welfare. ✓✓
 - Monopsony power. A firm with monopoly selling power may also be in a position to exploit monopsony buying power. For example, supermarkets may use their dominant market position to squeeze profit margins of farmers ✓✓
- 4.5 Discuss advantages of a monopolistic competition (2x2) (4)**
- There are no significant barriers to entry; therefore, markets are relatively contestable. ✓✓

- Differentiation creates diversity, choice and utility. ✓✓ For example, a typical high street in any town will have a number of different restaurants from which to choose. ✓
- The market is more efficient than monopoly but less efficient than perfect competition – less allocatively and less productively efficient. ✓✓
- However, they may be dynamically efficient, innovative in terms of new production processes or new products. For example, retailers often constantly have to develop new ways to attract and retain local custom. ✓✓

QUESTION 5:

Study the graph below and answer the questions that follow.

- 5.1 Identify the equilibrium of monopolist above (1)**
- $MR=MC$ ✓
- 5.2 Which equilibrium position is represented above? (1)**
- Economic loss ✓
- 5.3 Briefly describe the term *monopolistic*. (2)**
- Monopolistic competition is a market structure which combines elements of monopoly and competitive markets
- 5.4 How can the government solve the problem of monopoly? (2)**
- Government can leave production to a private firm and subsidise its losses. ✓✓
 - Government can supply the good or services itself and use tax revenue to compensate for the losses. ✓✓
- 5.5 Why do we say that a monopolistic is neither allocatively nor productively efficient? (2x2) (4)**
- Monopolist produces less, employs fewer resources charges a higher prices than society will prefer ✓✓
 - Does not producer at the lowest possible cost per unit of output. ✓✓

QUESTION 6:

Study the picture below and answer the questions that follow.

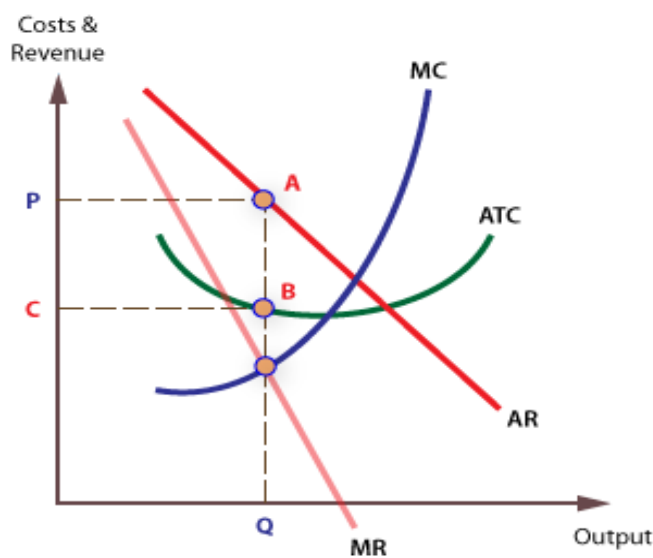
- 6.1 Name the market above associated with brands above (1)**
- Monopolistic competition ✓
- 6.2 Identify the characteristic of the market above (1)**
- Difference in packaging ✓

- 6.3 Briefly describe the term *market information* (2)
- The market information refers to the knowledge of the market, which is incomplete in the monopolistic market ✓✓
- 6.4 Explain the long-term profit in the market illustrated by the above brands (2)
- Only normal profit is made ✓✓
 - Long-term profit position of the business in the monopolistic-competitive market is the same as that of perfect competitor. ✓✓
- 6.5 How do you provide a good after sales service? (4)
- Promoting releases that prioritize existing customers is excellent for customer loyalty, because it demonstrates that the brand cares and values old customers, giving them first-hand access to news involving new products and services ✓✓
 - Email marketing is one of the most cost-effective content marketing techniques, because you deliver content directly to the recipient's inbox without algorithms limiting your message's reach, as occurs with certain social media ✓✓

HINT: All section B questions have TWO 8 marks questions, numbered according to questions not like in this document. EcoleBooks

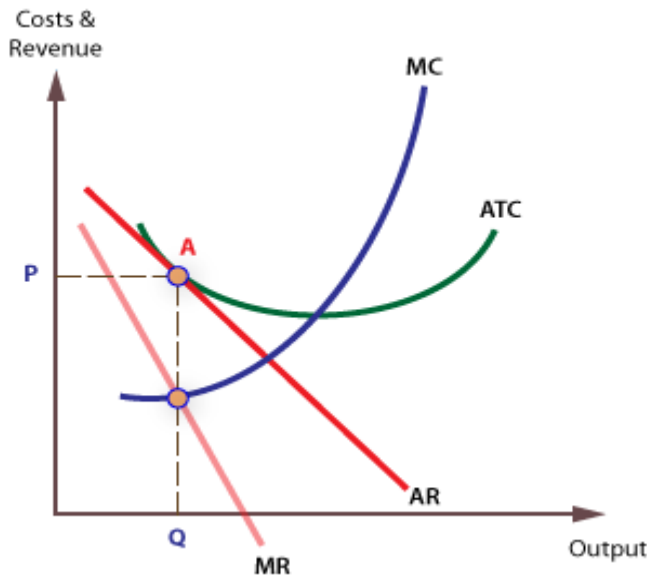
QUESTION 7 Paragraph type questions – Middle Cognitive

