Chapter 10 McConnell, Brue and Flynn 20th

Pure Competition in the Short Run

In Chapter 6 we examined the relationship between product demand and total revenue, and in Chapter 9 we discussed production costs. Now, we connect revenues and costs to see how a business decides what price to charge and how much output to produce. A firm's decisions concerning price and production depend on the character of the industry in which it is operating. There is no "average" or "typical" industry. At one extreme is an industry, in which a single producer dominates the market. At the other extreme are industries in which thousands of firms each produce a tiny fraction of market supply. Between these extremes are many other types of industries. Since we cannot examine each industry individually, we will focus on four basic models of market structure. Together, these models disclose an understanding of how price and output are determined in the differentiated product markets in the economy. Our study will also lead to a judgment on the efficiency of those markets, and, lastly, provide a crucial background for assessing public policies (such as antitrust policy) relating to certain firms and industries. We start with the important concepts regarding pure competition in the short- and long-run, which set the foundation for the study of market structures.