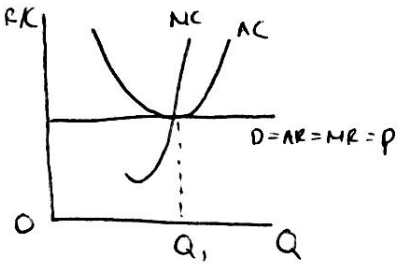
Competitive markets and perfect competition :

Long run equilibrium and efficiency



- firm is at equilibrium as it is making normal profit AC = AR
- profit maximisation MR = MC corresponds to optimum output where AC is at lowest point in equilibrium

↓

productive efficiency - firm producing at lowest C using existing technology

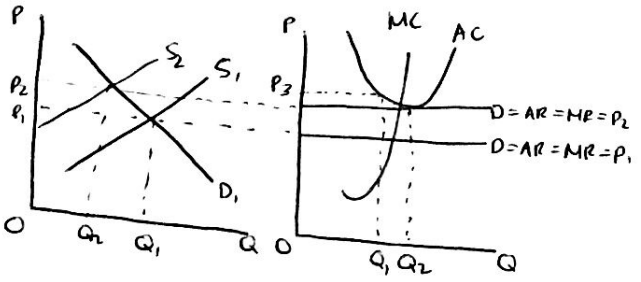
- MC of last unit = P of last unit ∴ allocatively efficient as P = lowest resource cost of supplying good

- In perfect competition, firms likely to be statically efficient - both allocative / productive

Assumptions :
- while firm will not grow big enough to exploit economies of scale, its activities result in an efficient allocation of resources
- but firm may search to ↓C, dispose wastes in ways that create negative externalities and ∴ will not be allocatively efficient

- Dynamic efficiency concerns production of new products / processes / techniques. For firms to undertake in R&D, they need supernormal profits.
- firms in perfect competition, unlikely to R&D as firms have perfect knowledge and free entry means supernormal profits competed away ∴ can't protect investment ∴ can't achieve dynamic efficiency

Firms making losses :



- At P_1, firm making loss as at Q_1 AC > AR
- At Q_1, profit maximisation / loss minimise as MC = MR meaning making smallest loss as possible
- If firms making losses, some leave, so S curve shifts left → ↑P ∴ firm is able to make normal profit as AC = AR at Q_2 and market share ↑ as firms left industry