

# Perfectly vs. Imperfectly Competitive Markets

*Mind-maps are very good revision tools. Our minds learn by making patterns. Mind-maps help you to make these patterns and so makes the content easier to learn and remember.*



**BEFORE** you start this unit (in pencil) ...

- write the key idea of this unit in the centre of the page
- write what you know about this idea around it and draw lines to them.
- try and group the ideas together

**AFTER** you finish this unit (in pencil) ...

- remove anything that doesn't belong to this unit
- ensure that things are grouped together appropriately. Move stuff around if needed
- add any extra ideas that you think are missing

# unit overview

1

it's not all perfect...

In economics we talk a lot about **free** or **competitive** markets and how they deliver the best outcomes to consumers and society. In fact there is a wide range of market types.

This unit looks at the indicators or characteristics that we can use to evaluate how **competitive** a market is, and how this helps us to classify **different types of markets**.

BY THE END OF THE UNIT, YOU SHOULD BE ABLE TO...

- describe the assumptions of a competitive market
- compare perfectly and imperfectly competitive markets

1

Rank the competitiveness of the following markets. First rank each market according to the each of the four assumptions of a competitive market, and then rank the overall competitiveness. The first one is done for you.

Market	Competitive Assumptions			
	no. of buyers & sellers	barriers to entry	identical product?	perfect knowledge?
Food Stalls in a Farmers' Market	few <input checked="" type="checkbox"/> many	none <input checked="" type="checkbox"/> high	unique <input checked="" type="checkbox"/> identical	imperfect <input checked="" type="checkbox"/> perfect
	<b>imperfectly competitive</b> .....		<b>perfectly competitive</b>	
	<input checked="" type="checkbox"/>			
Domestic Air Travel in New Zealand	few ..... many	none ..... high	unique ..... identical	imperfect ..... perfect
	<b>imperfectly competitive</b> .....		<b>perfectly competitive</b>	
New Zealand Market for Mobile Phones	few ..... many	none ..... high	unique ..... identical	imperfect ..... perfect
	<b>imperfectly competitive</b> .....		<b>perfectly competitive</b>	
Food Hall in a Shopping Mall	few ..... many	none ..... high	unique ..... identical	imperfect ..... perfect
	<b>imperfectly competitive</b> .....		<b>perfectly competitive</b>	
New Zealand Market for Petrol	few ..... many	none ..... high	unique ..... identical	imperfect ..... perfect
	<b>imperfectly competitive</b> .....		<b>perfectly competitive</b>	

2. Some people would argue that a market on Trademe (e.g. for LEGO blocks) is perfectly competitive. Use your understanding of the competitive assumptions (of a competitive market) to support or refute this statement.

---



---



---

4. Define the following terms. Check that you can define each term and use it in an appropriate context.

barriers to entry \_\_\_\_\_

\_\_\_\_\_

identical product \_\_\_\_\_

\_\_\_\_\_

imperfect competition \_\_\_\_\_

\_\_\_\_\_

perfect competition \_\_\_\_\_

\_\_\_\_\_

perfect knowledge \_\_\_\_\_

\_\_\_\_\_

# Perfectly Competitive vs. Imperfectly Competitive Markets

notes

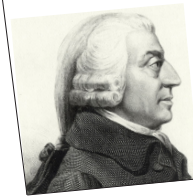
1

## How Do We Compare Markets?

In the first achievement standard we analysed how a market achieves allocative efficiency and so provides the best possible outcomes for consumers from a country's available resources.

In that analysis we assumed that the markets are **competitive**, i.e. that there are a number of firms competing with each other to provide consumers with the goods and services demanded, and that there are many consumers competing (bidding) to buy the goods and services supplied.

**A key indicator (or characteristic) of a market that we are concerned with is how competitive is it?**



*The assumption in this analysis is that competitive markets are good because they deliver the best outcomes to society. Much of this analysis comes from the work of economist Adam Smith and his book - The Wealth of Nations. He argued that an economy based on individual self-interest led by an "invisible hand" would achieve the greatest good for all. Do you agree? Read more about Adam Smith on WIKIPEDIA.COM or BIOGRAPHY.COM*

## Describe the Assumptions of a Competitive Market

To measure how competitive a market is, we need to define what an ideal or perfectly competitive market looks like. There are four main characteristics of a competitive market:

### 1. Many Buyers and Sellers

There is a very large number of firms and consumers in the market. No single firm or consumer having extra influence on the market, and consequently all firms are very small compared to the overall market.

