

Perfect competition essay sample

[Economics](#)



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Perfect competition can be used as a yardstick to compare with other market structures because it displays high levels of economic efficiency. Allocative efficiency occurs when there is an optimal distribution of goods and services. This involves taking into account consumer's preferences. In both the short run and the long run in perfect competition we find that price is equal to the marginal cost ($P = MC$) and thus allocatively efficient is achieved. At the ruling market price, consumer and producer surplus are maximised.

However, no one can be made better off without making some other agent at least as worse off. At the point where the price meets the marginal cost, allocatively efficient occurs assuming perfect competition is present. At the point $P = MC$ resources are being used as efficiently as possible. A perfect competition market has many key features. One of these features is that every firm is a price taker, meaning they cannot set the price. This causes businesses to be efficient as the most efficient competitor or they will be out-priced. This results in inefficient firms going out of the business whilst the most efficient businesses stay alive.

If most firms are making abnormal profits, this encourages the entry of new firms into the industry, which if it happens will cause an outward shift in market supply forcing down the ruling market price, as shown on the left graph. This increase in supply will eventually reduce the market price until $\text{price} = \text{long run average cost}$. At this point, each firm in the industry is making normal profit. Here firms operate at the minimum average total cost as they are producing the maximum possible output from inputs into the production process. If most firms are making abnormal profits, this encourages the entry of new firms into the industry, which if it happens will

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This increase in supply will eventually reduce the market price until price = long run average cost. At this point, each firm in the industry is making normal profit. Here firms operate at the minimum average total cost as they are producing the maximum possible output from inputs into the production process. Productive efficiency occurs when a firm operates at minimum average total cost, producing the maximum possible output from inputs into the production process. Productive efficiency occurs when the equilibrium output is produced with average cost at a minimum. This is not achieved in the short run, but is attained in the long run equilibrium for a perfectly competitive market. A perfectly competitive market leads to productive efficiency.

Some economists claim that perfect competition is not an optimal market structure for high levels of research and development spending and the resulting product and process innovations. In terms of research and development and innovation a more ideal market would be one operating under a monopoly or oligopoly. A cost reducing innovation from one producer will be transferred to other suppliers without any cost and in a short time period, assuming there is perfect information in the economy.

Perfect competition exists when there are many small businesses in a market that produce homogenous goods. For pure competition to result in allocative and productive efficiency there must be many small operations producing goods with no one business dominating the market. By definition

of allocative efficiency it is not necessary that it can occur only under one condition of perfect monopoly. We can assume that perfect competition automatically results in allocative efficiency, only when there are no externalities, such as pollution, and distribution of income under competitive market is accepted as fair.

Along with productive and allocative efficiency, we also have static and dynamic efficiency. Static efficiency is efficiency at a point in time. Static efficiency includes both allocative and productive efficiency. Static efficiency focuses on how much output can be produced now from a given stock of resources and whether producers are charging a price to consumers that fairly reflects the cost of factors of production used to produce a good or service.

Dynamic efficiency is concerned with the productive efficiency of a firm over a period of time. We assume that a perfectly competitive market produces homogeneous goods. This means there is very little scope for innovation as businesses are more focused on being the most efficient supplier in the perfectly competitive market. The lack of scope for innovation removes the chance of a monopoly, which would be unlikely to operate in a productively efficient manner as it is capable of exploiting consumers, which will result in the firm not producing at the minimum average total cost.