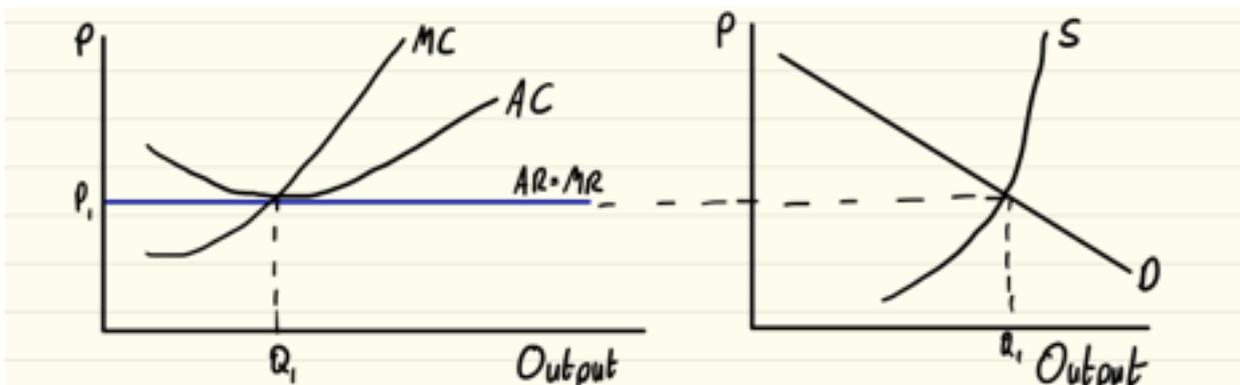


**JUNE 2013 2B DISCUSS, USING EXAMPLES FROM A LEISURE INDUSTRY OF YOUR CHOICE, THE EXTENT TO WHICH COMPETITION CREATES EFFICIENCY**

There are many kinds of efficiency within an economy, these efficiencies do not just extend towards a firm but resource allocation and others. Allocative efficiency is concerned with whether we are producing the goods and services that match our changing needs and preferences and which we place the greatest value on. Allocative efficiency is usually achieved when the market clears, there is no surplus, thus everything that has been produced has been consumed therefore the economy has produced everything that is demanded of it. This can be seen as Pareto efficiency where no one can be made better off without making someone else worse off. Another kind of efficiency is productive efficiency which is when the output is produced at minimum, therefore producers minimise the wastage of resources in their production processes. Another kind of efficiency to consider is dynamic efficiency which is when, over time, there is a change in the amount of consumer choice. L1

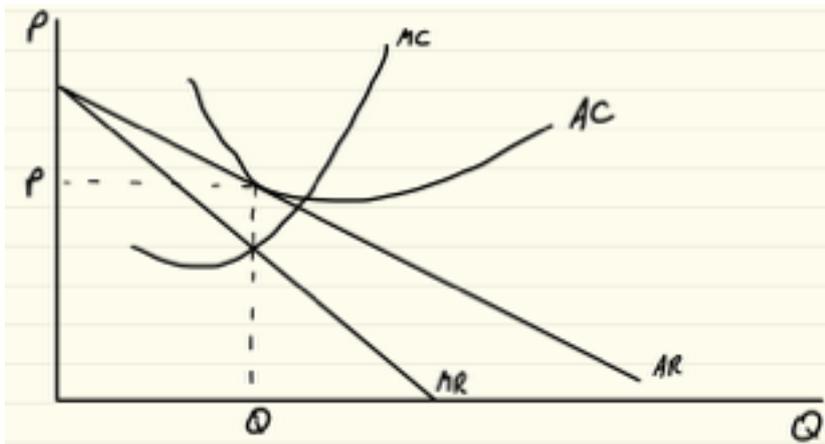
Perfect competition is a form of market competition which creates two kinds of efficiency, allocative and productive efficiency. in the long run