### 2. No Barriers to Entry and Exit (Full Mobility of Resources)

Any firm can enter and leave the market if it wants to. There is nothing stopping a new firm from entering a market, or an existing firm leaving a market if it wants to. Put another way, firms are free to move their resources in or out of a market.

Barriers such as high setup costs, consumer loyalty schemes, legal barriers (e.g. patents) do not exist in a perfectly competitive market. Only one factor - time - affects firms' ability to move in or out of a market, and all firms are affected exactly the same. We will look at this idea (shortrun vs longrun) later in this standard.

### 3. Identical Product

All firms produce exactly the same product. Every firms' product look the same, has the same design and features, is the same quality, has the same guarantees, etc. For consumers, the product of one firm is a perfect substitute for the product of any other firm.

### 4. Perfect Knowledge

All firms and consumers in the market know everything about the product, consumers and other producers. Firms know each others' costs of production and design features. If one firm were to improve its design, all other firms would immediately find out about this and be able to copy it.

Consumers also know about all firms' costs of production, selling prices, and the features of their products. If one firm tries to sell its (identical) product at a higher price, consumers will immediately know that this price is higher than all other firms ... and not buy from that firm.

The more that these four characteristics can be found in a market, the more competitive a market will be - usually. They are the four main criteria that we will use to measure how competitive or not, a market is.

There are also some other assumptions that we make in our analysis:

- **Consumer Sovereignty**  
Producers use their resources to produce only what consumers demand. Therefore consumers' wants and needs determine what goods and services are produced in a market.
- **People Act Rationally**  
Individuals (i.e. firms and consumers) will act logically and consistently to maximise their personal welfare. For example we assume that all firms will try to maximise their profits, and that consumers will try to buy goods as cheaply as possible.
- **Property Rights**  
Resources such as land, timber, etc, can be owned by individuals or firms. This means that the owner can legally stop (exclude) others from using or accessing that resource unless they pay to do so.  
  
For example if a firm owns a gymnasium, it can stop people entering the gymnasium and using it if they don't pay. This allows the gymnasium to earn an income from its resource - the gymnasium. Property rights are essential for a market to operate.
- **No Public Goods or Externalities**  
The goods or services are private goods and all benefits and costs are included in the price. We will look at what this means in more detail in achievement standard 3.4.
- **Firms are Price Takers**  
Because all firms' products are identical and there is perfect knowledge, firms are "price-takers", i.e. they can not influence the price.  
  
If one firm raised its price, it would sell nothing as consumers would choose to buy from other firms. If a firm lowered its price, all other firms would copy it and lower their price - and so it would gain no extra sales.  
  
Firms will only change their selling price if consumers bid the market price up or down, and all firms change their price as a consequence.

## Compare Perfectly and Imperfectly Competitive Markets

If we use these four main characteristics to measure the competitiveness of a market, we get two main types or categories of markets - perfectly competitive markets and imperfectly competitive markets.

A perfectly competitive market is any market where all four assumptions are met. An imperfectly competitive market is any market where one or more assumptions are broken. For example if there are barriers to firms entering the market, then the market is considered to be imperfectly competitive. Within the category of imperfectly competitive markets, we can identify five specific types of markets. These are shown in Figure 1.1 over the page.

In this achievement standard (3.2) we will analyse and compare two specific market types - perfect competition and monopoly. We look at the other specific types of imperfectly competitive markets (duopoly, oligopoly, monopsony and monopolistic competition) in achievement standard 3.3.



**Perfect Competition:** A market where all four competitive assumptions are met, i.e. many buyers and sellers, no barriers to exit and entry, identical product, and perfect knowledge.

