Innova Junior College
H2 Question 2

a) Explain the relevance of barriers to entry in determining the key differences between oligopolistic competition and monopolistic competition. [10]

	Monopolistic Competition	**Oligopoly**
Barriers to entry and exit - define - can be natural or artificial	Relatively Low or No BTE Example: Low setup costs for hawker stall – Ease of obtaining license; relatively low rental cost, fewer workers and easier to obtain raw materials.	High BTE Example: Telecommunication firms require high setup costs as well as licensing requirement from the government.
The differences in the ability to prevent entry results in some key differences between the 2 market structures.		
Difference in terms of Structure : **MC has a large number of sellers while Oligopoly dominated by a few large firms mainly due to BTE** Why? Example of Oligopoly - Telecommunications industry in Singapore → Dominated by a few large firms mainly due to high barriers to entry in the form of licensing (legal barriers) as well as high fixed cost. → In contrast, hawker stalls (MC firm) faces relatively low barriers (ease of obtaining license) as well as low start-up cost		
Number of Sellers	Large number of small firms Each firm has an insignificant market share E.g. food and beverage industry with many small restaurants, cafes etc.	A few large firms dominating the market. Each firm has a significant market share E.g. telecommunications service industry with 3 dominant firms: SingTel, M1, StarHub.
Difference in terms of Conduct **Due to relative differences in BTE, there is a difference in the way the firms conduct themselves in terms of their pricing and non-price strategies** Why? Example of Oligopoly - Telecommunications industry in Singapore → Due to high barriers to entry in Oligopoly → Dominated by a few large firms → High degree of mutual interdependence which results in price rigidity and therefore conduct of non-price competition → In MC → Low barriers → large number of sellers → try to differentiate themselves in terms of product differentiation but also engage in price competition		
Price Strategy	Independent and Price Setter. Market power depends on degree of product differentiation. E.g. Restaurant owners could set price more independently as they are less mutually interdependent.	Mutual interdependence: Price Rigidity Or collude to set monopoly price (usually tacit) E.g. Telecommunication firms may follow the kinked demand model where firms follow a decrease in price but not an increase.

Non-price strategy	Differentiated products or service E.g. Restaurants try to distinguish themselves by offering signature dishes which customers may find unique.	Differentiated/Undifferentiated E.g. Essentially the services they provide such as mobile calls and SMS is homogenous. However they try to distinguish themselves by coming up innovative subscription plans to suit different market segments
Difference in terms of Performance **Ability in erecting BTE will determine the degree of competition and hence the amount of supernormal profits in the long run** → Due to low BTE in the MC industry, MC firms earn only normal profits in LR unlike oligopolistic firms who, due to their significantly higher degree of price setting ability, are able to earn supernormal profits in the LR.		
BTE affects profit position in the LR	No barriers to entry → LR normal profits → Must draw in AC curve to show normal profit	High barriers to entry → LR supernormal or normal profits → Must draw in AC curve to show supernormal profits in the LR

L3	Well-developed explanation on how BTE leads to the key difference between the two market structures. Max 8 marks for 2 well-developed points	7 – 10
L2	Under-developed explanation on how BTE leads to the key differences.	4 – 6
L1	Descriptive understanding on how BTE leads to key differences between the two markets.	1 – 3

b) Consider different retailers in Singapore and assess the extent to which barriers to entry may be detrimental to competition and economic welfare. [15]

Thesis: **High degree of BTE may be detrimental to competition and economic welfare**	**Anti-thesis:** **High degree BTE may not be detrimental to competition and economic welfare**

• In theory, the higher degree of BTE → less competition
• Most extreme case is monopoly and to a lesser extent oligopoly where there is perceived to be little competition due to the number of firms present.
• Explain using diagram how high degree of BTE can result in ability to set high prices → lack price competition
• Explain how ***high degree of BTE can result in higher degree of allocative inefficiency***
Evaluation:
  • Oligopolistic firm might restrict output more and charge a higher price which might result in a higher deadweight loss than the MC firm.
  • In Singapore, oligopolistic firms may not necessarily charge excessively higher prices – depends on contestability, level of government intervention e.g. in the transport and telecommunications industry where prices are regulated by the government.
 	
• **Equity** – ***higher degree of BTE can result in higher degree of inequity***
• Oligopolistic firm can make supernormal profits in the long run due to the strong barriers to entry in this market.
• Profits will be not be equally distributed in this market but concentrated in the hands of a few large producers as new entrants are unable to compete for a share of the profitable market.
• MC firm on the other hand can only make supernormal profits in the short run but not in the long run due to the low level of barriers to entry in this market.
• Profits will be more equally distributed in this market rather than concentrated in the hands of a few large producers as new entrants are more able to compete for a share of the lucrative market.
	• Productive Efficiency – ***Higher degree of BTE may lead to higher degree of productive efficiency***
	• Using diagram, explain how oligopolistic firm does produce on the LRAC in the long run and is also productive efficient.
	• It is able to produce at the lowest possible cost for every level of output. However, the oligopolistic firm has a greater scope for EOS due to the larger size of the firm. Hence the firm is still able to increase output further with a much lower AC than the MC firm.
	
	• Dynamic Efficiency – ***Higher degree of BTE may lead to higher degree of dynamic efficiency***
	• Moreover, high degree of BTE → LR supernormal profits as mentioned in part (a)
	• Oligopolistic firm has high barriers to entry which will restrict potential new entrants into the market to compete away the supernormal profits in the long run.
	• Hence, it will be able to retain its supernormal profits and use it to improve production techniques, improve product quality. The degree of product differentiation is more in depth and requires a much greater level of technological research and innovation.
	<u>Evaluation:</u>
	In Singapore context, even when the MC firm does not achieve dynamic efficiency, the competition amongst MC firms for profits is often aggressive and intense. E.g. clothing and hairdressing shops at Far East Plaza.

Conclusion - Higher degree of BTE does to certain extent be detrimental to competition and economic welfare in terms of equity and allocative efficiency. However, consumers can still gain in terms of higher dynamic and productive efficiency.	

L3	Well-developed 2 sided analysis on whether BTE may be detrimental to competition and economic welfare, with good use of examples from Singapore context. Candidates are able to explain how the relative degree of BTE affects attainment of allocative efficiency, productive efficiency, dynamic efficiency and equity. Diagrams are expected.	9 – 11
L2	Under-developed explanation on whether BTE may be detrimental to competition and economic welfare. Max. 8m if no appropriate diagrams are presented.	6 – 8
L1	Sputtering of points.	1 – 5
E2	Judgment is based on economic analysis.	3 – 4
E1	Unexplained judgment.	1 – 2