LC Economics – Perfect Competition

Perfect competition	A market structure in which there are many sellers of an identical product. Examples: strawberry sellers on the side of the road. Lowest prices will be charged and scarce resources will be used efficiently. It is the ideal market structure for consumers.
PC characteristics: Many buyers	There are many buyers in the market. Each firm is a price taker, i.e. accepts the price set by the market. Each firm supplies a small fraction of the market and so cannot influence the market price.
PC characteristics: competitive sellers	There are many competitive sellers in the market. Each sellers' contribution is insignificant in the context of the total market. E.g. if production is increased by one seller, they will not have to lower their price to sell this extra output.

Cut dotted horizontal lines. Fold vertical lines.

LC Economics – Perfect Competition

PC characteristics: homogenous goods

The goods supplied by each firm are identical. They are perfect substitutes for each other and consumers can switch between products from different firms. This means that advertising from a single seller is pointless.

PC characteristics: no barriers to entry

There is freedom of entry to and exist from the industry and no barriers to enter or exit. Existing firms cannot prevent new ones from entering and existing firms can close down as they wish.

PC characteristics: perfect knowledge exists

Perfect knowledge relating to prices and profits exists. Each firm is fully aware of the profits made by others. Consumers are fully aware of prices being charged as well as the details of those products.

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PC characteristics: maximisation of profits

Each firm seeks to maximise their profits. To achieve this, they produce the quantity where MC=MR and MC cuts MR from below.

PC characteristics: no collusion in the market

No collusion exists between sellers and buyers of goods. Buyers don't group together with other buyers and sellers don't group with sellers in order to influence the market price. This is because there are too many firms for them to collude.

PC characteristics: supply of the factors of production

Firms face a perfectly elastic supply of the factors of production. If a firm wants to increase output, it can do so and acquire the necessary factors of production at the existing price, i.e. a scarcity of factors of production will not arise, which would push up the price. The unit cost of each of the factors of production is the same for all.

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PC benefits: production costs	Production occurs at the point of lowest cost. Market price equals minimum average cost. This means the firm produces at the lowest point on the AC curve, thereby achieving maximum efficiency.
PC benefits: minimum prices	The firm earns only normal profit and therefore the consumer is not being exploited as only minimum prices are charged, i.e. the minimum price that could be charged while encouraging firms to stay in business.
PC benefits: no advertising	The cost of advertising is not incurred, so this cost does not have to be passed on to the consumer as a result.

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PC benefits: encouraged efficiency	Competition between firms will acts as encouragement to increase efficiency, as only those producing at the lowest point of the AC will survive in the long run.
PC disadvantages: economies of scale	There is no scope for economies of scale as there are many small firms producing relatively small amounts, one single firm cannot achieve economies of scale.
PC disadvantages: choice	There is little choice for consumers. Undifferentiated products are unattractive and give little choice to consumers, unlike markets such as clothing and footwear.

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LC Economics – Perfect Competition

PC disadvantages: no research and development

Lack of supernormal profits may make investment in R&D unlikely. This is particularly important in industries like pharmaceuticals, where research is essential.

PC disadvantages: development of technology

With perfect knowledge there is little incentive to develop new technology, as it would be shared with other companies.

Supernatural profit (SNP)

SNP is profit in excess of normal profit, i.e. AR>AC.

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