LESSON 11

PERFECT COMPETITION MARKET

The word Market signifies a special place where buyers and sellers are engaged in buying and selling of goods and services.

In Economics, the term is used in wider perspective. Market can, but need not be a specific place or location where buyers and seller come face to face for the purpose of transacting goods and services. It refers to all the formal and informal information network such as telephone or mobile, by means of which goods are bought and sold covering a vast area. There exists competition amongst buyers and sellers. It does not refer only to a fixed location.

Curnot's Definition- "Economists understand by the 'market' not any particular place in which things are bought and sold but the whole of any region in which buyers and sellers are in such free intercourse with one another that the prices of the same goods tend to equality easily and quickly".

Thus in Economics the term 'market' is used in a wider sense.

Types of markets:-

In real life we see many types of market which the economists have classified in four categories :-

1. **Local Market –** Local markets are confined to a locality, mostly a village a town or a city. Market of perishable goods like fish etc. falls in this category.
2. **Regional Market-** Regional market covers a wider area may be a district, state or inter-state. The turban of Marwar, Rajasthani chunri-lehanga etc are specific examples of a regional market.
3. **National Market-**When for a specific good its buyers and sellers are spread over the whole country then it is known as National Market. For e.g. markets of food grains, clothes, ornaments etc fall in this category.
4. **International Market-** If the buyers and sellers of a given product are scattered not only in a country but throughout other countries of the world, it is called as International Market. e.g. gems and jewellery, crude oil, engineering product & goods and services of MNC (Phillips, Toyota, Maruti etc.)

Shopping malls- In modern times to acquire the advantage of large gap between the prices of retail and wholesale market, some national and foreign companies buy and sell large varieties of goods under one roof, called shopping malls. For e.g. Big Bazar, Reliance Mart, Patanjali store etc.

On basis of goods :

The classification on basis of nature of work of buyers and sellers falls under this category -

1. **Common Market-** When various types of goods and services are bought and sold in one market then it is called Common Market. In cities and villages, various goods are available easily like foodgrains, clothes, books, vegetables, machinery etc. and goods and services of multi-national companies like Philips,Toyata, Maruti etc.
2. **Specific Market-** If only specific goods and services are sold in a market then it is known as Specific Market, like vegetable market, garments market, provision market, iron market, cloth market, food grain market etc.
3. **Sale by sample-** When goods are sold and purchased by sales representatives through samples. Then it is known as Sample Market. Today most of the companies use this method of sale.
4. **Sale through grading-** Goods are purchased & sold on basis of quality determined by grading

& standardization of goods like food grains, fruits and vegetables. Further for instance 'ISI' is standard used for the electronic goods, ***'FSSAI'*** for foods grains and 'Hallmark' for valuable goods.

Online market- At present time people in small towns to metropolitans, buy & sell, goods and services of their general need through online market, sitting at home like Amazon, Flipkart. Home shope18 etc.

On the basis of sales:-

1. **Retail market-** In this market, the items of daily use are bought and sold in small quantities. The price is slightly more in this market as compared to wholesale market for e.g. A provision store in a colony.
2. **Wholesale market-** In wholesale market, goods are sold and purchased in large quantity, as the price is comparatively less. In wholesale market, a specific good is bought and sold like vegetable and fruit, Iron, cement, hardware etc.

Classification on basis of time:-

A market can be classified on basis of the time elements-

1. **Very short period Market-** Market period is very short period in which supply of a good is fixed or constant. Supply does not increase or decrease. There is change only in the demand. Such market is called very short period market. The market of perishable goods like milk, fruits, vegetable, eggs come under this category.

