Année 2024-2025, semestre Automne

EC1E <u>Examen écrit 14/01/2025 (1h30)</u>

Consignes :

QCM : Pensez à marquer votre Nom

Barème : + 1 points par bonne réponse

Questions sur le texte :

En utilisant vos connaissances et en vous appuyant sur le texte joint, vous apporterez une réponse <u>argumentée</u> aux questions ci-dessous.

Attention, prenez du recul : il ne s'agit pas de recopier le texte mais de reformuler les idées à l'aide de vos propres mots (<u>pas de paraphrase</u>). Cette capacité à prendre du recul sera évaluée.

Soignez l'orthographe et la présentation

NOM :
Prénom :

QCM (/ 4)

Entourez la bonne réponse.

1. Interest rate is an instrument of:
 a) Budgetary policy
 b) Monetary policy
 c) Fiscal policy

2. Which is/are related to structural policies:
 a) Pension reform
 b) Raising interest rate
 c) Public debt

3. Macroeconomics analyses :
 a) GDP
 b) Individual economic agents
 c) Prices

4. Keynesian policy is :
 a) Expansive policy
 b) Austerity or restrictive policy
 c) Free trade policy

Document distribué: What is competition, and why is it so important for prices?

Published: July 28, 2024 **Author:** Paul Blacklow, Lecturer in Economics, University of Tasmania

Question 1: What is the role of prices in the market economy? / 5

Question 2: Explain in your own words what is competition? / 5

Question 3: How can big enterprises use market power? Give examples from the text. / 6

It's hard to remember a time before the cost-of-living crisis dominated news headlines. Most of us would certainly like it to be over.
But the fundamental question at its heart – which points to the problem we have to solve – seems simple. What determines the prices we pay?
The cost of producing goods and services is certainly one big factor in determining how much we pay for them. So, too, is what we're prepared to fork out.
But when we talk about lowering prices, we often also talk about increasing competition – the number of firms vying to sell us a particular offering.
It's so important for efficient pricing that the government body tasked with making our markets fair is called the Australian Competition and Consumer Commission – the "ACCC" for short.
But why does having more people trying to sell us things drive down their prices? And can companies find ways to get around this?

More sellers, lower prices
In a free market system, there are a few different types of competition.
In the most ideal, a **perfectly competitive** market, firms must use resources efficiently to produce what we consumers want at the lowest possible cost.

In **perfect competition**:

- the products and services traded are identical (or very similar)
- there are many buyers and sellers
- information is perfect
- firms can enter and exit freely.

A firm charging prices well above the minimum cost will sell no goods or services and be forced to leave the market. Why? Because its competitors will be able to steal customers by charging slightly less for exactly the same thing.
In true perfect competition, the products traded by different sellers are identical.
Only lower-cost firms will remain and compete prices down until they cover the lowest cost of supplying the good or service, plus an average or normal "return on capital".
At a high level, think of this return as an acceptable monetary reward for the business for investing the inputs and taking on the risks required to operate.
If ever an industry is earning above-average returns given its level of risk, new firms will enter and charge less, until only normal returns are earned.
Conversely, below-normal profits will see firms exit, decreasing supply and raising prices.

Do perfectly competitive markets exist? There are arguably some examples that come close, such as casual labour services, some agricultural commodities like grain, livestock and fruit, and financial and currency markets.
But there are more examples of less competitive markets.

The winner takes it all
At the opposite extreme, in **monopoly** markets, there is only one seller of a good or service.
Typically, there is some barrier preventing new firms from entering the market and driving prices down.
Without government regulation, monopoly firms will reduce supply, increase prices and earn above-normal profit levels.
In many countries, postal services are regulated as monopolies.
However, sometimes monopolies emerge naturally because it is far more efficient to have a single coordinating supplier of a particular service – such as in letter delivery, rail tracks, or internet infrastructure.
To strike a balance, governments typically regulate or own monopolies.

Same same, but different
More common than monopoly is what's called **monopolistic competition**, which is the market structure for many of our tech, entertainment and dining goods and services.
In monopolistic competition, firms try to make their offering *different* by investing in R&D and advertising, so that they do not have to compete on price alone.
Think Apple's iPhone versus Samsung's Galaxy. Both are technically the same kind of product, but have created their own unique markets.
Differentiation allows firms to price above minimum cost and earn above-normal rates of return. At least, that is, until new firms enter and imitate them, increasing supply and lowering prices and profits to normal levels.

A few big players hold market power
In Australia, many key goods and services are traded in **oligopoly** markets.
Oligopolies arise when a few large firms dominate a particular industry, such as supermarkets, domestic airlines, banking, mobile telecommunications, and petrol retailing.
Some oligopoly markets are very competitive and drive prices down to cost, plus normal return to capital. But in other more concentrated markets with a few powerful firms, firms may have significant **market power** and be able to keep prices above the competitive level.
Recent inquiries into Australia's two big supermarkets have examined alleged abuse of market power.

It is not illegal to possess market power, but according to Australia's Competition and Consumer Act 2010, it is illegal to use it "for the purpose, effect, or likely effect of substantially lessening competition". It is illegal, for example, for firms to explicitly work together when setting prices. This is called collusion. Neither can they force suppliers to deal with them exclusively, or set prices below cost when new firms attempt to enter a market.
But that doesn't mean some firms haven't learned subtle and legal ways of reducing competition.
For example, loyalty programs and charging special loss-leading prices can seem at first glance to be good for consumers, but can also increase the cost of switching to the lowest-priced firm.

Are we getting a good deal?

Still, you may have noticed the prices charged for many goods and services are very similar across different firms in the economy.
Have these prices been driven down by competition to their cost plus a normal return to capital? Or are firms abusing their market power to lessen competition in the market?
What can we do if firms are reducing competition through legal measures?
These are just some of the difficult questions both government and industry are currently grappling with.