

Market and Price Determination under Perfect Competition

Market is a network of dealings between buyers and sellers.

Market is the characteristic phenomenon of economic life and the constitution of markets and market prices is the central problem of Economics.

They can be classified as local, national and world markets.

Classification relevant to us is based on competition prevailing in the market.

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Perfect market is marked by prevalence of uniform price for the commodity.

On the other hand, different prices prevail for the same commodity in the imperfect market .

The imperfect market has forms of monopoly, duopoly, oligopoly and monopolistic competition.

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Characteristics of Perfect Competition :-

- ☺ A large number of Buyers & Sellers.
- ☺ Homogeneous Commodity.
- ☺ Free Entry and Free Exit
- ☺ Perfect Knowledge
- ☺ Perfect Mobility
- ☺ No transport costs

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Pure Competition and Perfect Competition :-

Pure competition has only

- ☺ A large number of Buyers & Sellers.
- ☺ Homogeneous Commodity
- ☺ Free Entry and Free Exit

While perfect competition has *additionally*

- ☺ Perfect Knowledge
- ☺ Perfect Mobility
- ☺ No transport costs

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Price Determination under Perfect Competition : -

Under perfect competition, Price is decided by forces of demand and supply.

► As the price goes up demand decreases but supply increases. When it falls demand increases but supply is reduced.

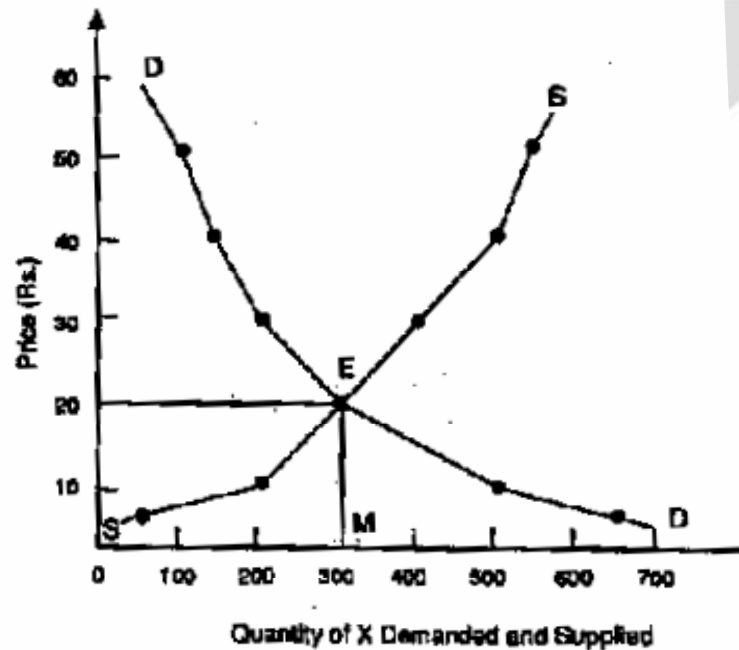
See graph on the next slide

► Market price E is the price at which quantity demanded and quantity supplied are at equilibrium.

► Hence it is called Equilibrium price.

