Webnote 1594
Syllabus: Items 53 - 55

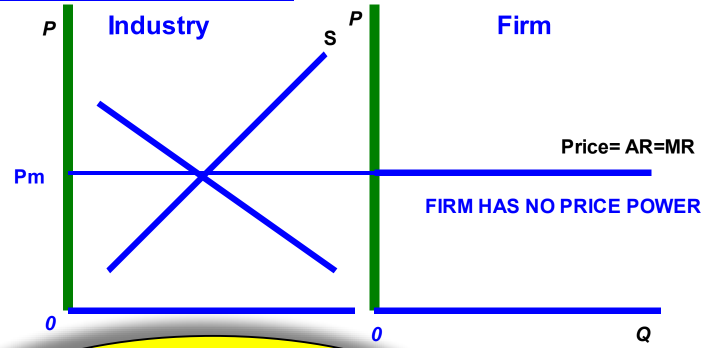
SYLLABUS REFERENCE 1.5 HL EXTENSION [1]
Economics Models : Perfect Competition

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



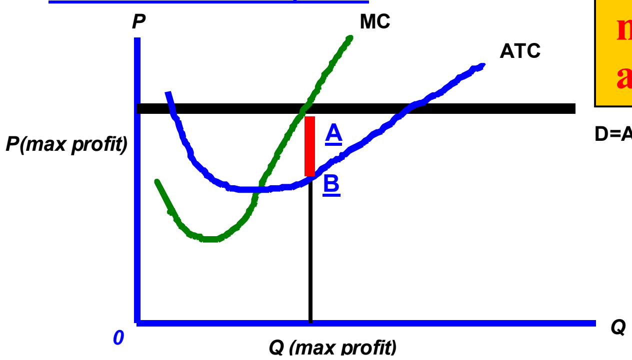
Perfect Competition

Perfect Competition
For: (+)
- Efficient allocation
- Low prices
- competitive

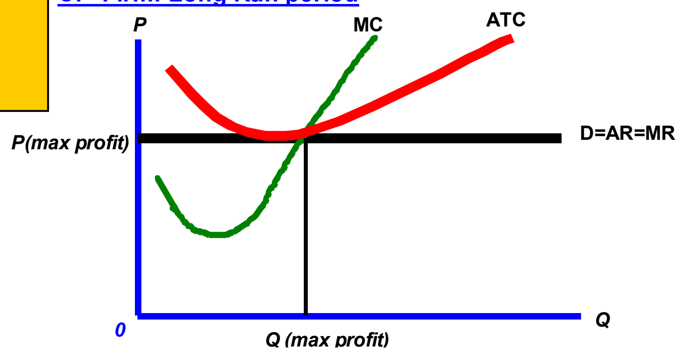
Perfect CompetitionAgainst: (-)
- Theoretical
- No economies of scale
- Poor choice
- R+D not likely

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

B. Firm: Short Run period



C: Firm: Long Run period



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Summary of Perfect Competition:

The Output and Price of a Perfectly competitive firm:

1. **productive efficiency quantity** occurs at lowest point of ac curve: **mc = ac**

2. **allocative efficiency quantity** occurs at **mc = ar** (price)

3. **maximum profit quantity** occurs at **mr = mc** (profit max output)

4. **No Supernormal profits: ar = ac**