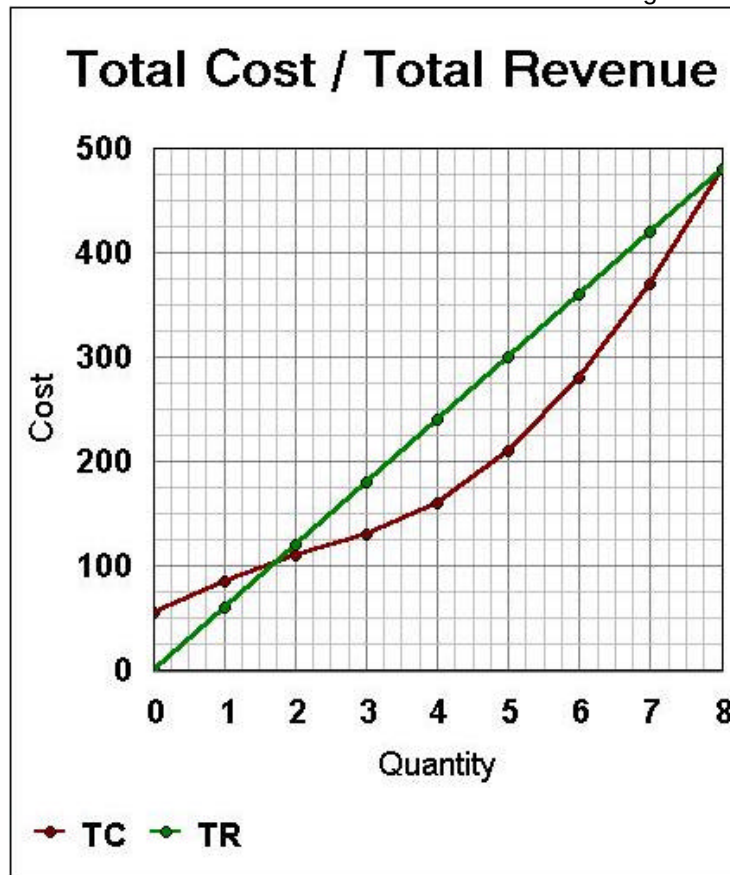




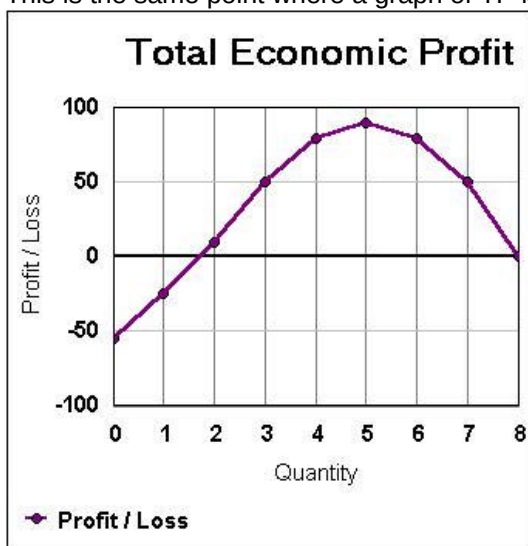
Notes – Module 6

Perfect Competition

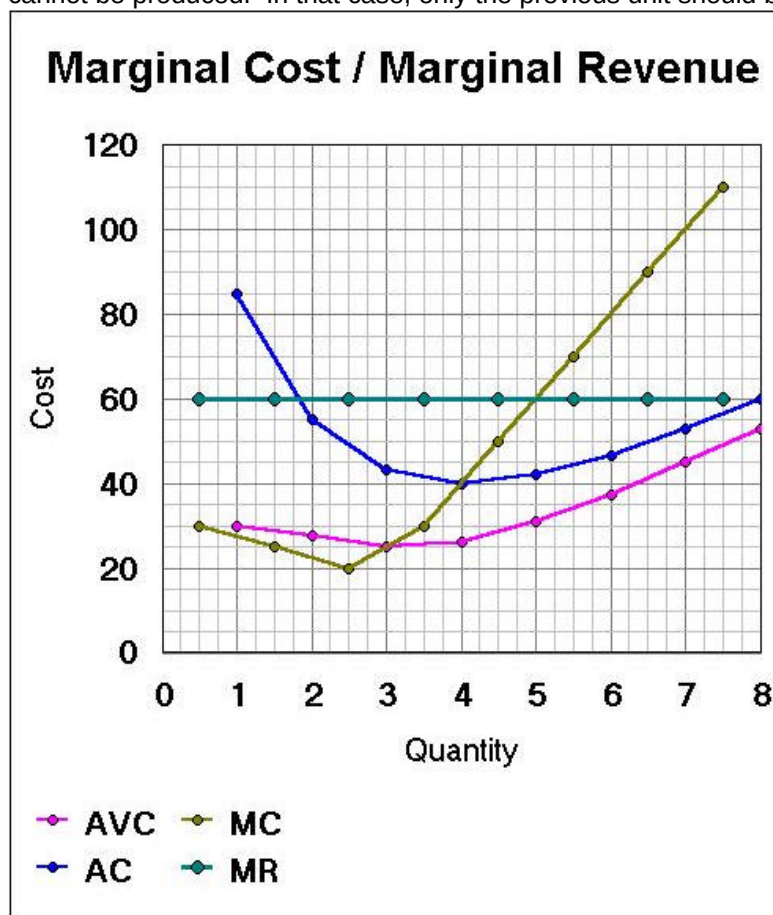
- I. Characteristics.
 - a. Many buyers, many sellers.
 - b. All sellers produce the same product – consumers don't care which brand they buy.
 - c. Sellers cannot set prices as they have too little control over the total market output.
 - d. New firms can enter and exit at will.
- II. Demand
 - a. Perfectly elastic. Regardless of the output produced, each unit sells at the market price.
 - b. Marginal Revenue is also the same at any quantity – every unit adds exactly its cost (the same) to revenue.
 - c. Total Revenue increases in a straight line, as the amount added per unit never changes.
- III. Profit Maximization
 - a. The difference between TR and TC is Total Profit, so the most profit can be made where the distance between the TR and TC curves is greatest.