- 7.1 Illustrate a monopolistic competition in the short run (4x2) 8



- At profit maximisation, $MC = MR$, and output is Q and price P . Given that price (AR) is above ATC at Q , supernormal profits are possible (area $PABC$) ✓✓
- As new firms enter the market, demand for the existing firm's products becomes more elastic and the demand curve shifts to the left, driving down price. Eventually, all supernormal profits are eroded away. ✓✓

7.2 Explain with an aid of graph of monopolistic competition in the long run (4X2) 8



- Super-normal profits attract in new entrants, which shifts the demand curve for existing firm to the left. ✓✓
- New entrants continue until only normal profit is available. At this point, firms have reached their long run equilibrium ✓✓
- the firm benefits most when it is in its short run and will try to stay in the short run by innovating, and further product differentiation ✓✓

QUESTION 8 Paragraph type questions – Higher cognitive

8.1 Evaluate the monopolistic competition on small firms (4X2) 8

- There are no significant barriers to entry; therefore markets are relatively contestable. ✓✓
- Differentiation creates diversity, choice and utility. For example, a typical high street in any town will have a number of different restaurants from which to choose.
- The market is more efficient than monopoly but less efficient than perfect competition – less allocatively and less productively efficient. ✓✓

- However, they may be dynamically efficient, innovative in terms of new production processes or new products. For example, retailers often constantly have to develop new ways to attract and retain local custom. ✓✓

Disadvantages of monopolistic completion

- Some differentiation does not create utility but generates unnecessary waste, such as excess packaging.
- Advertising may also be considered wasteful, though most is informative rather than persuasive. ✓✓
- there is allocative inefficiency in both the long and short run. ✓✓
- This is because price is above marginal cost in both cases.
- In the long run the firm is less allocatively inefficient, but it is still inefficient. ✓✓

8.2 How would competitors in monopolistic competition ensure their operational success in the market? (4X2) 8

- Creating opportunities for non-price competition due to factors relating to their product's uniqueness compared to those of competitors ✓✓
- Attracting more customers by advertising their products, making them more appealing to customers ✓✓
- Packaging their product in an attractive way for customers, making them stand out from those of competitors ✓✓
- Providing free deliveries for the convenience of their customers ✓✓
- Extending their working hours ✓✓
- Building customer loyalty through product branding ✓✓
- Giving out loyalty points to consumers for certain purchases ✓✓

8.3 Why do firms in monopolistic competition make economic profit in the short run only? (4X2) 8

- Entry into the market is easy ✓✓
- The economic profit the business made in the short term attracts new businesses to enter the market ✓✓
- The entry of new firms leads to an increase in the supply of differentiated products ✓✓
- Competition causes all economic profit to disappear, which means that long-term average cost equals the price of the product ✓✓
- The excess profits are eliminated in the long run through imperfect emulation of successful product design, production systems, and marketing efforts by both established and new competitors ✓✓
- Only normal profit is made in the long run ✓✓

8.4 How will a monopolistic competitor, like KFC, compete with other fast-food chicken outlets to increase its market share?

8

- How will a monopolistic competitor, like KFC, compete with other fast food chicken outlets to increase its market share? ✓✓
- The monopolistic competitor can increase its market share by competing on non-price factors ✓✓
- KFC might use unique spices (recipe) or new product lines (e.g. mealie pap) to offer a differentiated product ✓✓
- Using unique red/white packaging to promote KFC-branding ✓✓
- Aggressive advertising campaigns can be launched by focusing on the use of bill boards / sponsor ships like mini cricket ✓✓
- Extending shopping hours at more KFC branches, will be more convenient for customers in close vicinity to make use of their services (e.g. 24 hour service) ✓✓
- Providing more free deliveries within a certain range of the business will ensure an edge over other competition ✓✓
- The monopolistic competitor can increase its market share by competing on promotional specials based on price ✓✓

(Accept any other correct relevant response) (8)

(Allocate a maximum of 2 marks for mere listing of facts/ examples)



SECTION C

QUESTION 9

- Compare the market structure of monopolistic competition with that of a perfect competitor. (26 marks)
- With a well labelled graph, explain why the business will stop producing output at the shut-down point. (10 marks)

INTRODUCTION

- A market structure is a framework of how a market is organized ✓✓
- Monopolistic is a market structure with many buyers and sellers where entry is relatively easy, but the product is differentiated ✓✓
- Perfect competition is a market structure with many buyers and seller ✓✓
(Accept any other correct relevant introduction) (Max. 2)

