Perfect Competition

A perfectly competitive market must meet the following requirements:

- Both buyers and sellers are price takers.
- The number of firms is large.
- There are no barriers to entry.
- The firms’ products are identical.
- There is complete information.

A perfectly competitive market is one in which economic forces operate unimpeded.

Perfect Competition

Perfect competition is a firm behavior that occurs when many firms produce identical products and entry is easy. Characteristics of perfect competition:

- There are many sellers.
- The products sold by the firms in the industry are identical.
- Entry into and exit from the market are easy, and there are many potential entrants.
- Buyers (consumers) and sellers (firms) have perfect information.
A Perfectly Competitive Market

For a market to be perfectly competitive, six conditions must be met:

1. Both buyers and sellers are price takers – a price taker is a firm or individual who takes the price determined by market supply and demand as given.
2. The number of firms is large – any one firm's output compared to the market output is imperceptible and what one firm does has no influence on other firms.
3. There are no barriers to entry – barriers to entry are social, political, or economic impediments that prevent firms from entering a market.
4. Firms' products are identical – this requirement means that each firm's output is indistinguishable from any other firm's output.
5. There is complete information – all consumers know all about the market such as prices, products, and available technology.
6. Selling firms are profit-maximizing entrepreneurial firms – firms must seek maximum profit and only profit.

The Definition of Supply and Perfect Competition

- These strong six conditions are seldom met simultaneously, but are necessary for a perfectly competitive market to exist.
- Supply is a schedule of quantities of goods that will be offered to the market at various prices.
  - When a firm operates in a perfectly competitive market, its supply curve is its short-run marginal cost curve above average variable cost.

Price Taker

- A firm in a perfectly competitive market is said to be a price taker because the price of the product is determined by market supply and demand, and the individual firm can do nothing to change that price.
### The Necessary Conditions for Perfect Competition

<table>
<thead>
<tr>
<th>Condition</th>
<th>Description</th>
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<tr>
<td>Both buyers and sellers are price takers.</td>
<td>A <em>price taker</em> is a firm or individual who takes the market price as given. In most markets, households are price takers – they accept the price offered in stores.</td>
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<tr>
<td>The number of firms is large.</td>
<td>Large means that what one firm does has no bearing on what other firms do. Any one firm’s output is minuscule when compared with the total market.</td>
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<tr>
<td>There are no barriers to entry.</td>
<td><em>Barriers to entry</em> are social, political, or economic impediments that prevent other firms from entering the market. Barriers sometimes take the form of patents granted to produce a certain good.</td>
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<td>The retailer is not perfectly competitive.</td>
<td>A retail store is not a price taker but a price maker.</td>
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The Necessary Conditions for Perfect Competition

- There are no barriers to entry.
  - Technology may prevent some firms from entering the market.
  - Social forces such as bankers only lending to certain people may create barriers.

- The firms' products are identical.
  - This requirement means that each firm’s output is indistinguishable from any competitor’s product.

The Necessary Conditions for Perfect Competition

- There is complete information.
  - Firms and consumers know all there is to know about the market – prices, products, and available technology.
  - Any technological breakthrough would be instantly known to all in the market.

Demand Curves for the Firm and the Industry

- The demand curves facing the firm is different from the industry demand curve.
- A perfectly competitive firm’s demand schedule is perfectly elastic even though the demand curve for the market is downward sloping.
Perfect Competitors’ Demand Curve

- The result is that the individual firm perceives the demand curve for its product as being perfectly horizontal.

**Market Demand Versus Individual Firm Demand Curve**

- Market demand and supply are shown in Figure 4.5. The top diagram price is $10 per unit, and 10,000 bananas are purchased and sold. The equilibrium price defines the firm.

**Market Supply and Demand**

- When a firm operates in a perfectly competitive market, its supply curve is its short-run marginal cost curve above average variable cost.

**The Definition of Supply and Perfect Competition**

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