Very short period market

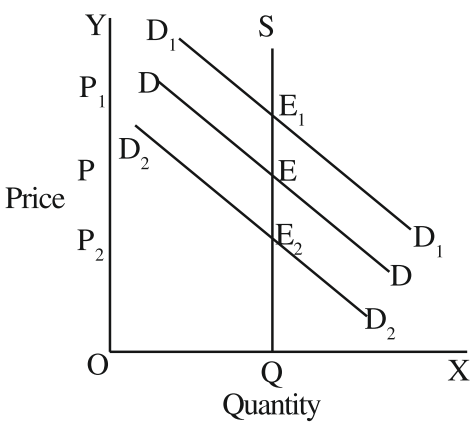

Figure 11.1

In the above figure 11.1on O X axis quantity and on OY axis price is depicted. At point E_1 DD the demand curve intersects the supply curve SQ (Vertical line) thus determining price OP. With an increase in demand, the demand curve shifts upward to D_1D_1 and new equilibrium is at point E_1. Hence the price increases to OP_1. On the contrary with the decrease in demand, the demand curve shifts downward to D_2D_2 with new equilibrium at point E_2 the price decrease to OP_2. Thus in market period demand has greater influence than supply, as supply remains constant in price determination.

2. Short period market:-

The short period market is related to time in which supply can be increased or decreased in response to the demand, by changing the variable factors. A producer can change the supply of its product by fully utilising the existing capacity of plants and increasing the variable factors.

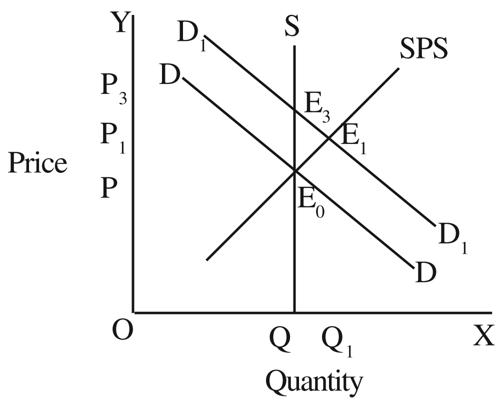

Figure 11.2

It is clear from above figure 11.2 that the initial demand curve DD intersects the initial supply curve SQ at E_0 and price determined is OP. In short period, a producer can slightly increase the supply by making change in variable factors, hence the supply curve is SPS. With increase in demand, the demand curve shifts to D_1D_1 and intersects SPS at point E_1, where the price increases to OP_1 and quantity bought and sold to OQ_1. In market period, with increase in demand equilibrium is at E_3 and price rises to OP_3.

3. Long period market- When the time period is sufficient to adjust supply fully according to the demand then the market is known as long period market. With sufficient time period, all the factors of production can be changed so as to increase or decrease supply according to demand. Producer can make changes both in fixed as well as variable factors of production.

Long period market

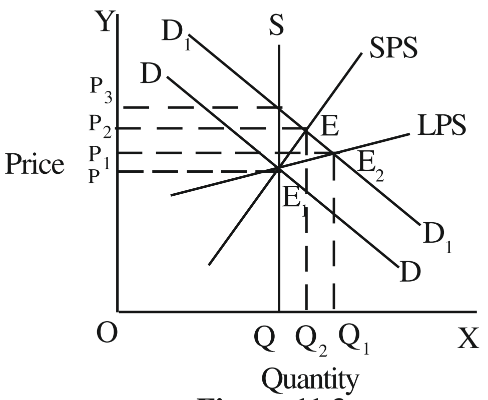

Figure 11.3

In the above fig 11.3 the initial demand is shown by DD, SQ depicts very short period supply, SPS (short period supply) and LPS (long period supply). The initial equilibrium of demand and supply is at point E, where price determined is OP and quantity is OQ. In the long period the equilibrium between supply curve LPS and demand curve D_1D_1 is at point E_2 hence the price increases to OP_1 and quantity demand & supply to OQ_1. The market period price is OP_3 and quantity OQ_2 while of short period the price is OP_2 and quantity OQ_2.

Very long period market- (secular period) When the time period is very long, in which supply fully adjusts to changes in demand. This is referred to very long period market. New products, new technologies, new invention, bring substantial changes in supply. On the other hand, changes in nature, fashion, change size and structure of population bring about changes in demand.

Classification on basis of Competition:

On the basis of competition, markets classification is given in the table below:-

Perfect Competition Market- A market in which the number of buyers and sellers of a homogeneous goods is very large. They possess complete knowledge about market conditions, which assures prefect & free competition in the market. There is one prevailing price of the good in the market. It is an imaginary condition.

