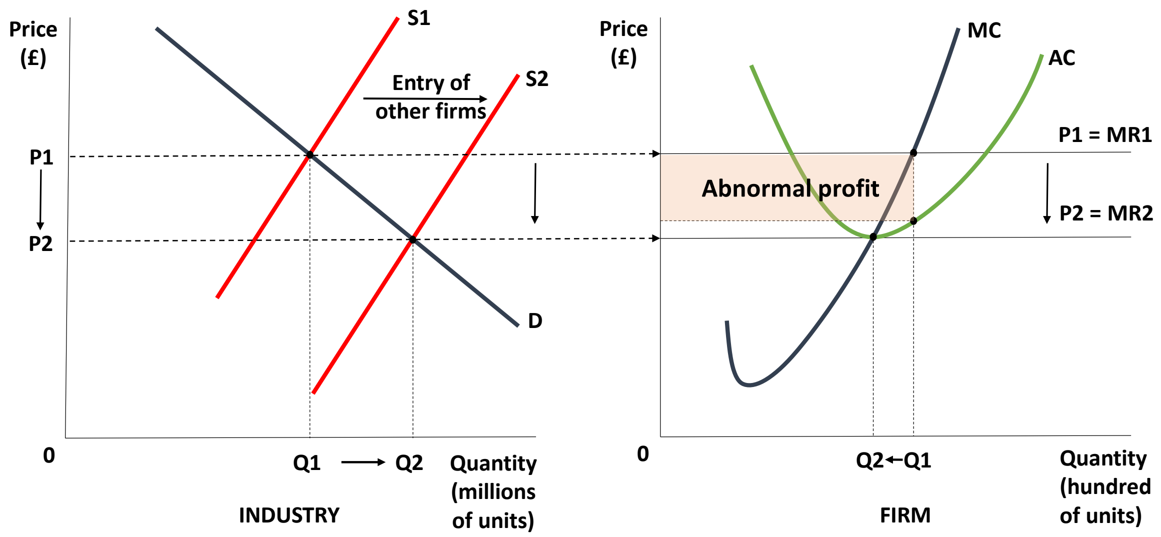
Figure 1. The adjustment process from short-run abnormal profits to long-run equilibrium in a perfectly competitive market



Source: Gillespie, 2014:205

Assume that the price of carrots in the UK agriculture industry is £3 or P1 per unit and the quantity supplied is Q1. Each firm is 'price taker'. Hence, it can be seen that P1 = MR1. Each firm will produce a profit-maximising output Q1, where MC=P1. At this point, the average cost of carrot is lower, for example, £2.5. Therefore, firms make an abnormal profit of £0.5 per unit of carrot. This phenomenon acts as a powerful motivator for other firms to enter the market to get abnormal profits as well and due to zero-level barriers it can be easily done. The entry of more firms will shift the industry supply curve from S1 to S2 and the quantity supplied in the industry will increase to Q2. This process will force the price for carrots to fall to £2 or P2. Subsequently, the quantity supplied by the firm will drop to Q2, where MC=AC=P2. At this point, the abnormal profits will entirely disappear, and firms will have no longer any incentives to enter the market. This situation, when firms have no incentives to either enter or leave the market, in other words, when firms make normal profits, known as long-run market equilibrium (Maunder et al, 1995: 374-375). The figure 2 below demonstrates the long-run equilibrium in the perfect competition.