



Figure 2.1 Market structure, competition and market power.

The different market structures, and their varying degrees of competition, market power and control over price are important issues because each one affects the allocation of resources and the efficiency of resource use differently. Each structure has its own particular advantages and disadvantages. Of the four market structures, perfect competition gives rise to highly desirable outcomes from a social point of view. It usually results in larger quantities of output, and products are sold at lower prices. It can give rise to an allocation of resources which best satisfies the needs and wants of consumers, and it can also minimize waste in the use of resources, by ensuring that they are used in the most efficient way. The greater the degree of competition, understood to mean the inability of economic decision-makers to control price, the closer is an economy to realizing these desirable results. The model of perfect competition is therefore studied extensively, even though in the real world most markets are not perfectly competitive. Perfect competition provides a standard for comparison of other market structures with an ideal. In addition, a study of perfect competition offers important insights into the workings of mixed market economies, discussed in Chapter 1, page 23.

Test your understanding 2.3

- 1 What is the meaning of 'competition' in Economics?
- 2 Explain the relationship between competition and market power, and show how the four market structures relate to each other with respect to these features.
- 3 Why are competitive markets studied extensively?

2.2 Demand, supply and price determination

We now turn to a study of a competitive market. We are interested in seeing how the independent actions of numerous buyers and sellers, none of whom individually have any control over price, interact in markets where prices are determined.

Demand

Demand is concerned with the behaviour of buyers. Consumers (or households) are buyers of goods and services in product markets, whereas firms are buyers of factors of production in resource markets (recall the circular flow model). In our analysis of demand and supply we will focus mainly on product markets and therefore on the behaviour of consumers as buyers (though the same general principles described here apply also to the behaviour of firms as buyers in resource markets).

Individual demand

Consumers buy goods and services in product markets. As buyers, they are demanders of those items they wish to buy.

The **demand** of an individual consumer indicates the various quantities of a good (or service) the consumer is **willing and able to buy** at different possible prices during a particular time period, *ceteris paribus* (all other things equal).

A consumer's demand for a good can be presented as a **demand schedule**, which is a table listing quantity demanded at various prices. Table 2.2 shows a consumer's demand schedule for chocolate bars. When the price of chocolate bars is \$5, the consumer is willing and able to buy two chocolate bars in a week.