An Introduction to Microeconomics
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Lecture – 114
Perfectly competitive market

So, let us talk about perfectly competitive market. And let me begin by saying that in real world and in reality perfectly competitive market is highly idealized that it does not exist. Then why do we study something that really does not exist. For two reasons that several markets can be approximated by perfectly competitive market, and I will come to this point slightly later and the second that perfectly competitive market is highly idealized and which gives the best possible outcomes for all the consumers and the society. So, this gives us the benchmark that society can aspire can try to achieve.

Also let us understand that idealized thing is much much simpler to deal with and that a simple thing is easier to understand. So, this can very well be a beginning point. So, what is the defining characteristics of perfectly competitive market?

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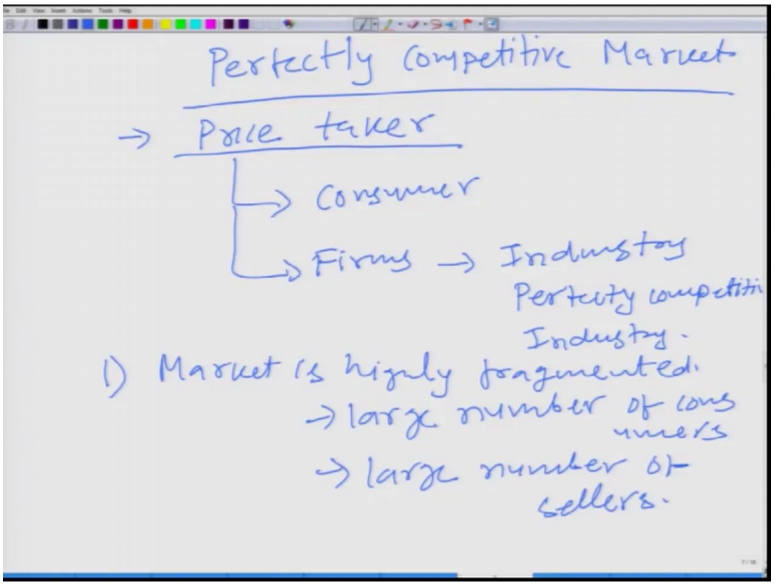

That each agent operating in this perfectly competitive market is price taker ok. What it means that consumer does not influence the price, it takes price as given consumer is price taker and which is largely true we go to market we ask the price some time, we handle some time we bargain, but most of the time the consumers are price taker, we pay the price which is asked from us. So, consumer is price taker and which is not a you know unreasonable assumption.

The second is firms, that each form is price taker which is a much more its little unrealistic that firms typically set the price what do I mean firms typically set the price that they have some leeway how they should price their product in the market they decide through you know perhaps the bit profit optimization in mind. So, firms in reality are not price taker, but here we would assume that they are price taker.

So, when all the firms in an industry is price taker then we call that industry perfectly competitive industry perfectly competitive industry. So, this is the defining characteristics. But we should also understand that what are the other characteristics what are most likely to be true in the case of a click competitive market. So, the first point that I want to make that in perfectly competitive market is highly highly fragmented. What do I mean by the market is highly fragmented that the one particular any particular consumer is small in comparison to whole market. There are large number of consumers trying are willing to buy the same product. So, large number of consumers of consumers, and large number of sellers there are large number of sellers. Just for example, let us say that we have seen the extreme of monopoly when market has only one seller.

Let us say in place of having one seller a market has two or three seller which is closer to I either monopolistic competition or oligopoly what will happen in that case the firms with have will have some ability to set the price. So, to have perfectly competitive market the market should be highly fragmented and all the agents in this market should be small in comparison to the whole market.

The next point that I want to make is that the firms are selling standardized product.

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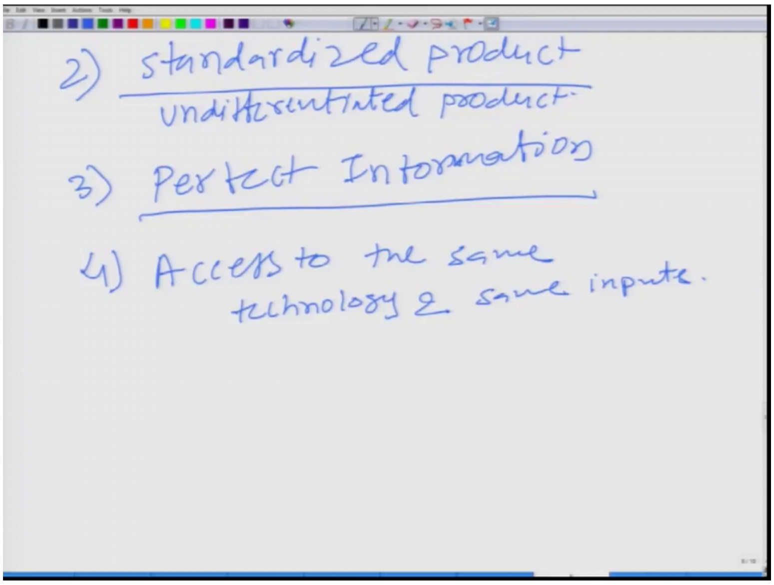

What do we mean by standardized product? I can also say instead of a standardized product we can say undifferentiated product. It simply means that an output from form a can be perfectly substituted by output from firm b, they are selling almost identical product at least the consumers would perceive their product as identical because I already gave you the example from Hyundai I 10 and let say for that example some other car because if the products are not identical then they would not be perfect substitute and then some consumers in the market would have affinity for a particular kind and then that would lead to some sort of price making behaviour not price taking, but price making behaviour in the market.

So, third thing that is required is perfect information; information is very much required because if you do not know that there are certain sellers selling the product at lower price you would not go to that particular seller to buy the good. So, perfect information is required for having a perfectly competitive market. And fourth is access to the same technology and seem inputs because let us say that if you do not have the firms do not have access to same technology then of course, the cost structure for firms would change. If their cost structure would change then they would not be able to price their product in the same manner or they may you know they may in exit the market if it cost them too much to manufacture the product and they are not able to charge the higher price.

So, these are the four important characteristics the first one is of course, that market is fragmented which implies price taking behaviour. I want to caution you that price taking behaviour is fundamental. The fractionalization or fragmentation of the market is not fundamental. What I mean to say that if market is fragmented enough then the firms and the consumers would be would exhibit price taking behaviour, ok.

Similarly when we have standardized an undifferentiated product then all can have the same price we can say that law of one price prevails. And similarly I talked about it that if a firms have access to the same technology and the same inputs then of course, entry and exit would be feasible.

Thank you.