BODY

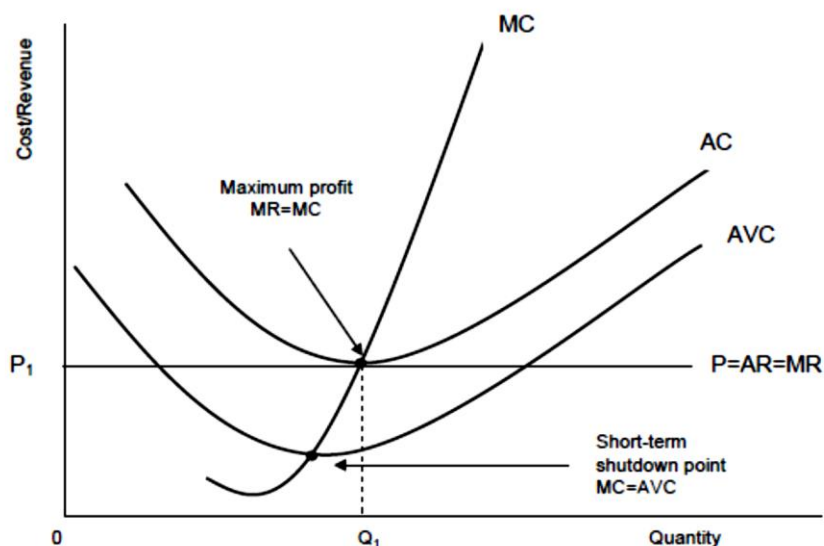
MAIN PART

54

	Perfect Competitor	Monopolistic Competition
Number of businesses	The number of seller is so large that individual participants are insignificant in relation to the market as a whole ✓✓, e.g. securities exchange or fresh produce market. ✓	A large number of sellers are active in the monopolistic competitive market ✓✓, e.g. producers of cleaning materials, toothpaste, soap, cold drinks, etc. ✓
Output	The demand curve for the perfect competitor is horizontal. ✓✓	The demand curve is downward sloping. ✓✓
Profit	The firm can realise economic profits in the short-term but only normal profit in the long term under conditions of perfect market. ✓✓	The firm can realise economic profit in the short-term as well as in the long term in the monopolistic competitive market. ✓✓
Marketing	There is no need for marketing strategy due to perfect market knowledge. ✓✓	Marketing strategy is applied in the monopolistic competitive market. ✓✓ Deliberate advertising campaign is launched to create brand loyalty. ✓✓
Nature of a product	Homogeneous e.g. maize ✓	Products are heterogeneous. E.g. they differ slightly in terms of appearance, shape, size and taste. ✓✓
Market knowledge	Both buyers and sellers have complete knowledge about prevailing market conditions. ✓✓ It is assumed that buyers and sellers instinctively know, e.g. quantities, price at which the product is sold. ✓✓	Market information is not complete. The many brands, variety of products or marginal differences cause a lack of information for sellers and buyers. ✓✓
Entry	Completely free ✓ The entry into the perfect market is completely free, with no barriers to entry ✓✓	Easy and free. There are no barriers such as licenses, or permits. ✓✓
(Accept any other relevant fact) (Maximum of 8 marks for mere listing of examples)		(Max. 26)

ADDITIONAL PART

ADDITIONAL PART



	<u>Mark allocation</u>
Axes	1 mark
Correct intersection of MC and AVC	1 mark
Cost curves	1 mark
$P=AR=MR$	1 mark
Indication $MR=MC$	1 mark
Indication of shut-down point	1 mark
	6 marks

- A firm will shut down if it cannot meet its average or total variable costs ✓✓
- The firm will not produce here because $AR < AVC$ ✓✓
- The firm will not keep on producing from the shut-down point down because the firm cannot meet its operational cost ✓✓
- Below the shut-down point, the firm will not sell any goods. A firm will sell goods if the price is above the shutdown price level (supply curve) ✓✓

Any (2 x 2)
(Max. 10)

CONCLUSION

While perfect does not exist, it serves as a standard that imperfect markets such as monopolistic competition should strive to achieve. ✓✓
(Accept any other relevant conclusion)

(Max. 2)

[40]



SESSION 21: MARKET-FAILURE- PART 2**SECTION A: TYPICAL EXAM QUESTIONS****MARKET FAILURES****QUESTION 1: Section A – Short Questions****(Taken from various sources)**

1.1 Various options are provided as possible answers to the following questions. Choose the answer and write only the letter (A–D) next to the question number.

- 1.1.1. A✓✓ (are not reflected in market prices, so they can be a source of economic inefficiency.)
- 1.1.2. C✓✓ average private cost in trucking is lower than average social cost, so that some trucking firms remain in the industry when efficiency calls for them to leave .
- 1.1.3. B✓✓ (excess supply of labour)
- 1.1.4. C ✓✓ (individuals acting according to their own self-interest)
- 1.1.5. A ✓✓ (Allocated efficiently)

1.2 Choose a description from COLUMN B that matches the item in COLUMN A. Write only the letter (A – I) next to the question number (1.2.1 – 1.2.8) in the ANSWER BOOK, for example 1.2.9 J.

1.2.

- 1.2.1. B✓ (prices would be low and consumers would be spoiled for choice)
- 1.2.2. D✓ the cost incurred by the individual firm
- 1.2.3. A✓ (help to quantify the social costs and benefits of related projects)
- 1.2.4. C✓ increased international profile of the airport

1.3.

