What is Perfect Competition?

Worksheet

Perfect competition is a market with many sellers offering identical products, perfect information for buyers and sellers, and zero barriers to entry or exit — all firms are price takers earning zero economic profit in long-run equilibrium.

Questions

1. Perfect competition requires...
A) Few large firms
B) Many identical firms with free entry
C) One dominant seller
D) High barriers to entry

2. A price taker is a firm that...
A) Sets its own price
B) Accepts market price, cannot influence it
C) Controls supply
D) Has monopoly power

3. Long-run economic profit in perfect competition?
A) Positive
B) Negative
C) Zero
D) Undefined

4. Difference between perfect competition and monopolistic competition?
A) No difference
B) Products are identical vs. differentiated
C) Number of firms
D) Entry barriers

5. In wheat farming, a farmer cannot raise their price above the market rate. Why?

6. An online reseller of common goods faces intense competition. Long-run profit?

7. A farmer sells at market price, earns above-normal profit. Next year?

8. Define: Is perfect competition realistic?

9. Define: Why can't a perfect-competition firm raise its price?

10. Define: What happens if a firm earns above-normal profit?

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Answer Key

1. B) Many identical firms with free entry — Perfect competition: many firms, homogeneous products, zero barriers.

2. B) Accepts market price, cannot influence it — Price taker: firm is too small to affect market price.

3. C) Zero — Free entry and exit drive profit to zero in long run.

4. B) Products are identical vs. differentiated — Perfect: identical products. Monopolistic: differentiated products. Both free entry.

5. Perfect competition: many farmers sell identical wheat. If one raises price, buyers switch to others. Farmer is a price taker.

6. Free entry allows rivals to enter, compete away above-normal profit. Long-run economic profit = zero.

7. Free entry: new farmers enter, supply rises, price falls. Long-run: profit → zero as price drops to minimum cost.

8. No — idealized model. Few real markets match all assumptions perfectly.

9. Buyers have perfect info and can switch to identical products from many rivals instantly.

10. Free entry: rivals enter, supply rises, price falls until profit = zero.

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