Meaning of Perfect Competition- There are large number of buyers and sellers, so that none of them individually is in a position to influence the price

Table 11.1 Classification on basis of competition

Forms of market	Number of firms	Nature of goods	Price elasticity of individual person
Perfect Competition	Large	Homogeneous	$E = \infty$
Monopoly	One	No close substitution	$E < 1$ very less
Monopolistic	Few	Differentiated product	$E > 1$ more
Oligopoly	Few	Homogenous & differentiated	$E < 1$
			$E < 1$

Classification of Market

- On Basis of area
  - Local
  - Regional
  - National
  - International
- On basis of goods-
  - Normal
  - Specific
  - Sale by sample
  - By classification
- On basis of time-
  - Very short period
  - Short period
  - Long period
  - Very long period
- On basis of competition-
  - Perfect competition
  - Monopoly
  - Imperfect competition
    - Monopolistic
    - Oligopoly
    - Duopoly

in market. Under perfect competition the price is determined by demand and supply of an industry. The supply of an indvidual seller is so small in fraction to total output that he cannot influence the price of the product.

According to Mrs. Joan Robinson- "Perfect competition prevails when the demand for the output of each producer is perfectly elastic. This enacts first that the number of sellers is large so that output of any one seller is negligibly small proportion of the total output of the commodity and second that buyers are all alike in respect of their choice between rival sellers so that the market is prefect."

A firm can sell its product at the price determined by the industry. The demand curve of the firm is perfectly elastic i.e. horizontal straight line. Thus, it is concluded that Perfect Competition is a market where there are a large number of buyers and sellers having cut throat competition amongst them which results in a single prevailing price of a commodity.

Table 11.3

Demand and supply schedule		
Price of x goods (in rupee)	**Demand of x goods (units)**	**Supply of x goods (units)**
10	100	20
20	80	40
30	60	60
40	40	80
50	20	100

In competitive market various firms together form an industry. The price is determined by an industry, which is accepted by all the firms. Thus, a firm is called price take and quantity adjuster.

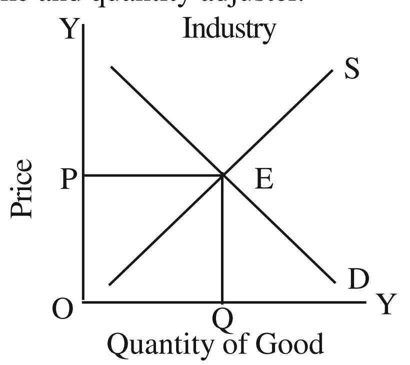

Figure 11.4 (A)

From the above fig. 11.4(A) it is clear that the equilibrium price is determined by the total demand and total supply in the industry. All firms have to accept the price determined and can sell any amount at this price.

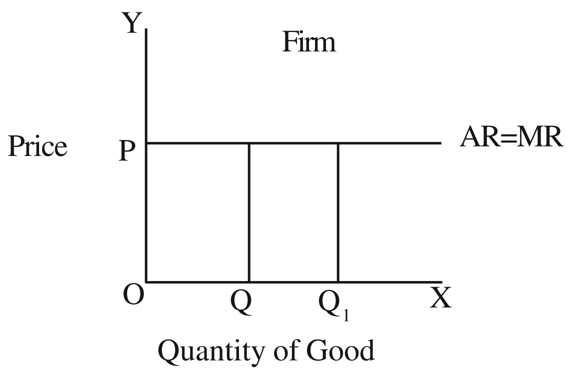

Figure11.4(B)

Fig. 11.4(B), the firm sells OQ quantity at OP price. This is firm's average revenue (AR). Quantity OQ_1 is also sold at OP price thus both Marginal Revenue (MR) and Average Revenue (AR) are equal.