- 1.3.1. Redistribution of income ✓
- 1.3.2. Social benefit ✓
- 1.3.3. Externalities ✓
- 1.3.4. Sin tax✓
- 1.3.5. Market failure ✓

SECTION B**QUESTION 2:**

HINT: When the question requires you to “list” or “name”, you need not write a sentence but merely one or two words. This **MUST** be done in bullet form. This types of questions are applicable for 2.1.1, 3.1.1 and 4.1.1

- 2.1.1 List any TWO examples of community goods (2x1) 2**
- Defence services ✓
 - Police services ✓
 - Light house ✓
 - Street lighting ✓
 - Flood control ✓
 - Storm water drainage ✓
- 2.1.2 Name any TWO characteristics of public goods (2x1) 2**
- Non rivalry/non-competitive ✓
 - Non excludable ✓
 - Social benefit outstrip private benefit ✓
 - Infinite consumption ✓
 - Non-rejectable ✓
- 2.1.3 Name TWO examples where maximum prices can be applied. (2x1) 2**
- Rent ✓
 - Food ✓
 - Tickets ✓
- 2.1.4 Name any TWO consequences of market failure. (2x1) 2**
- Allocative inefficiency ✓
 - Productive inefficiency ✓
 - Externalities ✓
 - Government intervention ✓
- 2.1.5 Name TWO instruments of imperfect markets(government intervention) (2x1) 2**
- Competition from abroad ✓
 - Competition promotion ✓
- 2.1.6 List TWO examples of minimum wage (2x1) 2**
- Domestic workers ✓
 - Farm workers ✓

QUESTION 3:

(Taken from various sources)

HINT: This types of questions are applicable for 2.1.2, 3.1.2 and 4.1.2

- 3.1.1 Why is it important for the state to administer prices of certain goods? (1x2) 2**
- To make them more affordable ✓✓
- 3.1.2 How do externalities affect equilibrium and create market failure? (1x2) 2**

- Externalities, or consequences of an economic activity, lead to market failure because a product or service's price equilibrium does not accurately reflect the true costs and benefits of that product or service. ✓✓
- This would result in decreased production and a more efficient equilibrium ✓✓

3.1.3 Why would productive inefficiency and allocative inefficiency be wasteful? (1x2) 2

- Allocative inefficiency is also wasteful because society is not using the resources in the way that they most desire, which is not maximizing utility ✓✓

3.1.4 What are the strengths of cost benefit analysis? (2x1) 2

- it provides an objective way to compare projects. ✓✓
- Business owners who are emotionally attached to or have time invested in certain projects may be predisposed to pursue those projects, even if there are better options available ✓✓

3.1.5 Why is minimum wage a price floor? (1x2) 2

- The minimum wage price floor is enacted so that the suppliers (current or potential employees in this case) will not sell their labour below the designated price even if the demanders (employers) are willing to hire them for less. ✓✓
- A price floor is the lowest possible price that can be paid for the particular good or service ✓✓

Data Response

HINT: All section B questions have TWO data interpretation questions – each total 10 marks. Section B consist of Questions 2-4 not as numbered in this document

QUESTION 4:

Study the graph below and answer the questions that follow

- 4.1 At which point on the graph above are the demands of consumers met? (1)**
- Point c ✓
- 4.2 What is represented by point E or F? (1)**
- Allocative and productive inefficiency ✓
- 4.3 Briefly describe the term *indifference curve*. (2)**
- Indifference curve shows the combination of two goods which gives the consumer the same level of satisfaction ✓✓

- 4.4 Explain the reason for the slope of the Production Possibility curve above. (2)
- The production possibility curve is concave to the origin because increases in the production of one good will lead to an increasing sacrifice in terms of a reduction in other goods ✓✓
- 4.5 How can negative externality be reduced using quantity control? (2x2) (4)
- Regulating the production of a good ✓✓
 - Issuing licences to allow production ✓✓
 - Setting quota limits to the total amount of a good to be produced ✓✓

QUESTION 5:

Study the pictures below and answer the questions that follow.

- 5.1 What type of externality is shown in the pictures above? (1)
- Positively externality ✓
- 5.2 Give any example of negative externality (1)
- Pollution ✓
 - Tobacco smoking ✓
 - Alcohol abuse ✓
- 5.3 Briefly describe the term *merit goods*. (2)
- Goods and services that are provided to benefit the user and society as a whole ✓✓
- 5.4 How can this externality lead to market failure? (2)
- When there is less consumption of products that are over-supplied ✓✓
- 5.5 Explain the results of efficient allocation of resources (4)
- The correct quantity of goods and services are made available ✓✓
 - There is no wastage of resources ✓✓

QUESTION 6:

Study the information below and answer the questions that follow.

- 6.1 Identify ONE intangible cost associated with the implementation of the BRT system in South Africa (1)
- The costs of obtaining and maintaining buses are high. ✓
 - The BRT system is restricted to specific routes only, which can limit its operations. ✓

- The buses are competing with taxis/Uber operators, which could make buses inefficient or un-economical. ✓
(Accept any other correct relevant response.)

