MICRO ECONOMICS - PAPER 2

PERFECT MARKET – GRADE 11(CAPS)

1. CHARACTERISTICS / CONDITIONS OF A PERFECT MARKET

- The way in which markets function and the relationship between markets are also determined by the market structure.
- In economics we are interested in finding ways and means to ensure that our scarce resources are used efficiently to produce those goods and services that we want.
- One such a market structure is perfect competition where the competition between the sellers of a product and the competition between the buyers of a product ensure that effective use is made of our scarce resources.
- However, for this market structure to exist, a number of conditions must be met. These conditions are not always met in the real world.

For a perfectly competitive market to exist a number of conditions must be met.

a) **Many buyers and sellers**

- For a perfectly competitive market to exist, there must be many buyers and sellers of an identical or homogeneous product.
- It is important to ensure that there is sufficient competition so that no single producer or buyer can fix the price of the product.
- When there are many sellers or producers of a homogeneous product, the share of each individual producer is so small that it cannot influence the market price.
- Each seller or producer is a price taker and it regards the market price as given. The market price is determined by forces of demand and supply

b) **Homogeneous products**

- Another condition for a perfectly competitive market is that the competing products should be homogeneous (or identical).
- This is important because if a supplier can distinguish its product from its competitors, and thereby limit competition, it would be able to sell its product at a higher price without losing all its customers.
- With homogeneous products there is therefore no reason for buyers to prefer the product of one seller to the product of another seller.
- This ensures that sellers and buyers compete with one another in terms of the price of the product. Examples of homogeneous products are, for instance, agricultural produce, metals, electricity and water.

c) **Perfect information**

- Perfect information implies that all market participants (buyers and sellers) have complete and correct information about market conditions.
- For example, buyers know what the market price of a product is and will know if a supplier charges a price higher than the market price.
- Some economists also believe that many markets will experience increased competition due to the availability of information on the Internet.

d) **No collusion**

- Collusion occurs when sellers or buyers enter into an agreement, arrangement or understanding to limit competition in order to fix the price of product.
- In a perfect competitive market, each buyer and seller acts independently from one another and no collusion occurs.

e) **Freedom of entry and exit**

- Under conditions of perfect competition, buyers and sellers are completely free to enter or leave a market.
- There are no barriers to entry in the form of legal, financial, technological, physical or other restrictions, which inhibit the free movement of buyers and sellers.
- This means that new firms can enter the market to compete with existing firms.
- This will usually happen when existing firms are making big profits which attract new entrants.
- This ability to enter and exit is important to ensure that efficient use is made of our scarce resources.

f) **Unregulated market**

- An unregulated market means that the government does not interfere in the market and decisions are left to individual producers and suppliers, as well as buyers.