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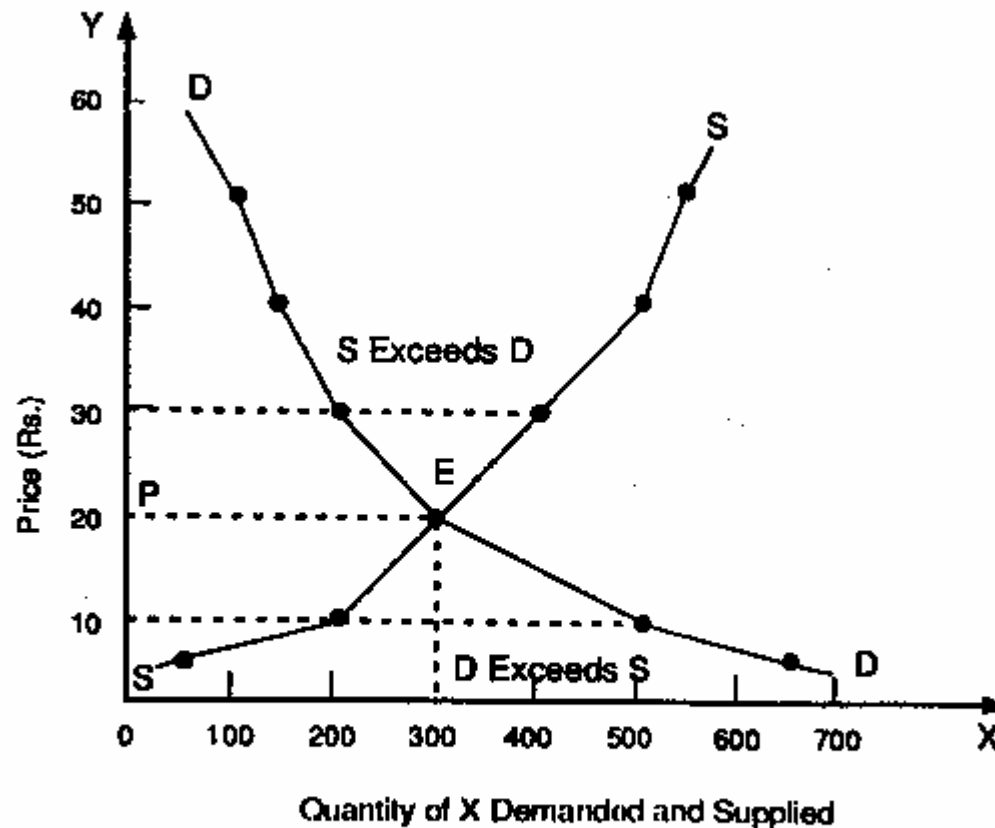
We may note that there exists the tendency towards prevalence of only one price for the commodity in the market under perfect competition.

If price moves over E, supply S exceeds demand D and price starts falling.

If it is low, D exceeds S and price starts rising. This continues until price reaches E at which $D=S$. please see the next graph

Market and Price Determination under Perfect Competition

Price Determination under Perfect Competition :-



Market and Price Determination under Perfect Competition

Price Determination under Perfect Competition : -
Effects of Shifts in Demand and Supply on
the Price Level.

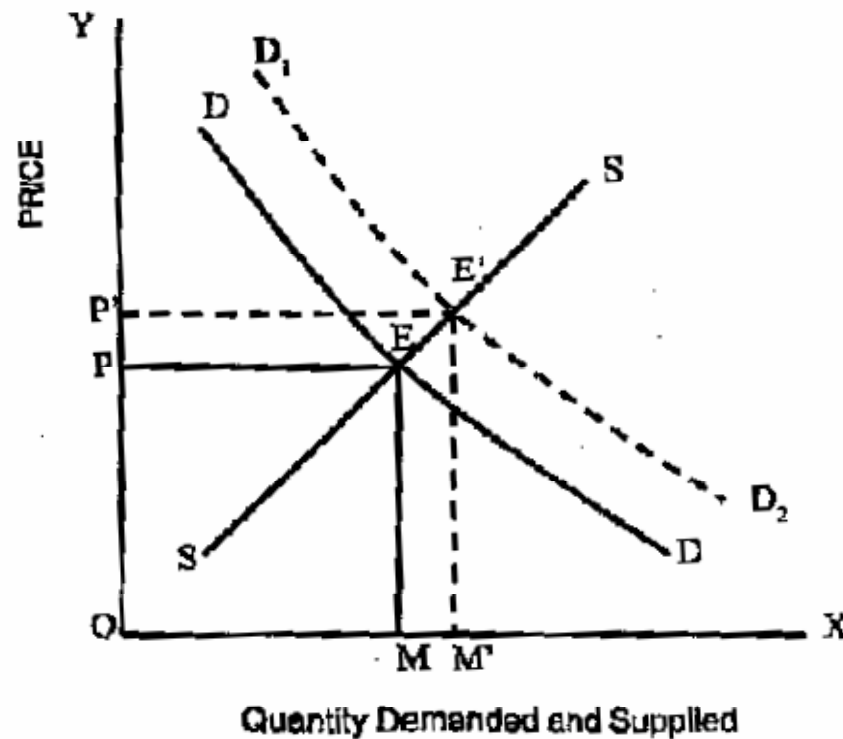
When does the price rise?

