Perfect Competition Overview
Webnote 1594

Assumptions of the Model:

- Many buyers and sellers (`000)
- Homogenous product
- Perfect knowledge
- No barriers to entry or exit

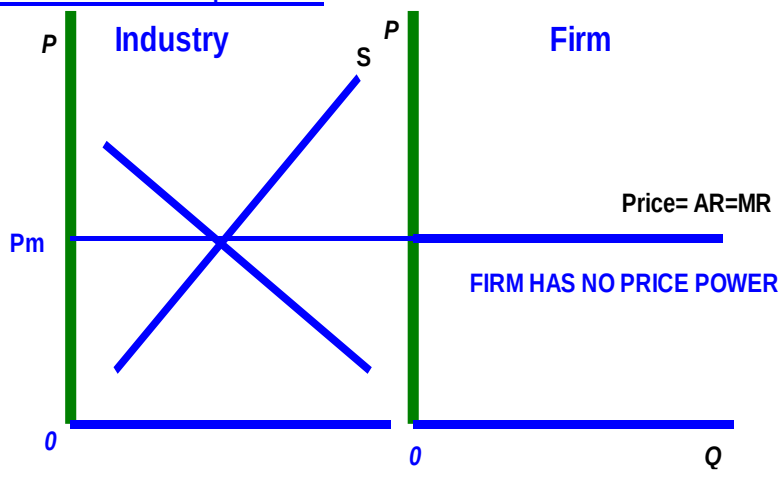
The model suggests that:

1. Efficient - firms forced to produce at lowest point on AC curve [1]
1. Lower prices
2. Higher output for the Industry than in Monopoly
3. Resource Allocation is better (lowest point on AC in long run –see fig C)
4. No price power

SHORT RUN AND LONG RUN

- Short run ~ at least one Fop is fixed
- Long run ~ all factors variable
- Closest real market situation is a farmer/ commodity maket

DIAGRAM A: Firm is a price taker



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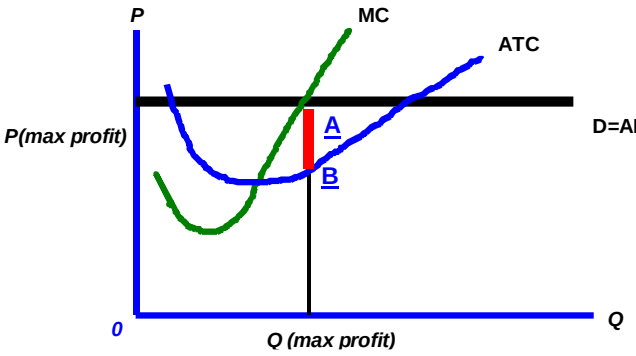
mc = ac
mc = ar
mc =mr
ar = ac

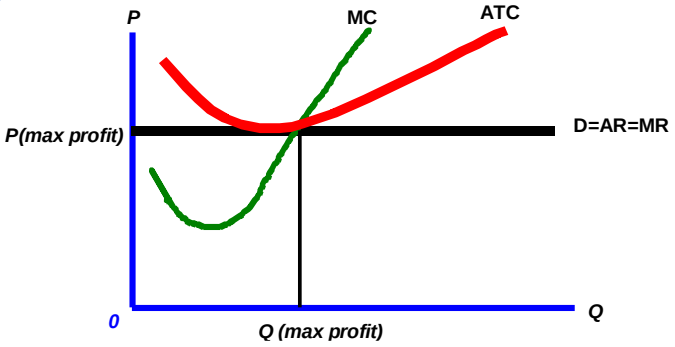
Note on diagrams b and c:

Draw the price in figure C is lower than in figure B. This is because the industry supply curve in figure A above will shift downwards to the right making the market bigger and price lower

B. Firm: Short Run period



C: Firm: Long Run period



Evaluation

Perfect Competition

For: (+)

- **Efficient allocation**
- **Low prices**
- **competitive**

mc = ac
mc = ar
mc =mr
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Perfect CompetitionAgainst: (-)

- **Theoretical**
- **No economies of scale**
- **Poor choice**
- **R+D not likely**

Summary of Perfect Competition:

The Output and Price of a Perfectly competitive firm:

1. **maximum profit quantity** occurs at **mr = mc** (profit max output)
2. **allocative efficiency quantity** occurs at **mc = ar** (price)
3. **productive efficiency quantity** occurs at lowest point of ac curve: **mc = ac**
4. **No Supernormal profits: ar = ac**