Name ______________ Date ______________ Class ______________

STUDY GUIDE Chapter 7, Section 1

For use with textbook pages 163–171

COMPETITION AND MARKET STRUCTURES

KEY TERMS

laissez-faire The philosophy that government should not interfere with commerce or trade *(page 163)*

market structure The nature and degree of competition among firms operating in the same industry *(page 164)*

perfect competition Competition characterized by a large number of well-informed independent buyers and sellers who exchange identical products *(page 164)*

imperfect competition The name given to a market structure that lacks one or more of the conditions of perfect competition *(page 166)*

monopolistic competition The market structure that has all the conditions of perfect competition except for identical products *(page 166)*

product differentiation Real or imagined differences between competing products in the same industry *(page 166)*

nonprice competition The use of advertising, giveaways, or other promotional campaigns to convince buyers that the product is somehow better than another brand *(page 166)*

oligopoly A market structure in which a few very large sellers dominate the industry *(page 167)*

collusion A formal agreement to set prices or to otherwise behave in a cooperative manner *(page 168)*

price-fixing Agreeing to charge the same or similar prices for a product *(page 168)*

monopoly A market structure with only one seller of a particular product *(page 169)*

natural monopoly A market situation where costs are minimized by having a single firm produce a product *(page 170)*

economies of scale A situation in which the average cost of production falls as the firms get larger *(page 170)*

geographic monopoly A monopoly based on the absence of other sellers in a certain geographic area *(page 170)*

technological monopoly A monopoly based on ownership or control of a manufacturing method, process, or other scientific advance *(page 170)*

government monopoly A monopoly the government owns and operates *(page 170)*

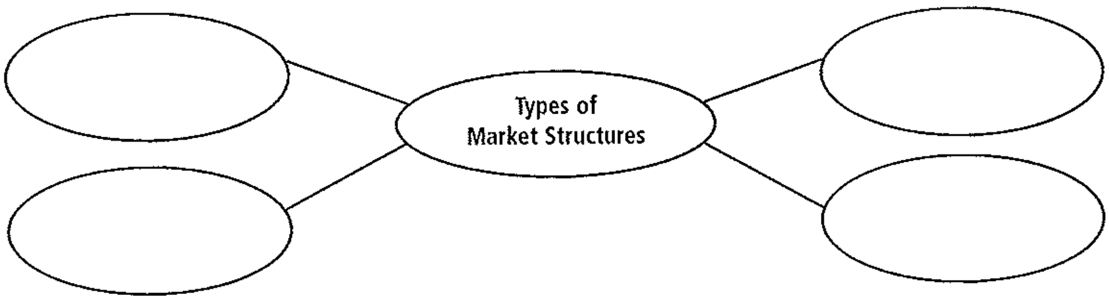
DRAWING FROM EXPERIENCE

Do you own items of clothing with manufacturer or designer logos? When you shop for clothes, do you only buy products with these logos? Why?

This section focuses on the different types of market structures.

ORGANIZING YOUR THOUGHTS

Use the diagram below to help you take notes as you read the summaries that follow. Think about the differences between the different market structures.



READ TO LEARN

Introduction *(page 163)*

In 1776 the average factory was small, and there was a high level of competition among businesses. Economist Adam Smith called for ***laissez-faire,*** the philosophy that government should not interfere with business. Since then, industries have become much more highly developed, and the way in which businesses compete with one another has changed. Today, economists classify markets according to their market structure. ***Market structure*** refers to the kinds of competition among businesses in the same industry.

1. How has business changed since Adam Smith's time?

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Perfect Competition *(page 164)*

The market structure called ***perfect competition*** has the following conditions:

A. There are a large number of well-informed buyers and sellers.

B. These buyers and sellers deal in identical products.

C. Each buyer and seller acts independently of all other buyers and sellers.

D. The buyers and sellers know about the products and prices that are available.

E. Buyers and sellers are free to enter into business and get out of business.

Perfect competition almost never happens. ***Imperfect competition*** refers to any market structure that is missing one or more of the characteristics of perfect competition.

2. Suppose that there are five different lemonade stands in the same neighborhood. Explain how the lemonade stands meet most of the conditions of perfect competition.

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Monopolistic Competition *(page 166)*

Monopolistic competition is a market structure that is like perfect competition except that it does not have identical products. Unlike perfect competition, monopolistic competition has ***product differentiation***—real or imagined differences between similar products. Most products today are differentiated—that is, they are not exactly like any other product. The differentiation may involve the product itself. Products may also be different in such characteristics as store location, store design, the way in which customers pay for the products, and the way in which the products are delivered. One kind of differentiation is nonprice competition. ***Nonprice competition*** is competition among similar products through methods other than price, such as advertising the product and giving away samples. Methods like these may sooner or later let the seller raise prices higher than its competitors. This, in turn, helps competitors make their profits as great as possible.

3. How is monopolistic competition different from perfect competition?

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Oligopoly *(page 167)*

An ***oligopoly*** is a market structure in which a few large sellers of similar products control the industry. The auto industry is one example of an oligopoly. Whenever one company in an oligopoly does something, the other firms usually do the same thing. For example, if one airline lowers its prices, all the other airlines usually lower their prices, too. Sometimes lowering prices can lead to a price war, or price cuts in which different competing companies keep lowering their prices, one after another. A price war leads to unusually low prices.

Sometimes companies in an oligopoly take part in collusion. ***Collusion*** is an agreement to cooperate. ***Price-fixing*** occurs when companies agree to charge the same or similar prices for a product. The companies might also agree to divide the market among themselves. That way, each company will be able to sell a certain amount of product. Price-fixing and other kinds of collusion are against the law because they limit trade.