6.2 Name ONE benefit associated with public transport systems in South Africa. (1)

- Bus transport is effective in cities to transport people to work. ✓
- In most cities public bus services are subsidised by the councils, to the benefit of the commuters. ✓
- Bus services can provide transport to a large volume of people, even across provincial borders. ✓
(Accept any other correct relevant response.)

6.3 Briefly describe the term *net present value* (2)

- This indicates the present value of an investment project. ✓✓
- The present value is calculated by discounting all present and future receipts and expenses at an appropriate interest rate. ✓✓
- If the net present value is positive, it is worthwhile for the government to invest in the project. ✓✓
(Accept any other correct relevant response.)

6.4 What is meant by “the BRT system is draining the fiscus”? (2)

- The bus service is not profitable enough. ✓✓
- The cost of operations is more than the income that it generates. ✓✓
- Tax money is used/wasted to fund these ✓✓

6.5 Evaluate the impact of the BRT on other transport systems in South Africa. (4)

- The bus services require large amounts of capital, at the expense of subsidising other transport systems. ✓✓
- The bus service industry is also in conflict with other types of transport, such as Uber/taxi operators, which are not subsidised. ✓✓
(Accept any other correct relevant response.)

QUESTION 7

Study the graph below and answer the questions that follow

7.1 Name the shaded area in the graph (1)

- Negative externality ✓

7.2 Give ONE example of a positive externality (1)

- Education ✓
- Health ✓
- Security ✓

- 7.3 Briefly describe the term *externalities*** (2)
- Externalities are costs or benefits to third parties which are not included in the market price of a product ✓✓
- 7.4 Explain the negative effect of a decrease in the demand for cigarettes on the economy** (2)
- Decrease in demand for cigarettes will decrease levels of their supply which might cause shortage of cigarettes and increase in its price. ✓✓
 - Due to lesser production of cigarettes employment levels would decrease. ✓✓
 - Economic growth would decrease since lesser quantities of production. ✓✓
 - Government revenue would decrease due to lesser taxes received from businesses and workers. ✓✓
- 7.5 How does the government encourage positive externalities in the economy?** (4)
- The government encourage positive externalities by:
- Subsidizing the production of merit goods. ✓
 - Charging lesser taxes/ offer tax rebates on the production of merit goods. ✓✓
 - Providing merit goods at affordable prices or for free to consumers. ✓✓
- (Accept any correct and relevant answer)

QUESTION 8



Study the cartoon below and answer the questions that follow.

- 8.1 Name the factors of production that is immobile above** (1)
- Technological applications change production methods. ✓
 - Land/ Natural resources ✓
 - labour ✓
- 8.2 Give any other cause of market failure other than the one above** (1)
- Externalities ✓
 - Missing markets ✓
 - Imperfect markets ✓
 - Lack of information ✓
- 8.3 Briefly describe the term *market failures*.** (2)
- Market failures refers to when the forces of demand and supply fail to allocate resources efficiently / when markets fail to allocate goods and services efficiently. ✓✓

8.4 How is the immobility of labour a significant problem? (2)

Unemployment

- Occupational immobility is a barrier to people finding work ✓✓
- Towns with low mobility more exposed to external shocks ✓✓

Poverty

- Long term unemployment damages lifetime earnings ✓✓
- Areas with low mobility more likely to suffer economic deprivation leading to a fall in incomes/higher debt levels ✓✓

Welfare

- Immobility stops scarce resources being used optimally ✓✓
- Social costs from increased unemployment and from rising level of relative poverty. ✓✓

8.5 What actions should government take to increase mobility in the labour market? (2x2) (4)

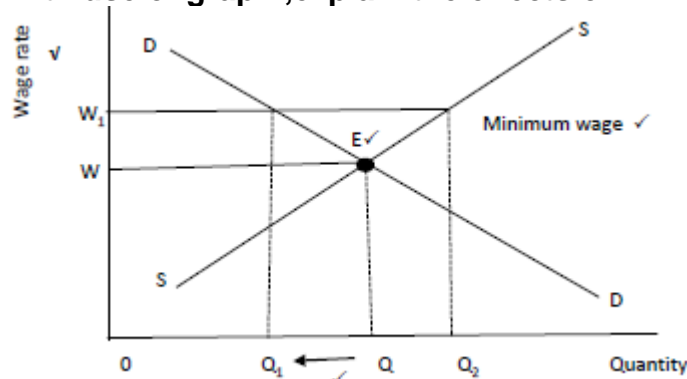
- More information about job vacancies so that searching for is easier ✓✓
- Subsidies to labour or firms such as help with re-location expenses, and subsidized housing ✓✓
- Incentive to domestic firms to relocate to the regions including providing "tax break and investments grants ✓✓
- Training and retraining schemes to enable labour to develop their general skills and become more employable in a variety of occupations or industries. ✓✓

HINT: All section B questions have TWO 8 marks questions, numbered according to questions not like in this document.