The diagram presents a market in perfect competition in the long run. It can be seen that it is in the long run as there is no abnormal profit being made thus no new firms will want to join the market. L2 The firm produces at  $MC = MR$ , which is the point of profit maximisation. This is profit maximisation as if production was above this point then the firm makes a loss as cost is higher than revenue and if production is below this point then more profit can be made thus the firm increase production to  $MC = MR$ . Therefore the firm produces at  $Q_1$ . At the point  $Q_1$  it can be seen that allocative efficiency and productive efficiency is met. Firstly productive efficiency is where production is at its lowest point of the AC curve. As seen in the diagram  $MC = AC$ , thus production costs are at their lowest so the market achieves productive efficiency. Secondly we can see that allocative efficiency is met by  $MC = AR$ , which proves that the supply curve, MC, cuts the demand curve, AR, and as a result the quantity produced at the market price is  $Q_1$ . This shows how a perfectly competitive market creates efficiency. The features of this market which make it competitive are lots of buyers and seller, this insures that no one can influence the price of the good in the market. Under this condition if a firm increases price they will not see any revenue as there are plenty of alternative firms selling the same good and service. Another feature is homogenous goods which results in no branding therefore higher prices are not justified, it also means that the demand is very elastic as there are lots of substitutes in the market. L3

Perfectly competitive markets, in theory, are very good at achieving this efficiencies as they take into account these features however in a real life market. An assumption the theory of a perfectly competitive market makes is that there is perfect knowledge, in reality this does not work as firms do not share information and consumers can not be aware of all the happenings in the market. An aspect of competition is that firms are competing against each other therefore it is non sensical that firms share their strategies with other firms. Whilst a perfectly competitive market will create efficiency it will not occur as it assumes too much. L3

In contrast the concept of monopolistic competition is a more realistic theory. It shares characteristics of both monopoly and perfect competition, it is usually characterised by a market where there are many firms producing similar but not perfectly homogenous goods. A good example of this is cinemas. Every firm in the market for cinemas features the same films and sells the same experience of watching a movie.



The diagram shows the behaviour of a firm in monopolistic competition. Firstly there is competition between firms as there is product differentiation. Firms try to create a brand for their product, a monopoly over their own good. They can do this in several ways such as patenting and advertising heavily. This allows firms to influence the price of their good rather than accept the market price. As there are no barrier to entry, firms can enter the market and participate in the market and differentiating the market, thus creating a close substitute. This aspect makes the market competitive as firms can not charge extortionately high prices as the presence of close substitutes ensures that the firm will fail as choose the substitutes over their goods. Therefore this kind of market is definitively competitive. **L3 Refer to cinema industry**

However this market achieves neither productive efficiency and allocative efficiency. It can be seen on the diagram that it is not productively efficient as it does not produce at the minimum point of the average cost curve. It is furthermore not electively efficient as sets price above the point of the market price,  $MC = AR$ , and the new price is  $P$ . **L4**

This kind of competition proves how there is no efficiencies gained via monopolistic competition. On the other hand this diagram ignores the benefits gained from a monopoly. Monopolies benefit from having a stronger financial account therefore they can invest more into research and development. This creates new innovations which might become more attractive to consumers. As technology improves through this the range of products produced will increase which results in dynamic efficiency. This shows how monopolistic behaviour has created efficiency as the continued investment in research and development has resulted in consumers having an abundance of choice. In contrast it could be said that the firm is only investing in this as a form of branding. Firms try to innovate to create a new product to monopolise it and charge higher prices. For example in the market for cinemas, Cineworld created moving chairs and charged much more for these seats as no other firm has the technology for this innovation. **Good example**

This therefore suggests that the dynamic efficiency is either as a result of competitive forces or monopolistic behaviour. As mentioned previously monopolies benefit from having large financial funds, which allows firms to exploit economies of scale. Economies of scale are when a firm can increase production and reduce their total costs. Cinemas are an example of firms with economics of scale, especially managerial ones. Firms such as Odeon and Cineworld have the financial backing to gain large amounts of credit to build multiplex cinemas and buy land in the middle of towns and cities whilst maintaining the expensive rent. Firms can cover these higher costs, whilst maintaining lower pricing, as they will move away from profit maximisation. This will move the price closer to allocative efficiency. This could not happen under perfect competition where lots of smaller firms would not be able to afford the large rent costs. **L4**

In conclusion whilst in theory competition can create perfect allocative and productive efficiency, however it is just that, a theory. In reality it can not be achieved but as stated previously not all competition in theory can produce efficiencies as shown by monopolistic competition. However this was disproved by the behaviour of the monopolistic firms which innovated to create dynamic efficiency and have the ability to utilise economies of scale. Therefore competition does create efficiencies, but it also doesn't create efficiencies dependent on the market, however as proven by the behaviour of monopolies it is not the only cause for efficiency. **L4 Last sentence needs clarification.**