Table 11.3

TR,AR and MR in perfect competition

Goods Unit	Average Income or Price AR / P	Total Revenue TR	Marginal Revenue MR
1	5	5	5
2	5	10	5
3	5	15	5
4	5	20	5
5	5	25	5

Features of Perfect Competition

Following are the features of prefect competition

i. **Large number of buyers and sellers-** As there are large number of buyers and sellers in a Perfect Competition Market, none of them individually is in position to influence the prices and output. The contribution of a buyer or seller in the market is insignificant. Thus, they cannot alter the price by individual action.

ii. **Homogenous product-** All sellers sell identical units of a given product. There is homogeneity in colour, shape, size, design, quality packing, trademark etc. Thus, it does not create any preference amongst the consumer. The products are perfect substitutes of each other i.e. the cross elasticity of demand is zero.

iii. **Free entry and exit –** Under Perfect Competition, there is free entry and exit of firms. In Perfect Competition a firm gets only normal profit in long period. If the existing firms are making super normal profit in short-run, then new firms will enter the industry to compete away the profits. On the other hand, if firms are making losses in short-run, then some of the existing firm will leave the industry. Thus, it is evident that due to free entry and quit of firms in industry each firm earns only normal profit in the long run.

iv. **Perfect mobility of the factors of production –** Under Perfect Competition, there is free mobility of the factors of production, i.e. the factors are free to move from one industry to another and from one place to another. By optimum allocation of factors of production, they get maximum returns.

v. **Perfect knowledge of buyers and sellers –** Buyers and sellers have close contact in the market. They possess complete knowledge about the price at which goods are being bought and sold and prices at which others are prepared to buy and sell. So, they avoid charging higher price of a product. Such perfect knowledge of market condition forces the sellers to sell their product at prevailing market price.

vi. **Transport cost is ignored -** There is no transport cost in carrying the product from one place to another as buyers and sellers are closely situated. For the existence of Perfect Competition it is required that the commodity must have same price everywhere. Thus this condition is very essential. If transport costs are added to price of a product then the homogenous product would have different prices, depending upon transport cost.

vii. **Firms are price taker and quantity adjuster-** Firms accept the price determined by the industry and adjust their output to earn maximum profit.

viii. **Cut-throat competition –** The competition found in this market among the sellers is known as 'cut-throat competition.'

Perfect Competition is an imaginary concept:-

Perfect Competition is a rare phenomenon . Though real world does not fulfill the condition of perfect competition, yet perfect competition is studied in understanding the working of economy A hypothetical model of perfect competition provides the basis of appraising actual working of economic institutions and organization.

Important points

- In economics, market does not depict a specific place but refers to the competetive relationship between buyers and sellers.
- In a very short period market supply is constant, hence price is influenced by demand. The demand and supply in a very long period can't be foreseen at present time.
- Firm is a price taker and quantity adjuster in Perfect Competition.
- The demand curve of a firm is perfectly elastic or horizontal straight line.
- The contribution of an individual purchase and sale is negligible under Perfect Competition.

Excersice questions

Objective type questions :-

1. The market of perishable goods is :-
   (A) National
   (B) International
   (C) Local
   (D) Regional
2. Price of a good is determined in competitive market by:
   (A) Sellers
   (B) Demand and supply

(C) Government

(D) Finance minister

3. Under perfect competition in long run a firm gets-

(A) Abnormal profit

(B) Losses

(C) Normal profit

(D) Zero profit

4. In which of the following markets the number of buyers and sellers is very large?

(A) Oligopoly

(B) Perfect Competition

(C) Monopolistic Competition

(D) Duopoly

5. The market of ' Rajasthani chunri' will be called-

(A) International

(B). National

(C) Regional

(D) Local

Very Short Answer Type Questions:-

1. Define the word 'market'.
2. Give two examples of 'specialized market'.
3. What do you understand by online market?
4. Write any 2 features of a Perfect Competition market.

Short Answer Type Question:-

1. Explain the difference between 'retail market' and 'wholesale market' .
2. What do you understand by very short period market? Explain with a figure.
3. Classify markets on the basis of time.
4. What do you understand by Perfect Competition Market

Essay Type Question :-

1. Describe the main features of a Perfect Competition Market.
2. Explain price determination of an industry in Perfect Competition market with the help of a figure
3. Calculate Total Revenue and Marginal Revenue in the given table-

Unit of goods (Q)	Average revenue (AR)	Total Revenue (TR)	Marginal Revenue (MR)
1	8	–	–
2	8	–	–
3	8	–	–
4	8	–	–
5	8	–	–
6	8	–	–

4. "Perfect Competition is an imaginary concept" Explain the statement.

Answer Table

1	2	3	4	5
C	B	C	B	C