QUESTION 9

Paragraph type questions – Middle Cognitive

9.1 With use of graph ,explain the effects of minimum wage (4x2) 8



- Minimum wage is set by the government – above the ongoing wage ✓✓
 - Distribution of income will improve from W to W1 ✓✓
 - Consumers will have more to spend thus improving their standard of living ✓✓
 - Demand for labour will decrease from Q to Q1 while supply increases from Q to Q2 because employers will not be willing to pay the minimum wage ✓✓
 - Some employers will retrench workers ✓✓
- (Accept any other correct relevant response)

9.2 Discuss the reasons for cost benefit analysis (4x2) 8

- Cost benefit analysis is done by identifying all the relevant benefits and costs of a project so that an informed decision can be made. ✓✓
 - Cost benefit analysis bring greater objectivity to decision making. ✓✓
 - Objective criteria may be required to ensure economic efficiency in resource allocation. ✓✓
 - It serves a market signal (e.g. price helps to allocate resources through demand and supply). ✓✓
 - With the absence of market signal, decisions on the desirability of a project may be subjective. ✓✓
- (Accept any other correct relevant response)

(Allocate a maximum of 4 marks for mere listing of facts / examples)

9.3 Discuss how minimum wage legislation can affect a perfectly competitive labour market (4x2) 8

- The legislation leads in more labour supplied because they are motivated to enter the labour market. ✓✓
- The labour supplied will increase because workers are guaranteed of a higher wage ✓✓
- When production level increase, labour supplied is likely to increase a little because of the legislation. ✓✓
- The legislation has a negative effect on the labour market as it forces employers to pay a certain wage or more. ✓✓

9.4 Differentiate between private sector and public sector project evaluation of cost benefit analysis. (4x2) 8

Private sector

- In the private sector a comparison needs to be made between expected private costs and benefits over the estimated time new project. ✓✓
- A feasibility study would be done, which also provides for the aspects relating to externalities ✓✓

Public sector

- In the public sector a comparison needs to be made between expected social costs and benefits over the estimated time span new project. ✓✓
- A cost-benefit analysis needs to be done. ✓✓
- funding of these projects are mainly financed through tax revenue and does not impoverish any individual as such. ✓✓ this infrastructure adds to the welfare of the community at large and is non-excludable to anyone using it. ✓✓

9.5 Explain public goods as a market failure. (4x2) 8

- Markets are incomplete –they do not meet demand for certain goods – public sector provides these goods known as public goods ✓✓
- Private people are reluctant to produce these goods due to the large capital outlay and a low return on investment ✓✓
- Divided into community (police and street lighting) which is non-excludable ✓✓ and collective goods (parks, community swimming pool) which can be excludable if a fee is charged ✓✓
- Public goods are not provided via the price mechanism – producer cannot withhold goods for non-payment ✓✓
- State finance public goods through taxation and provide it themselves ✓✓
- In RSA – most goods and services private goods – have rivalry in consumption and excludability ✓✓

- Features of public goods:
 - non-rivalry ✓✓ consumption by one person does not reduce consumption by another individual e.g. lighthouse ✓✓
 - non-excludability ✓✓ consumption of public goods cannot be confined to those who pay for it (free riders e.g. radio) ✓✓
 - social benefits outstrip private benefits ✓✓ large social benefits relative to private benefits e.g. health care and education ✓✓
 - infinite consumption ✓✓ once provided, marginal cost of supplying one more individual is zero (traffic lights) ✓✓
 - non-excludable ✓✓ individuals may not be able to abstain from consuming them even if they want to (e.g. street lighting) ✓✓

QUESTION 10

Paragraph type questions – Higher cognitive

10.1 Evaluate the effectiveness of Cost Benefit Analysis as a decision-making tool. (4x2) 8

CBA may be effective as a decision-making tool by ...

- evaluating whether capital invested is worth it ✓✓
- influencing decisions whether to hire new employees ✓✓
- developing a benchmark for comparing of projects ✓✓
- helping predict whether the benefits of a policy outweigh its costs relative to other alternatives ✓✓

CBA may not be effective as a decision-making tool because there could be:

- potential inaccuracy in identifying and quantifying costs and benefits due to accidentally omitting certain costs and benefits as a result of inability to forecast indirect causal relationship ✓✓
- ambiguity and uncertainty involved in quantifying and assigning a monetary value to an inaccurate CBA ✓✓
- increased subjectivity for intangible costs and benefits since some costs are non-monetary in nature, e.g. increases in customer and employee satisfaction ✓✓
- inaccurate calculation of present value which may

10.2 Why did the government implement a minimum wage in the labour market? (4x2) 8

- Pressure was put on the South African government to introduce labour laws that require employers to pay minimum wages. ✓✓
- The application of minimum wages is needed to improve redistribution of income ✓✓
- To redress income inequality (gap between wealthy and poor) ✓✓
- To improve the standard of living ✓✓

- Government tries to protect domestic and farm workers by preventing exploitation ✓✓
(Accept any other correct relevant response)
(Allocate a maximum of 2 marks for mere listing of facts/examples)

10.3 How does the government deal with lack of information as a consequence of market failure? (4x2) 8

- The SABS regulates standards in South Africa. This means that all firms must produce goods that meet with certain health, safety and quality standards. ✓✓
- Information must be included on the packaging of goods. ✓✓
- Regulations for advertising standards, exist to prevent false claims and deceptive advertising. ✓✓
- Access to information and regulations must be easily available. ✓✓
- E.g. prepared food products must carry details of the contents on the packaging. ✓✓

(Accept any other correct relevant response.)