a) When demand increases and Demand curve
DD shifts to D_1D_2 on the right.

please see the next graph

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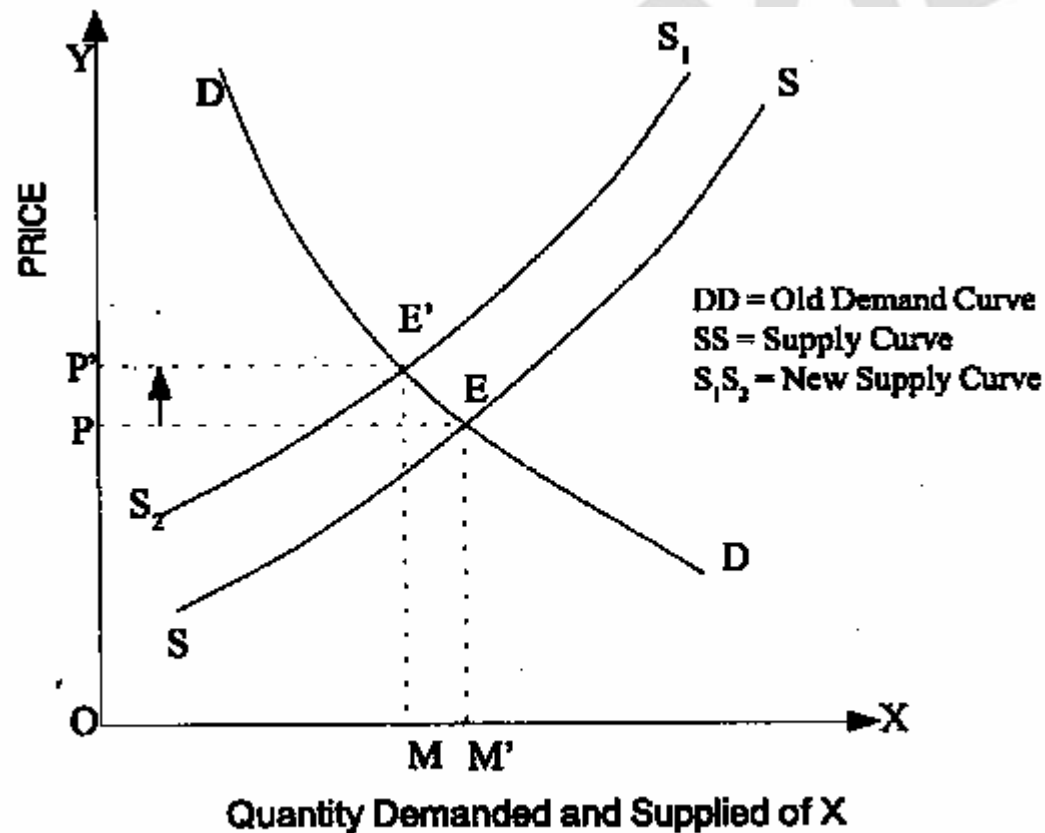
When does the price rise?

- a) When demand increases and Demand curve DD shifts to D_1D_2 on the right.
- b) When supply decreases and Supply curve SS shifts to S_1S_2 on the left.

please see the next graph

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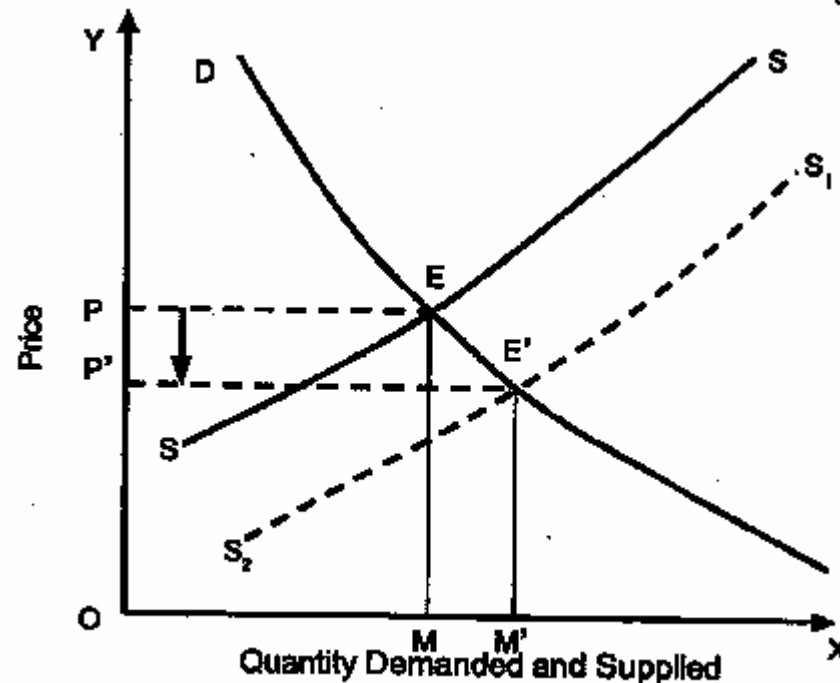
When does the price fall?