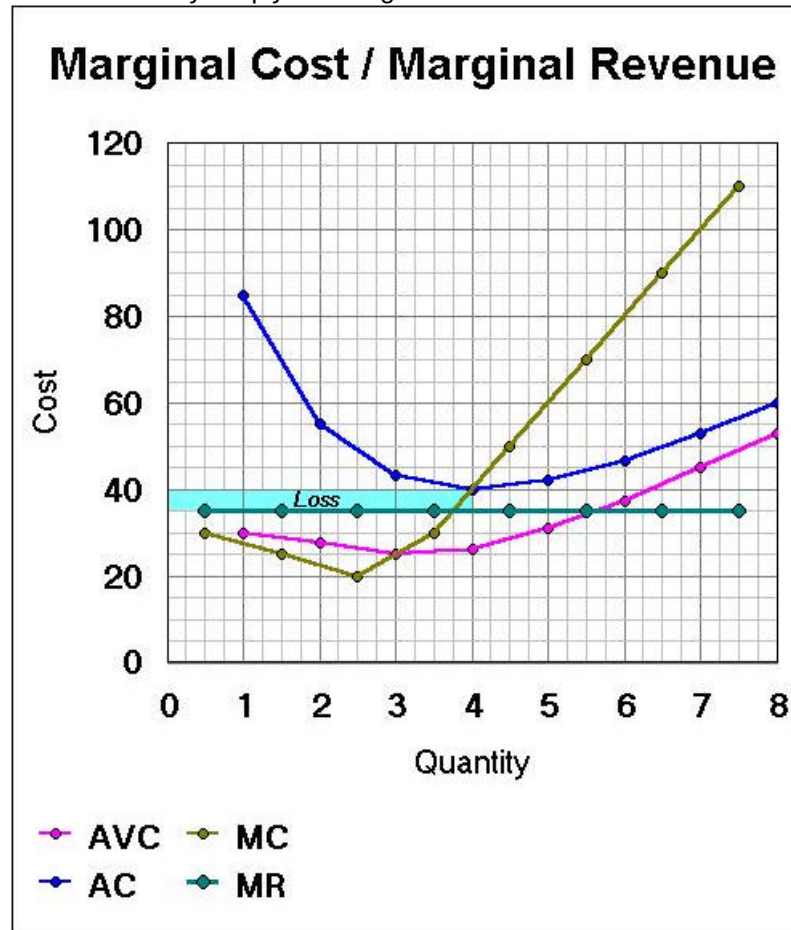
- b. This is the same point where a graph of TP is at its maximum.



- c. This is the same point where $MC = MR$ on the marginal graphs.
- If $MC > MR$, the cost of producing the unit is more than the revenue that will be obtained. Why bother?
 - If $MC < MR$, the firm can make profit, but not as much as it could if it produced another unit.
 - The only exception is where MC intersects MR at a fractional quantity that cannot be produced. In that case, only the previous unit should be made.



- d. Profit
 - i. The rectangle from where MC meets MR down to the ATC curve and across to the vertical axis.
 - ii. This is the difference between per-unit revenue and per-unit cost, multiplied by the number of units.
- e. Loss
 - i. If $MC = MR$ at a point below the ATC curve, the firm will suffer a loss. As long as this is above AVC, the firm is still better off producing and covering its variable costs.
 - ii. If $MC = MR$ below AVC, the firm should shut down and not produce. It will lose the least by simply suffering its fixed costs as losses.



- IV. Efficiency
 - a. Productive Efficiency
 - i. Where $P = \text{Minimum ATC}$.
 - ii. Consumers want this.
 - iii. The price paid is the lowest possible given existing technology.
 - b. Allocative Efficiency
 - i. $P = MC$
 - ii. Consumers have communicated their desire to see the product produced through its price.
 - iii. If $P > MC$, consumers are willing to pay more for the product, so more should be produced.
 - iv. If $P < MC$, consumers aren't willing to cover production costs – less should have been produced.
 - v. This is the "invisible hand" at work.