10.4 Why should government consider the Cost-Benefit Analysis (CBA) in deciding which major projects to undertake? (4x2) 8

It is important to do a CBA because:

- it helps to bring greater objectivity to decision making ✓✓ /
With the absence of market signals, decisions on the desirability of a project may be subjective
- goods supplied by the government such as roads, bridges etc. are provided free ✓✓
- resources are scarce, therefore we must consider the cost and benefits of a project before allocating resources to a project ✓✓
- it allows planners to work out if going ahead with the proposed project is a good decision ✓✓
- it ensures that the project's benefits exceed the cost of implementing the project / These projects require large sums of money and should be beneficial ✓✓

10.5 Evaluate the effects of the productive inefficiency in the secondary sectors. (4x2) 8

- Businesses do not maximise output from the factors of production. ✓✓
- Businesses do not produce at the lowest possible cost. ✓✓

- They produce too few goods. ✓✓
 - The consequence is lost output due to inefficient production. ✓✓
 - Factories do not maximize output for the factors of production. ✓✓
 - Factories do not produce at the lowest possible cost. ✓✓
 - The consequence is lost output due to inefficient production. ✓✓
 - Leads to low productivity. ✓✓
 - Supply can not meet the demand for quality goods. ✓✓
 - Factors of production are underutilised and get wasted. ✓✓
- (Accept any other correct relevant response)

SECTION C

QUESTION 11

Discuss in detail the following causes of misallocation of resources [26]

- Missing markets (10)
- Imperfect competition (8)
- Imperfect distribution of income and wealth (8)

INTRODUCTION

- Market failure is when the forces of supply and demand fail to allocate resources efficiently / when markets fail to allocate goods and services efficiently. ✓✓
(accept any other correct relevant introduction) (Max 2)

BODY: MAIN PART

Missing Markets

- Markets are often incomplete in the sense that they cannot meet the demand for certain goods. ✓✓
- Public goods: (community and collective goods) are in high demand but are not supplied by the market because of the low profit gained from them and the high cost of capital needed to supply them ✓✓
- They are not provided by the price mechanism because producers cannot withhold the goods from non-payment and there is often no way of measuring how much a person consumes. ✓✓

Public goods have the following features:

- **Non-rivalry:** ✓ The consumption by one person does not reduce the consumption of another person ✓✓ e.g. a lighthouse. ✓
- **Non-excludability:** ✓ Consumption cannot be confined to those who have paid, so there are free riders ✓✓ e.g. radio and TV in South Africa. ✓

Merit goods ✓

- These are goods/services that are deemed necessary or beneficial to the society, ✓✓ e.g. education, health care etc. ✓✓
- These goods are highly desirable for general welfare but not highly rated by the market, therefore provide inadequate output/supply. ✓✓
- If people had to pay market prices for them relatively too little would be consumed – the market will fail. ✓✓
- The reason for undersupply of merit goods is that the market only takes the private costs and benefits into account and not the social costs and benefits. ✓✓

Demerit goods ✓

- These are goods/services that are regarded as bad or harmful for consumption hence we should use less of these ✓✓ e.g. alcohol, cigarettes, etc. ✓✓
- Demerit goods lead to a lot of social costs, therefore, the government charges sin tax / excise duties to discourage the consumption of such goods. ✓✓
- While the market is willing to supply demerit goods, it tends to oversupply demerit goods. Some consumers may be unaware of the true cost of consuming them. ✓✓

Imperfect competition

- Power often lies to a greater extent with producers than with consumers ✓✓
- Businesses operate under conditions of imperfect competition that allows them to restrict output, raise prices and produce where price exceeds marginal cost. ✓✓
- They can also prevent new businesses from entering the industry ✓✓, by preventing full adjustment to changes in consumer demand occurring ✓✓



Imperfect distribution of income and wealth

- Low income lead to an inability to accumulate wealth ✓✓
- Low income individuals are unable to earn incomes that are necessary to achieve a decent living standard ✓✓
- Government welfare programmes are required to breach the gap between the rich and the poor ✓✓
- Free markets lead to the generation of huge amounts of wealth, however it is unevenly distributed due: to lack of skills, education and imperfect information. ✓✓

How can the South African government deal with supply of undesirable goods?