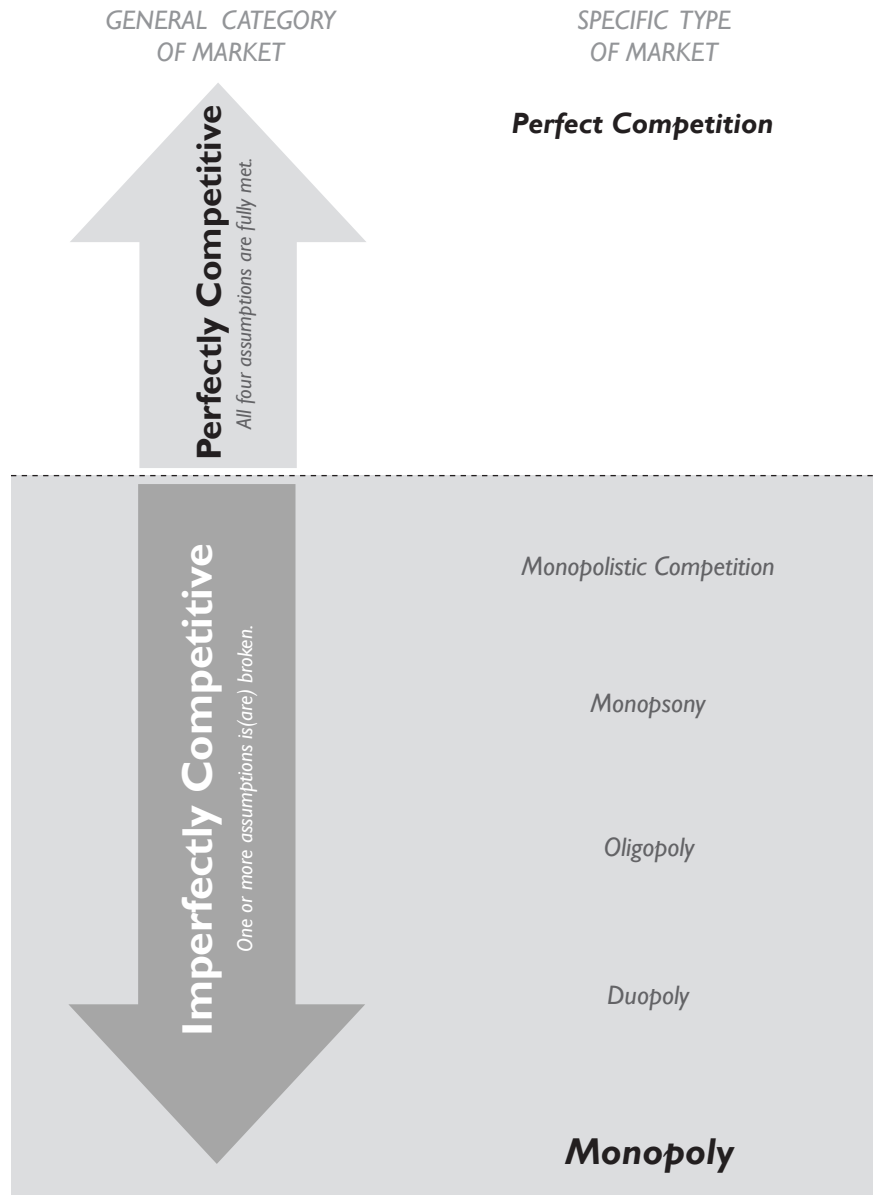


**Monopoly:** An imperfectly competitive market with only one firm.

**Figure 1.1 ... Perfect vs Imperfect Competition**

Perfectly competitive markets occur when all four competitive assumptions are met. Imperfectly competitive markets occur when one or more competitive assumptions are broken.

Within the two general categories of market (perfectly and imperfectly competitive) there are specific types of market. We study perfect competition and monopolies in this standard.



## 1

## UNIT 1 Perfectly vs. Imperfectly Competitive Markets

## Unit Content:

Understanding  
 1                      2                      3  
 (poor)                      (good)

**1.1 Perfectly vs Imperfectly Competitive Markets**

- How Do We Compare Markets?
- Describe the Assumptions of a Competitive Market
- Compare Perfectly and Imperfectly Competitive Markets


**checklist:**

I have ...

- done a mind-map of the main ideas (before and after I did the work)
- tried (and marked) all of the exercises
- watched the online videos of this work
- read the notes and summarised the key ideas in the margins of the pages
- made (or downloaded from quizlet) flashcards of the key ideas and definitions

**relevant current events and examples:***relevant events and examples for this unit are:***I didn't really get the following parts of this unit ...**

... and I'm going to ask \_\_\_\_\_ to help me with this