- a) When demand decreases and Demand curve DD shifts to D_1D_2 on the left.
- b) When supply increases and Supply curve SS shifts to S_1S_2 on the right.

please see the next graph

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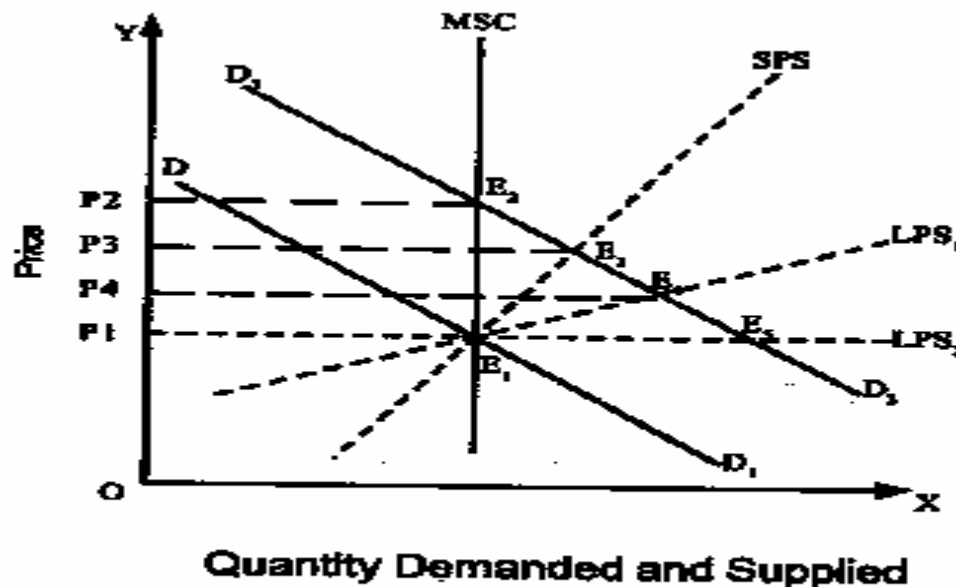
Price Determination under Perfect Competition : - Effects of Time Element in the Theory of Price .

In the very short period supply is perfectly inelastic. On a particular morning if demand for milk increases, there is no way to bring in more milk.

In the short period supply can adjust itself only partly to the change in demand. (to the extent of availability of surplus capacity.

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Effects of Time Element in the Theory of Price .



Market and Price Determination under Perfect Competition

Price Determination under Perfect Competition : - Effects of Time Element in the Theory of Price .

In the long period supply can adjust itself more fully or even fully to the change in demand. (by expansion of capacity or entry of new firms)

In the very long period we cannot predict what will happen to the forces of supply or demand. Hence for our study, we ignore this period.

Market and Price Determination under Perfect Competition

Price Determination under Perfect Competition : - Effects of Time Element in the Theory of Price .

In the very short period supply is perfectly in elastic. If demand increases price will increase considerably.

In short period supply can adjust partially, so price will be less than the new price above, but still will be higher than the original price.

Market and Price Determination under Perfect Competition

Price Determination under Perfect Competition : - Effects of Time Element in the Theory of Price .

In long period supply can adjust more fully or fully , so price will be close to or equal the original price.

To conclude, depending on the period of time allowed to pass, the supply may partly, fully or not at all adjust itself to the change in demand and will influence the price.