## 8.1 Perfect Competition and Why It Matters

### Learning Objectives

By the end of this section, you will be able to:

* Explain the characteristics of a perfectly competitive market
* Discuss how perfectly competitive firms react in the short run and in the long run

Firms are in perfect competition when the following conditions occur: (1) many firms produce identical products; (2) many buyers are available to buy the product, and many sellers are available to sell the product; (3) sellers and buyers have all relevant information to make rational decisions about the product that they are buying and selling; and (4) firms can enter and leave the market without any restrictions—in other words, there is free entry and exit into and out of the market.

A perfectly competitive firm is known as a price taker, because the pressure of competing firms forces it to accept the prevailing equilibrium price in the market. If a firm in a perfectly competitive market raises the price of its product by so much as a penny, it will lose all of its sales to competitors. When a wheat grower, as we discussed in the Bring It Home feature, wants to know the going price of wheat, they have to check on the computer or listen to the radio. Supply and demand in the entire market solely determine the market price, not the individual farmer. A perfectly competitive firm must be a very small player in the overall market, so that it can increase or decrease output without noticeably affecting the overall quantity supplied and price in the market.

A perfectly competitive market is a hypothetical extreme; however, producers in a number of industries do face many competitor firms selling highly similar goods, in which case they must often act as price takers. Economists often use agricultural markets as an example. The same crops that different farmers grow are largely interchangeable. According to the United States Department of Agriculture monthly reports, in December 2021, U.S. corn farmers received an average of $5.47 per bushel. A corn farmer who attempted to sell at $6.00 per bushel would not have found any buyers. A perfectly competitive firm will not sell below the equilibrium price either. Why should they when they can sell all they want at the higher price? Other examples of agricultural markets that operate in close to perfectly competitive markets are small roadside produce markets and small organic farmers.

Link It Up

Visit this [website](http://openstax.org/l/commodities) that reveals the current value of various commodities.

This chapter examines how profit-seeking firms decide how much to produce in perfectly competitive markets. Such firms will analyze their costs as we discussed in the chapter on [Production, Costs and Industry Structure](http://openstax.org/books/principles-microeconomics-3e/pages/7-introduction-to-production-costs-and-industry-structure). In the short run, the perfectly competitive firm will seek the quantity of output where profits are highest or, if profits are not possible, where losses are lowest.

In the long run, positive economic profits will attract competition as other firms enter the market. Economic losses will cause firms to exit the market. Ultimately, perfectly competitive markets will attain long-run *equilibrium* when no new firms want to enter the market and existing firms do not want to leave the market, as economic profits have been driven down to zero.