Benefits of perfect competition

ASSIGN BUSTER

Competition is a very important factor for the economists which makes them very enthusiastic, because is a very good thing economically because of its efficiency. Efficiency helps the society make the most of its scarce resources so markets that are high competitive force all the firms to very efficient if the conditions are right. Perfect competition is when the assumptions of a market structure are very strong and highly unlikely to exist in real world markets which means that in reality the most markets are imperfectly competitive. But in order to have perfect competition they are a lot of conditions that we have to assume which makes the perfect competition efficient in the short run as well as in the long run.

As I mentioned before for a market structure to be considered as a " perfectly competitive", there are some conditions which are necessary for this. The first assumption is the homogeneity of the product which means that the product sold by any one seller in the market is identical to the product sold by any other supplier. Buyers do not care who they buy from, when the products of different sellers are identical, as long as the price is also the same. It may sounds extreme, it is, but in fact its met in markets for many products.

Another assumption for a " perfectly competitive" would be that each firm is a price taker. This means that each firm can alter its output without affecting the market price of the product. When there is a large number of sellers or buyers, each individual seller or buyer is so small relative to the whole market that he doesn't have any power to change the price of the product. So the buyer or the seller must accept the existing market price, but it can sell or buy as much as it wants at that price.

A third assumption would be that the buyers of the product are well informed about the characteristics of the product being sold and the prices charged by each firm. It is required that all buyers, sellers and owners of resources have full knowledge of all relevant technological and economic data. If some firms decide to charge a higher price than the market price, there will be a large substitution effect away from this firm.

Another assumption would be that there no barriers to entry or exit of firms in long run which means that suppliers can enter the market thus affecting the long run profits made by each firm in the industry. The long run equilibrium occurs when the marginal firm makes normal profit only in the long term.

A last assumption of a " perfectly competitive" would be that all firms have equal access to resources and improvements in production technologies achieved by one firm can spill-over to all the other suppliers in the market. Also there are no externalities arising from production or consumption which lie outside the market.

In the short run the equilibrium market price is found by the interaction between market demand and market supply. To maximise our profits marginal revenue must be equal with marginal cost. If our market price is high enough then it is possible each firm makes a positive profit. If the firm start having great amounts of profit then new firms outside the industry will be attracted to enter the market because of the profits which means that the market price will fall as the market supply curve shifts to the right. As we can see from the graph we have a perfectly elastic demand curve which means

the market price remains unchanged in the short run so we can change only the quantity of output without change P which is the price of the product . Also as we can see in the short run we have the allocative efficiency because the price is equal to the marginal cost. Consumer and producer surplus are maximised because the price that the consumer willing to pay is equivalent to the marginal utility they get. We have also Productive efficiency which is achieved when the output is produced at the minimum average total cost. Productive efficiency is how efficient the firm is in the production stage and this is done by minimise the wastage of resources in the production processes.

In the Long run the case is different because as the firms maximising their profits in the short run new firms will be attracted to enter the market which means that the market price will decrease as there are much more firms now, so every firm now tries to maximise its profits by producing the product as cheap and efficient it can. This is good for the customers because due to the competition between the firms they are forced to decrease the market price of the product which prevents the firms form making long run economic profits. As we can see from the diagram the business will be working at the minimum point on both long run and short run average cost curves obtaining the full economy of scale. As more and more firms enter to the market they may reduce their cost of production and we can see it from the LRAC curve. When the price is Po and the business is operating at point E it means that we have long term equilibrium and any decrease or increase in output from Qo would result in a loss for the firm. In the long run we have also allocative efficiency as well as in the short run because a market with

allocative has no imperfections thus the marginal cost will be equal to the average revenue in the market MC= AR. If we wanted to explain more the phrase allocatively efficient we could say that a market produces the right goods for the right people at the right price thus, is how efficient the markets are in allocating their resources. As seen in the short run we have also productive efficiency as well as in the long run, because its achieved when we produce goods and services in the lower cost. For example we can consider whether the business is producing close to the low point of its long run average total cost curve. And as this happens the firm is exploiting most of the available economies of scale.

As we can see perfect competition is a very efficient way in the market nowadays and can gives to the firms huge profits in the short run but not in the long run, without meaning that stops it being efficient in the long run, and this efficiency can either allocative or productive. Also we can say that perfect competition is a theoretical model of a market structure which means that that assumptions that we made above are only in theory because in real world there aren't any fully perfect competition markets. But there are a lot of markets that are very close to this " world of perfection" of huge amount profits and using all of the assumptions stated above fully. And the important thing is that, these perfect competition markets especially in the long run are very helpful for the customers because they can get the products at the lowest market price value because the competitors being attracted have to cut the price to attract customers. The existing firms have to follow this price cut so the customers are, in the end the people that benefited more from these " battle" competition between the firms.