The theory of perfect competition

Finance, Market

Abstract

The theory of perfect competition is a theoretical structure of market that is principally used as the benchmark against which some other real-life structures of markets are measured. Several economists have argued that the theory is not perfect itself and cannot exist or be applied in the real world. Perfect competition can only exist in a world where time is not moving, and that is definitely an impossibility. There cannot be growth of industry via enhancing proficiency or new innovations. This forms the basis of this research where the paper will be critical of the concept and explain why it cannot be a reality. Such factors include: all sellers and purchasers are price takers due to their tiny market share; all goods are the same or identical; Lack of barriers to exit or entry; customers have perfect information, and all companies have equal access to thetechnologyand resources with reducing or constant returns to scale.

Introduction

Perfect competition can be described as a theoretical structure of market. The concept is principally used as the yardstick or standard against which some other real-life structures of markets are measured. Agriculture is perhaps the only industry that has most resemblance with the concept in real life. It is the complete opposite of monopoly. In this kind of setting, there is only one company doing the supply of a specific good or service, and the company can price the service or good the way they want as customers do not have any other option and it is also very difficult for any other companies that would like to join the market to do so (Bown and Meredith, 2007, p.

123). Under this kind of setting of market, there are several sellers and purchasers, and the prices represent or show the demand and supply. In addition, the buyers have several alternatives if the service or good that they wish to purchase becomes very costly or even its quality starts deteriorating. New companies can have an easy entry into the market, bringing about more competition. They can generate just sufficient revenues to sustain the business and no more, since if they were to get profits that are excess, some other firms would join the market and bring the profits back to where they are expected or to the normal rate (Buchanan and Wagner, 2009, p. 62).

Competition in the real world is very different from the paper version of perfect competition in several ways. Real firms or companies attempt to make their goods and services be very distinct from those of their rivals (Drexler, 2007, p. 60). They involve in various ways of making their products be considered as the best such as doing vigorous and aggressing advertisements. They reduce their prices in order to win more customers from their competitors. They also increase prices hoping to make more profits. Some other companies are very large with big brands that they are able to influence the prices in the market (Anderson, 2009, p. 88). However, the concept of perfect competition is not an ideal or perfect that firms should try achieving in the actual world. In the subsequent discussions, this paper will describe the factors that make it impossible for the concept to be a reality.

All sellers and purchasers are price takers due to their tiny market share

This is actually the most critical postulation of the concept, besides also being the easiest for disapproval. For this concept to work properly there should be a significant number of firms, which are in several hundreds. One should first think about the kind of industry this isIt is only possible in the industry of agriculture. For instance, there are a lot of carrot farmers, and none of them controls the market prices (Johnson and Guillermo, 2012, p. 81). All of them have very little power in the market, but sell to their customers. In this instance, there is nothing like perfect competition. Nevertheless, even this is being affected by the development of intensive agri-business in the United States who would enjoy a large market share. Similarly, supermarket chains also use their influence in the market to force down the prices that they pay the farmers. There is no other industry that has several firms; instead, there are a few (Anderson, 2009, p. 88).

All goods are the same or identical

It is required by this concept that all goods and services be similar and regarded as identical. In this manner, companies can only compete on the pricing, thus is one of them reduces its price, and then the customers will immediately rush to it to enjoy the offers. Whereas this applies to the carrots and agriculture, it does not anywhere else. Companies actively attempt to make their goods and services to be distinct from their competitors (Steve, 2009, p. 78). They do this by either making a slight difference or even playing as though there are genuine distinctions. For instance, producers go to great levels of proving that their razor is very different and the best in the market that cannot be compared to any other. Another good example can be

the various models of cars that are being manufactured by different companies; they appear quite different from one another such that they cannot only be compared in terms of price only (Drexler, 2007, p. 62). This presumption overlooks the fact that several companies compete actively based on the quality of their products. The industry offoodhas its basis on the similar food that is served in different ways, which makes restaurants to compete mainly on the quality of their foods and not price (Buiter and Ebrahim, 2012, p. 29).

