

3.4.2 Perfect Competition

- Characteristics of perfect competition
- Profit maximising equilibrium in the short-run and long-run
- Diagrammatic analysis
- Characteristics of perfect competition:
 - Homogenous goods (perfect substitutes)
 - All firms have access to factors of production
 - Large number of buyers and sellers
 - Free entry/ exit
 - Perfectly elastic demand
 - Perfect knowledge
 - Profit maximisation is a key objective
- Profits are lower because each firm has a very small market share and therefore market power. If there are supernormal profits, new firms will enter the market and the profits will be pushed down to the normal level.
- $MR=AR$ because all firms are price takers
- In the short-term supernormal profits may exist because the price level is above average costs
- In the long-term there will only be normal profits because if supernormal profits exist supply will expand and the price level will reduce until $AR=MC=MR$ which is the normal profit level
- The supply curve is the MC curve above the shutdown point because supply is positive

