ECONOMICS

Name of the course:- MA Part I & BA Hons. Part I, ECO.
Paps - I

TOPIC - PERFECT COMPETITION

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Characteristics of perfect competition:

(1) Large number of buyers and sellers

The term 'Large number' signifies that the market share of one individual seller or the buyer is so insignificant that any variation in it, big or small, has no influence on the market price. The price determined collectively by the sellers and the buyers remains unchanged. It makes an individual firm a price taker.

(2) All firms produce homogeneous products

The term 'homogeneous products' implies that the buyers give the same rating to the products produced by all the firms. The products may or may not be physically the same, but so long as the buyers treat them the same, the products are called homogeneous products. The outcome is that the buyers are not willing to pay a different price for the product of different firms. They are willing to pay only the same price. Similarly, no seller is in a position to charge a different price for its products. The same market price prevails for all the firms.

(3) Perfect knowledge:

Both buyers and sellers have perfect knowledge about the market. The 'ignorance factor' is absent. No buyer pays a higher price due to ignorance, and no seller charges a lower price due to ignorance. Each producer has full knowledge about the inputs and technology. Therefore, each producer has the same cost of production.

(4) Freedom of entry and exit to firms:

There is no restriction, legal and others, on the firms to make an entry attracted by positive economic profits. Firms make exit when unable to bear losses. This factor is operative only in the long-run.

It makes the economic profits earned by each firm to stay at zero level in the long-run. In the short run if profits rise above zero (i.e normal) new firms enter, raise the output of the industry and bring down the price till normal profits are reduced to zero. ~~level~~. If there are losses the existing firms start leaving, output falls, price rises till the losses are wiped out and profits reached zero level. To sum up, the profits remain at the zero level in the long-run.

(5) Perfect mobility of factors of production.

~~(6) Negligible/No transport cost.~~

~~PRICE DETERMINATION~~

The factors of production are free to move from one firm to another throughout the economy. It is also assumed that workers can move between different jobs, which implies that skills can be learned easily. Finally, raw materials and other factors are not monopolised and labour is not unionised. In short, there is perfect competition in the markets of factor of production.

6) Profit Maximisation:—

The goal of the firm is profit maximisation. No other goals are pursued.

(7) No Government regulation:-

There is no govt. intervention in the market (tariffs, subsidies, rationing of production or demand and so on are ruled out).

PRICE DETERMINATION

The Industry (and not an individual firm), in interaction with demand forces, determines the price. The individual firm takes the price as given, and is free to sell any amount without fear of fall in price.

Graphically (Figure 4.1)

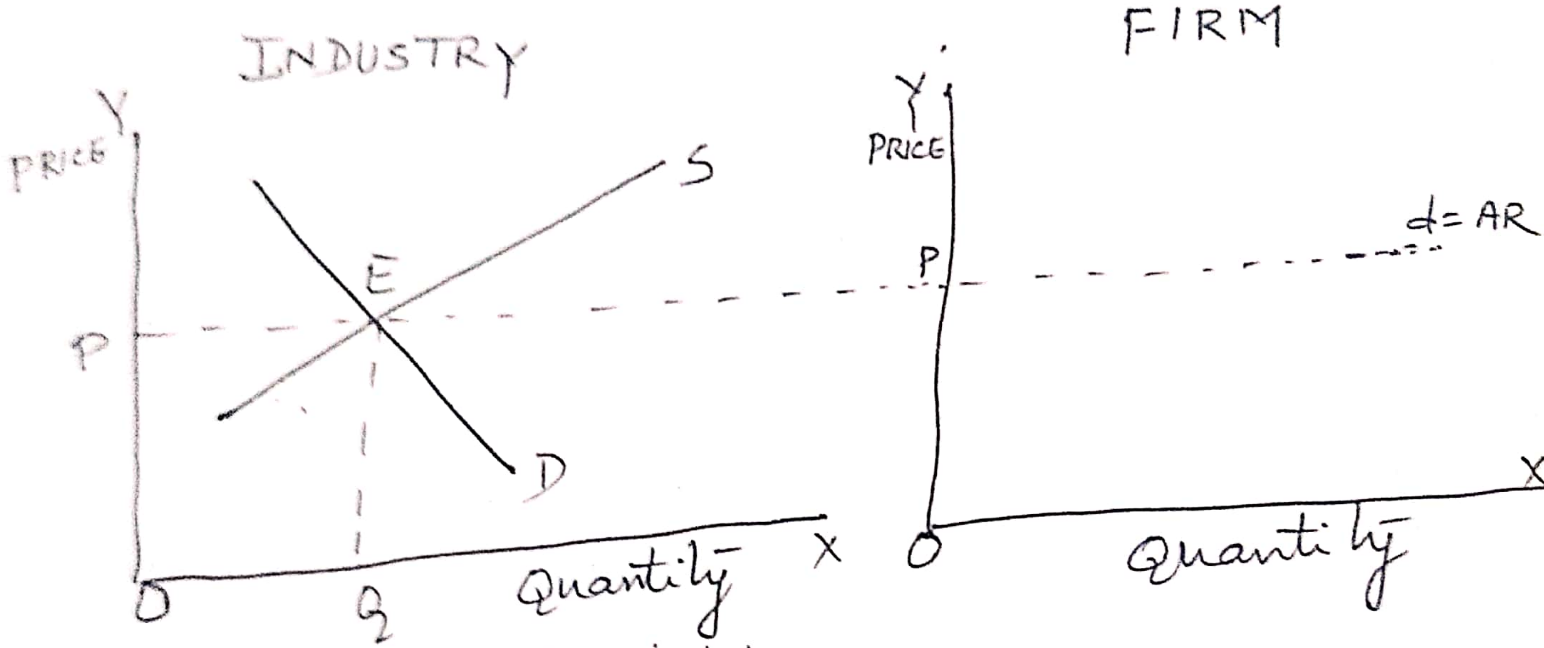

Figure 4.1

The demand curve is based on the inverse relation betwee price and demand. The supply curve is based on the positive relation between price and quantity supplied. Price is determined at E where demand equals supply. The price is OP.

The firm adopts the price and is free to sell any quantity at the price. Short run is a period during which actual production takes place. Long run is a period during which only ~~planning~~ planning is done.

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