(10 Marks)

- Items such as cigarettes, alcohol and non-prescription drugs are examples of demerit or undesirable goods. ✓✓
- These goods are often over supplied in the market, due to the fact that the external cost is not added to the market price. ✓✓
- Some consumers may be unaware of the true cost of consuming them, their negative externalities. ✓✓
- Government can ban their consumption or reduce it by means of taxation. ✓✓

- Taxation on these products will increase the market price and hopefully the demand for these products will drop. ✓✓
- The prices of cigarettes and alcohol is increased annually, to dissuade the public from using these undesirable goods

[40]

QUESTION 12

Discuss the following causes of market failure:

- **Missing markets** (10)
 - **Imperfect distribution of income and wealth** (8)
 - **Immobility of factors of production** (8)
- (26 marks)
- **Evaluate the success of the government intervention in markets in distributing wealth.**

(10 marks)

[40]

INTRODUCTION

Market failures occurs when the forces of demand and supply fail to allocate resources efficiently. ✓✓

Market failure means that the best available resources or optimal production outcome has not been achieved. ✓✓

(Max. 2)

(Accept any other correct relevant response)

MAIN PART



MISSING MARKETS

- A significant market failure is the failure to produce some goods and services despite it being needed ✓✓
- It relates to public goods rather than private goods ✓✓
- Markets can only perform under certain conditions and when these conditions are absent, markets may struggle to exist ✓✓

Community goods ✓

- These are goods such as defence, police services, prison services, street lighting etc. ✓
- Free for everyone to use and often exploited and wasted by certain users to the detriment of other users ✓✓

Collective goods ✓

- These are goods such as parks, beach facilities, streets, pavements, roads, bridges ✓
- They are privately owned and can be consumed by many people without causing a decrease in quantity ✓✓
- Goods that are specially characterised when it is possible to exclude free-riders by levying fees and tolls ✓✓

Merit and demerit goods ✓

- **Merit goods:** These are highly desirable for general welfare, but not highly rated by the market. ✓✓ e.g. health care, education and safety. ✓
- **Demerit goods:** These are over-consumed goods, ✓✓ e.g. cigarettes ✓

Public goods ✓

- Community and public goods are known as public goods ✓✓ They have two features:
- Non-rivalry ✓ the consumption by one person does not in any way reduce the consumption by another person ✓✓
- E.g. a lighthouse or street light ✓
- Non-excludability ✓ the consumption of a good cannot be confined to those who have paid for it, so there are free-riders ✓✓
- People enjoy the product without paying for, e.g. radio and television services ✓✓
- Public goods are in high demand but are not supplied by the market because of the low profit gained from them and the high cost of capital needed to supply them ✓✓
- Public goods are not provided by the price mechanism because producers cannot withhold the goods for non-payment and there is no way of measuring how much a person consumes, there is no basis for establishing a market price ✓✓ (10)

IMPERFECT DISTRIBUTION OF INCOME AND WEALTH

- The most important shortcoming of the free market system is that it distributes income unequally. ✓✓
- Those who have access to capital and people with more education and skills can earn more than people who lack education and skills. ✓✓
- The rich become richer and the poor become poorer. ✓✓
- Discrimination often affect the income of women, minority groups and people with disabilities. ✓✓
- The market produces goods and services only for those who can afford it. ✓✓
- This leads to some people having too many goods while others have too few goods. ✓✓
- The difference in income occurs because there is a difference in market power, unequal educational opportunities, discrimination and inheritance. ✓✓
- The government attempts to correct the uneven distribution of income through taxation, education, skills development and providing for the basic needs of the under-privileged. ✓✓ (8)

IMMOBILITY OF FACTORS OF PRODUCTION

- Labour takes time to move from one area to another. ✓✓
- The supply of skilled labour cannot be increased because of the time it takes to be trained or educated. ✓✓
- Physical capital, like factory buildings or infrastructure such as telephone lines cannot be relocated easily. ✓✓
- Structural changes like a change from producing plastic packets to paper packets or shifting from labour-intensive production to computer-based production requires a

change in labourers' skills employment and work patterns. This takes time to change. ✓✓

(A maximum of 8 marks can be allocated for mere listing of facts/examples)

(Accept any other correct relevant response)

(8)

(Max. 26)

ADDITIONAL PART

Producer subsidies impact the economy positively by:

- Leading to a reduction in production costs, thereby making it possible for an individual producer to increase the production goods and services in the economy (supply increases) ✓✓
- Preventing producers from leaving the markets as the result there will not be any shortage of products ✓✓
- Encouraging producers to invest their surplus revenue into their businesses ✓✓
- Allowing the poor to purchase more of the subsidised goods at a lower price ✓✓
- Concealing the real costs of production, thereby keeping the producers in business ✓✓

Producer subsidies impact the economy negatively by:

- Hiding the real costs of production, thereby giving the producer a false impression that they can cope on their own ✓✓
 - Creating reliance on the government for survival ✓✓
 - Reducing prices and forcing competitors out of subsidised industries ✓✓
 - Disturbing the harmonious relationship that countries have as others might view low prices as dumping and they can retaliate with increased tariffs ✓✓
- (Accept any other relevant explanation)

(Max. 10)

CONCLUSION

There are various factors that can cause market failures, and these can have devastating effect unless government intervenes to reduce them. ✓✓

(Accept any other correct relevant higher order response)

(Max. 2)