

Economics and market

[Economics](#)



**ASSIGN
BUSTER**

Assess the view that making an oligopolies market more contestable is the best way to improve the efficiency of that market. The theory of perfectly contestable markets was presented as a generalization of the theory of perfectly competitive markets and was presented as providing guidelines for the conduct of regulation, namely to allow freedom of entry and exit and to ensure equal access of competitors. An oligopolies market is a particular market that is controlled by a small number of firms.

An oligopoly is much like a monopoly, in which only one company exerts control over cost of a market, however in an oligopoly, there are at least two firms controlling the market. A contestable market is one where incumbent firms face real and potential competition. A market with only one firm can still be contestable if there are serious threats of entry into that market. By increasing a market's conceivability, the overall efficiency should improve because it would make incumbent firms more productively, dynamically, lucratively and x-efficient.

This essay will therefore argue that conceivability is the best way to make a market more competitive as it improves all four aspects of efficiency. In order to improve a market's conceivability, barriers to entry must be lowered. The Royal Mail used to be a legal monopoly but now firms are allowed to enter the market for sending letters. This has increased conceivability. Patents and other legislative barriers could be lowered in order to increase conceivability. Firms are therefore able to produce products that they would previously not have been allowed to make.

However there is also a danger that by reducing patents, firms and entrepreneurs will have no incentive to invent or innovate. Reducing tariffs, such as the European Union's decision to reduce tariffs on imported goods from the within the EX. from January 2014, will cause firms' costs to diminish thus making it more likely that they will sell their goods. Additionally, by fighting against collusion, predatory pricing and cartels, it is easier for firms to enter the market which will increase conceivability.

Firms that would have considered colluding or entering a cartel are unlikely to do so in a contestable market because of the possibility of a new firm that can produce the good at a lower price or a hit and run entry. If there are low entry and exit costs then firms can engage in hit and run tactics. This means that if an industry is making supernormal profits, then a firm can enter and take advantage of the high prices and high profits. Cartels and collusion are both inefficient because they involve limiting output while raising the price of their good which makes them lucratively and productively inefficient.

Thus a contestable market is more efficient. In an incontestable market, a firms' aim of gaining monopoly power through profit mastication by producing at the output of $MAC = MR$. (Figure 1) is productively, lucratively and x-inefficient because they can satisfies and produce above the SCARS (Figure 2). X-efficiency occurs when a firm operates on their CARATS and they are likely to be more inefficient if they are in an incontestable market because they do not need to produce on their CARATS.

Productive efficiency involves producing at the lowest point on a firms short run average cost curve where $AC = MAC$ and Allocation efficiency occurs

where $MAC = AR$ and when all resources are being distributed in order to meet demand. If this market Economics and Market By compel 2 lower prices, thus being more efficient. Unless the incumbent firm reduces its costs, then they will have to leave the market or risk making subnormal profits. This can be seen on Fig. 3 where UP and Q make normal profit thus avoiding threat of entry from other firms.

This is in comparison to the incontestable market of PI and IQ where the firm profit maximizes where $MAC = MR$. Firms in a contestable market are therefore is productively, lucratively and x-efficient. As a result of the fact that firms, in a contestable market, need to continuously improve consumer choice and their quality of goods or services, they are more likely to dynamically efficient. Dynamic efficiency comprises of firms investing in better quality of product or more consumer choice.

Although firms in an incontestable market are more likely to have larger supernormal profits, they are less likely to invest their money because they have less of an incentive to compete and may decide to satisfy rather than invest in research and development. Therefore a firm in a contestable market must be more dynamically efficient if they want to continue to make profit because they are competing with other firms and must differentiate themselves through an improved quality of product. Another way to improve conceivability is through the internet. The internet can lower market costs and sunk costs for new firms.

Firms no longer have to worry about spending excessively on advertisement to create powerful brand. With minimal expenditure, they

can easily reach millions of consumers worldwide. Also, since the costs of exit are lower, more will be willing to take risk. Furthermore, the internet means some businesses may choose to operate completely online which significantly helps to reduce large overhead costs. However large established firms can practice limit pricing and can lower down the price of their goods to a level where new firms may find it unprofitable to join the industry.