Introduction to Economics I
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Perfect Competition: a market structure which has the following characteristics.

- There are many firms.
- All firms are relatively small the market size.
- Firms are price takers.
- Perfect information.
- Identical poducts (perfect substitutes, homogeneous goods).
- Free entry and exit.

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- The industry price is determined by the interaction of Supply and Demand, leading to a price of Pe.

- The individual firm will maximise output where MR = MC at Q1.

- In the long run firms will make zero profits.

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- If positive profits are made in the industry, then new firms will be attracted into the industry causing prices to fall.

- If firms are making a loss then firms will leave the industry causing price to rise.

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Profit maximizing rule in perfect competition

P=MR=MC

where P is the market price, MR is the marginal revenue and MC is the marginal revenue.

marginal revenue The additional revenue that a firm takes in when it increases output by one additional unit.

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- **Efficiency of perfect competition**
- Firms will be allocatively efficient P=MC.
- Firms will be productively efficient. Lowest point on AC curve.
- Firms have to remain efficient otherwise they will go out of business. (X-efficiency)

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- **Efficiency of perfect competition**
- Firms are unlikely to be dynamically efficient because they have no profits to invest in research and development.
- If there are high fixed costs, firms will not benefit from efficiencies of scale.

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Examples of perfect competition

In the real world, it is hard to find examples of industries which fit all the criteria of ‘perfect information’ and ‘identical goods’. However, some industries are close.

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Examples of perfect competition

1. **Foreign exchange markets**. Here currency is all homogeneous. Also, traders will have access to many different buyers and sellers. There will be good information about relative prices. When buying currency it is easy to compare prices

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Examples of perfect competition

2. Agricultural markets. In some cases, there are several farmers selling identical products to the market, and many buyers. At the market, it is easy to compare prices. Therefore, agricultural markets often get close to perfect competition.