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B.A. Part- 1
Paper-1(Microeconomics)
Topic- Pure competition
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Pure Competition

- Goals of the firm :

In this model, the firm has a single goal i.e., "Profit maximisation" that means ; the firm acts rationally.

- Assumptions :

→ Homogeneous product

→ large no. of sellers, so that each one can not effect the market price by changing its supply. Price is fixed by industry rather then the firm. firm is "price taker"

→ There is free entry. it means, no barrier to entry. However, in the short run, entry is not easy. Entry is a long-run phenomenon.

→ Cost curves → U-shaped in both Short run & LR

→ Firm is planned to produce a single level of output with minimum cost (at optimum level)

→ Normal profit earned by the firm in the LR because ideal output / optimum output produced in LR.

Pure Competition

* **Behavioural Rule of the firm :**

- Demand curve is perfect elastic due to presence of large no. of buyers and sellers as well as homogeneous product. → It shows firm is "Price taker"
  Demand curve (AR) ⇒ Perfectly elastic i.e., $(e = \infty)$

- Firm can determine / set only output. (Price is set by the industry).

- There is no scope for research and development except that technological research.

- Firm acts atomistically i.e., it takes the decisions which will maximise its profit, ignoring the reaction of other firms. In this market decisions are taken by applying The Marginalistic Rule
  i.e., $\boxed{MC = MR}$

- Basically "Static Model"

- SR profit maximisation leads to LR profit maximisat

Pure Competition

- Under Pure competition, price is generally lower whereas output is generally higher than monopoly because; Here, output is produced at optimum cost (minimum point on the LAC curve) and earns just "Normal profit" (LR)
- Demand curve is perfectly elastic i.e., $\boxed{(e_d = e)}$
- Since, output produces at optimum cost in the LR equilibrium i.e., at the minimum point of the LAC curve that means; there are neither "unexhausted economies of scale" nor "diseconomies of large-scale production"
- The supply curve is uniquely determined and shows unique relationship b/w supply & price because different quantity of products are sold at same price.

  Part of MC above of AVC ⇒ supply curve
- No abnormal / supernormal profit is earned by the firm in the Long-Run. (Normal profit earned in LR).

Pure Competition

Comparision of Predictions :

- Shift in Market demand :→

In pure competition an increase in market demand will lead to an increase in price and output in the Short-run.
In Long run, the output will be larger but price may return to its initial level (constant cost industry), remain above the original level (increasing cost industry), or fall below the original level (decreasing - cost industry)

- A shift in Costs :→ i). When AFC changes :

Short Run: An increase in fixed costs in pure competition will not change the firm's output in the SR since MC is not affected (MC does depends on AFC)

Long Run : In long run firm will close down if they do not cover their higher total AC

ii) When AVC changes :

With the increase in AVC, MC shifted upward (MC depends of AVC), output is reduced and Price increase

AVC ↑ → MC ↑ → Y (output) ↓ → Price ↑

Pure Competition

- **Imposition of a tax :**

1). Imposition of lump-sum tax : Impact will be same as AFC

In Short Run → Imposition of lump-sum tax → Not lead to a change in output and Price ⇒ No change in SR

In Long Run → Imposition of lump sum tax / The shift in the TFC → will put the firms out of the business if firms were earning just the normal profit in the pre-tax situation.

2). Imposition of Profit Tax : Same impact as AFC } Lead to change in the LR

Imposition of profit Tax caused same impact as the imposition of Lumb-sum tax.

3). Imposition of a specific sales tax (per unit tax) : Same impact as AVC

Imposition of a specific tax → MC shift upward (as AVC increases) → Change in equilibrium → Output declines ↓ Price goes up ↑

⇒ More elasticity of supply curve → More burden on consumer

Note:- Specific tax will be partly or wholly beared by the consumer depending upon elasticity of supply curve.

This change in price may be equal, may be smaller or may be greater than the specific tax.