Perfect Competition Short Run

Chapter 10-1

A Perfectly Competitive Market

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

A Perfectly Competitive Market

- 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.

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

- A **perfectly competitive** market is a market in which economic forces operate unimpeded

From Colander text

- 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

14-5

A Perfectly Competitive Market

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

14-6

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

14-7

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

- Both buyers and sellers are price takers.
  - A ***price taker*** 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.

The Necessary Conditions for Perfect Competition

- Both buyers and sellers are price takers.
  - The retailer is not perfectly competitive.
  - A retail store is not a price taker but a price maker.

The Necessary Conditions for Perfect Competition

- The number of firms is large.
  - 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.

The Necessary Conditions for Perfect Competition

- There are no barriers to entry.
  - ***Barriers to entry*** 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.

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 Necessary Conditions for Perfect Competition

- 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.

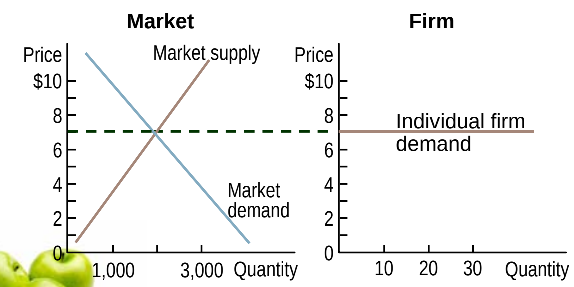
Demand Curves for the Firm and the Industry

- 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.

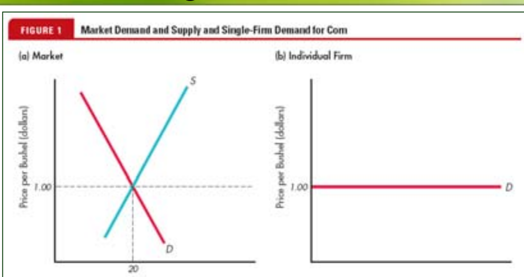
Perfect Competitors' Demand Curve

- 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 Supply and Demand and Single-Firm Demand



Market demand and supply are shown in Figure 1(a). The equilibrium price is $1 per bushel, and 20 billion bushels are produced and sold. The equilibrium price defines the horizontal, or perfectly elastic demand curve faced by the individual perfectly competitive firm in Figure 1(b).

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

14-20