

Perfect (or Pure) Competition Introduction



Four market models:

- A. Pure competition entails a large number of firms, standardized product, and easy entry (or exit) by new (or existing) firms. **Price Takers**
- B. At the opposite extreme, pure monopoly has one firm that is the sole seller of a product or service with no close substitutes; entry is blocked for other firms. **Price Makers**
- C. Monopolistic competition is close to pure competition, except that the product is differentiated among sellers rather than standardized, and there are fewer firms.
- D. An oligopoly is an industry in which only a few firms exist, so each is affected by the price-output decisions of its rivals.

Characteristic	Market Model			
	Pure Competition	Monopolistic Competition	Oligopoly	Pure Monopoly
Number of firms	A very large number	Many	Few	One
Type of product	Standardized	Differentiated	Standardized or differentiated	Unique; no close substitutes
Control over price	None	Some, but within limits, depends on differentiation	Limited because selling similar things, threat of price war; considerable with collusion	Considerable, depends on elasticity
Conditions of entry	Very easy, no obstacles	Relatively easy	Significant obstacles	Blocked
Nonprice competition	None	Considerable emphasis on advertising, brand names, trademarks	Typically a great deal, particularly with product differentiation	Mostly public relations advertising
Examples	Agricultural goods	Clothes, shoes, breakfast cereal, video games	Steel, automobiles, computer chip makers, household appliances	Local utilities, unique patented products

***Pure competition (also called Perfect Competition) and Monopoly are the easiest to analyze. Let's Start with Pure Competition.**

***Since each little firm cannot affect the market price by itself, it takes the market price as given and fixed. This means that demand for one little firm's output is perfectly elastic. In other words, they can sell as much as they want at the market price.**

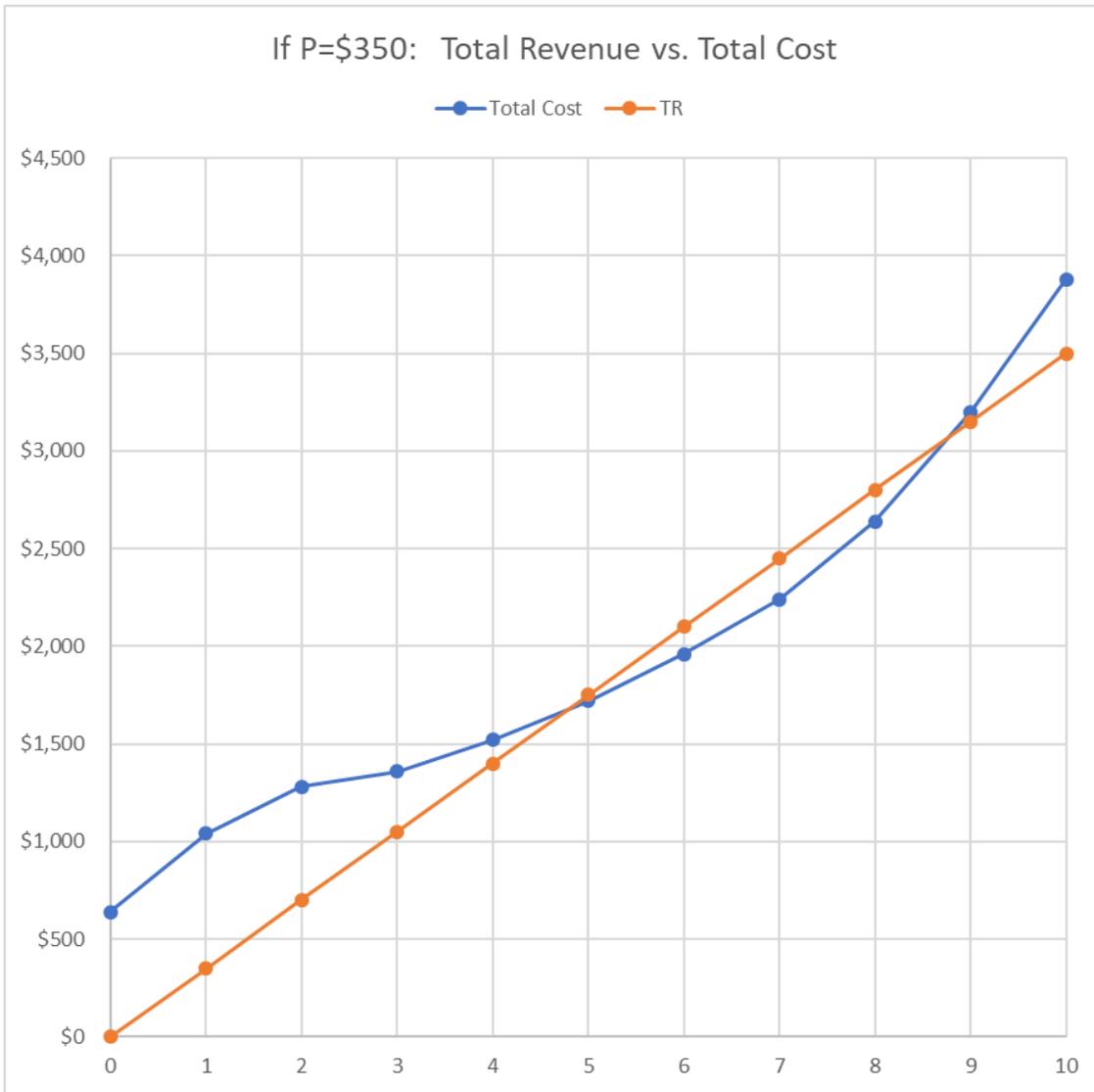
Our job is to figure out: How much does each little firm want to produce?

What does the demand curve for one firm look like?

What does the supply curve for one firm look like?

What is the shape of a firm's total cost curve?

What is the shape of a firm's total revenue curve?



<u>Q</u>	<u>Total Cost</u>
0	\$640
1	\$1,040
2	\$1,280
3	\$1,360
4	\$1,520
5	\$1,720
6	\$1,960
7	\$2,240
8	\$2,640
9	\$3,200
10	\$3,880



More Cost Table Practice: Complete this table and graph, and think about the questions below:

<u>Q</u>	<u>Total Cost</u>	<u>TFC</u>	<u>TVC</u>	<u>AFC</u>	<u>AVC</u>	<u>ATC</u>	<u>MC</u>
0	\$640						
1	\$1,040						
2	\$1,280						
3	\$1,360						
4	\$1,520						
5	\$1,720						
6	\$1,960						
7	\$2,240						
8	\$2,640						
9	\$3,200						
10	\$3,880						

Questions to think about:

- What is the minimum ATC?
- At what quantity does this occur?
- At what Quantity does the MC cross the ATC?
- What is the minimum AVC?
- At what quantity does this occur?
- At what Quantity does the MC cross the AVC?

- Suppose the market price was \$300 each.
- How many should you produce?
- Will you make a profit?
- Should you produce these units (today)?

*Should I produce? Produce zero if Price < lowest AVC (shut down price)

*How many to produce? Ignore downward sloping MC, then produce as long as Price ≥ MC

What should you do in the future?