Lack of barriers to exit or entry

In this concept, it is assumed that if companies in the industry are getting large amounts of profits, then more firms will be attracted to the market. Companies will continue joining the market until the excess profit being earned by the companies is brought back down to the normal rate, but what this normal means has never been stated. There are barriers to entry in nearly all of the industries in the world. Some of the barriers include official or maximum limits like in the legal and medical professions (Johnson and Guillermo, 2012, p. 81). However, the most common is the large amount of funds or resources that are required for a successful entry into the industry by a company. For instance, Irish airlines are only two because the costs of start up in the purchasing of aircraft are so high to afford. Whereas this might be the most clear and obvious instance, nearly all industries involve expenses of set up like the buying of premises and equipment (Petri, 2004, p. 52). This greatly prevents companies from making expansions into some other new industries and is a key limit on the number of companies.

Moreover, it is believed that companies do not attempt to prevent some other new potential competitors by either collusion or reducing their prices for a short term in order to discourage the new entrants.

Customers have perfect information

The assumption is that all customers have the information regarding all that they need to know. Therefore, if one company reduces its prices, then customers will be able to learn about very fast. Customers are believed to have the capability to do a comparison of all businesses and then choose the best to deal with (Anderson and Wincoop, 2008, p. 87). They are believed to be in a position of distinguishing the difference in quality between goods and services. If a company seeks to gain advantage by pricing its goods or services lower but their quality is also low, it would quickly be discovered. Apparently, it is true that the customers are not aware of everything and can always be fooled or cheated by the market (Anderson and Wincoop, 2008, p. 89). A good case in instance is advertising, which convinces consumers that the two services or goods that are similar are different in real sense. In some other instance, the consumers are convinced to purchase the goods and services that are of low quality. Consumers sometimes usually do not know the best quality of good that they should purchase or the cheapest price Anderson and Wincoop, 2008, p. 90).

All companies have equal access to the technology and resources with reducing or constant returns to scale

This concept or assumption has some other faulty presumptions that believe that all companies are on the same level. It is therefore impossible for one company to adapt or even invent a new technology ahead of its competitors; but instead it comes from a source that is not known and its distribution is done in a simultaneous and equal manner (Roark, 2006, p. 90). Similarly, it is presumed that all companies use similar resources in the say ways, and no company might be more competent than the other. It is also assumed that there is nothing like economies of scale, considering that were are at the core of industrial revolution and the concept of capitalist is itself ridiculous (Machovec, 2008, p. 67). If one company made the economies of scale available, then its goods and services would be soles at a lower price, its sales would be increased, meaning that it would become more competent, enabling it to sell its products as a lower cost until it assumes the market dominance. It is thus true that for a perfect competition to be feasible, economies of scale should not be there, but an industry filled with small cottage factories (Bernhofen and Brown, 2005, p. 54).

More so, the concept has the assumption that there is nothing likeloyaltyto brand, that customers will run away from their usual company when they are suited. It also assumes that there is nothing like promotions for convincing the people to purchase a particular product that they would not have otherwise purchased. There are also not costs of transportation and all of the companies can access the same markets equally such that there is no regional or local advantage (Obstfeld, 2012, p. 92).

Conclusion

Perfect competition can only exist in a world where time is not moving, and that is definitely an impossibility. There cannot be growth of industry via enhancing proficiency or new innovations. Companies do not invest or even save in the future. If a company makes losses and is not able to weatherthe storm, it goes bankrupt. It is a world where there is nothing like profit and it is treated just like sex in the Victorian era; it something that happens but people pretend that it does not. This concept is the model of all the conservatives and the neo-classical economics' bedrock. Sadly, it does not exist in the ideal world with the exception of agriculture. The theory only exists in the minds of those who admire it and in the papers. It cannot be found or applied anywhere where it should count. Like all the perfectiondreams, perfect competition should be recognized for what it is; that is something that can never be real.

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