A Perfectly Competitive Market

Four Types of Markets

- A **market structure** is the setting in which a seller finds itself. Market structures are defined by their characteristics. Those characteristics include the number of sellers in the market, the product that sellers produce and sell, and how easy or difficult it is for new firms to enter the market.

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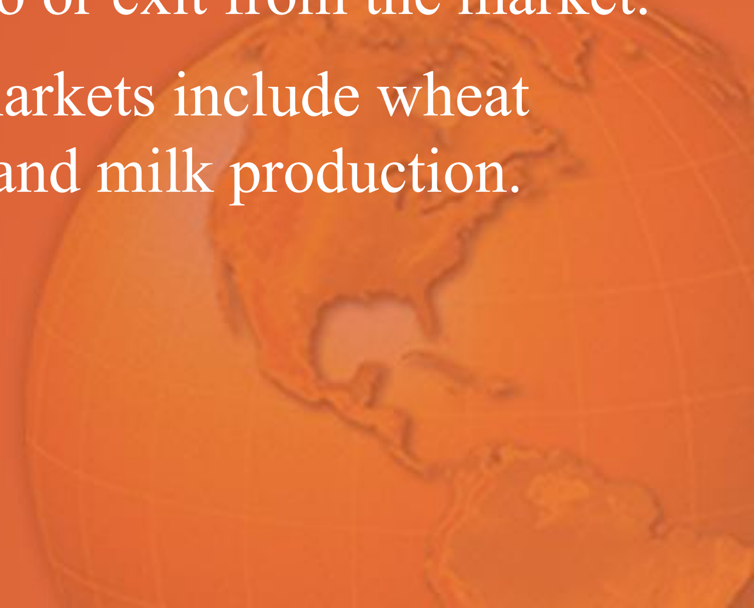
Characteristics of a Perfectly Competitive Market

- A **perfectly competitive market** has the following characteristics:
  - It has many buyers and many sellers.
  - All firms sell identical goods.
  - Firms can easily enter and exit the market. No entity, such as government, prevents entry into or exit from the market.
- Examples of perfectly competitive markets include wheat farming, soybean and corn farming, and milk production.



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Sellers in a Perfectly Competitive Market Are Price Takers

- A **price taker** is a seller that can sell all its output at the equilibrium price but can sell none of its output at any other price.
- Price takers could sell at a price lower than the equilibrium price, but they have no reason to. All of a particular seller's output can be sold at the equilibrium price.
- Even if a market does not perfectly match the four characteristics of a perfectly competitive market, it may still be considered a perfectly competitive market.

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What Does a Perfectly Competitive Firm Do?

- A perfectly competitive firm produces the quantity of output at which marginal revenue equals marginal cost. Because all firms in a perfectly competitive market are price takers, the competitive firm has no choice in the selling price.

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Profit Is a Signal in a Perfectly Competitive Market

- In a perfectly competitive market, profit is a signal to firms that are currently not in the market. It says, “Come over here and get me.”
- Because it is easy to enter a perfectly competitive market, new firms will enter the market as long as firms in the market are earning a profit. As new firms enter the market, they increase supply and decrease profits. They will continue to enter the market until profits decrease to the point that firms in the market are not earning a profit.

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Profits May Be Taxed Away

- Government may enact a tax to reduce the profitability of a market. This tax will discourage new firms from entering the market, reducing competition. The unintended effect is higher prices for consumers.

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