Lesson 1: Market Structure 1: Perfect Competition

PERFECT COMPETITION

Characteristics

- There are a large number of buyers and sellers.
- Each seller offers an identical product for sale.
- There are minimal barriers to entry.
- Sellers have no pricing power.
- There is no non-price competition in the market.

Demand in a Perfectly Competitive Market

The market demand curve is downward sloping (due to the income and substitution effects).

Total revenue (TR) equals price (P) times quantity (Q).

Average revenue (AR) is calculated as total revenue divided by quantity.

Marginal revenue (MR) is the change in total revenue brought about by selling an additional unit of output.

Elasticity of Demand

Price Elasticity of Demand

Price elasticity of demand measures the percentage change in quantity demanded given the percentage change in price of a product.

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Income Elasticity of Demand

Income elasticity of demand measures the responsiveness of demand to changes in income.

Cross Elasticity of Demand

Cross elasticity of demand measures the responsiveness of demand for a product to a change in the price of another product.

Consumer Surplus: Value Minus Expenditure

Supply Analysis in Perfectly Competitive Markets

Optimal Price and Output in Perfectly Competitive Markets

Schumpeter's Take on Perfect Competition

Joseph Schumpeter suggested that perfect competition is more of a long-run type of market structure.

In the short run, companies develop new products or processes that give them an edge over competitors.

- During this period innovative firms see their profits soar.

What follows is a "swarming" stage in which other firms follow the innovative company and try to copy its idea.

Eventually the innovation is no longer new as all firms have adopted it.

- Since no company has an edge, perfect competition prevails, and we have long run equilibrium until someone comes up with a new innovative product or process.