When prices go up or down, companies might make less profit than when prices stay about the same. Because of this, oligopolists generally prefer to compete in a way that does not involve raising or lowering prices. One example of nonprice competition is a new advertising gimmick.

4. If airlines do not change their prices, how else might they try to compete with each other?

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Monopoly *(page 169)*

In a ***monopoly,*** only one company sells a particular product. If only one company sells a product, that company can usually determine the product's price. There are few pure monopolies in the United States. However, certain kinds of monopolies are common. A ***natural monopoly*** is a monopoly in which costs are lower because only one business makes the product. Natural monopolies can provide cheaper service because of economies of scale. ***Economies of scale*** mean that production costs are lower because the firm is bigger than it would probably be if it were not a monopoly. ***Geographic monopolies*** happen when, in one geographic area, there is no other company that sells the same product. A ***technological monopoly*** happens when one company owns something such as a machine, a computer setup, or other scientific advancement that no other company has. Technological monopolies are made possible by patents and copyrights. A patent is a piece of paper, issued by the government, which gives a person or company the right to be the only one to make, use, or sell an invention. A copyright gives a person or company the right to be the only one to publish certain kinds of information. Governments own and operate government monopolies, which involve products and services such as sewage treatment, that private industry cannot adequately provide.

5. Why do you think a monopolist is called a *price maker?*

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Name ______________________ Date ________________ Class ______________________

STUDY GUIDE Chapter 7, Section 2

For use with textbook pages 173–176

MARKET FAILURES

KEY TERMS

market failure An event that can occur with inadequate competition, inadequate information, resource immobility, external economies, and public goods *(page 174)*

externality Unintended side effect that either benefits or harms a third party not involved in the activity that caused it *(page 175)*

negative externality The unwanted harm, cost, or inconvenience suffered by a third party because of actions by others *(page 175)*

positive externality A benefit received by someone who had nothing to do with the activity that generated the benefit *(page 176)*

public good Product that is collectively consumed by everyone, and whose use by one individual does not diminish the satisfaction or value received by others *(page 176)*

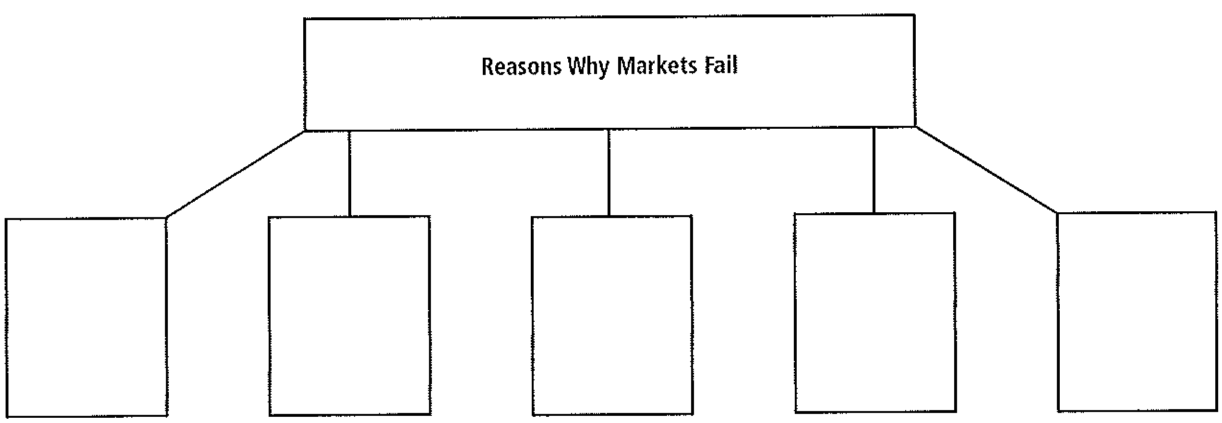
DRAWING FROM EXPERIENCE

Have you ever excelled at a sport? Would you ever realize your full potential in the sport if you never had to compete? Why or why not?

In the last section, you learned about the different kinds of competition. This section focuses on reasons why markets fail.

ORGANIZING YOUR THOUGHTS

Use the chart below to help you take notes as you read the summaries that follow. Think about what happens when markets fail.



READ TO LEARN

Introduction *(page 173)*

Market failures occur when any of the following conditions for a competitive economy are present:

A. There is inadequate competition.

B. Buyers and sellers are not well-informed.

C. Resources are not free to move from one industry to another.

D. The prices that firms charge are not close to the money that it cost the firms to produce the goods or services.

1. Give an example of how buyers and sellers keep informed.

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Inadequate Competition *(page 174)*

Mergers have resulted in larger and fewer firms controlling various industries. When this happens, there is very little competition among industries. The results of this include the following:

A. A monopoly that results from a merger controls resources and prevents them from being used for other things.

B. Since monopolies control the market, prices are higher and outputs decrease.

C. Businesses gain political power because of their economic power. For example, if a business controls the production of an item that is important to the government, it can influence the government by threatening to raise the price.

D. Reduced competition usually comes from the supply side of the market—monopolies and oligopolies. However, inadequate competition also occurs on the demand side in the cases of buyers for very expensive items, such as skyscrapers and fighter jets.

2. Why do you think high prices and reduced outputs are the result of inadequate competition?

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Inadequate Information *(page 174)*

Markets work best when everyone has enough information about market conditions. Some information, such as want ads or sale prices, is easy to find. Other information, such as whether a product is made by child labor, is more difficult to get. A market failure is present if the information is important to buyers but difficult to get.

3. Where might you learn about sale prices?

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Resource Immobility *(page 175)*

Resource immobility means that land, capital, labor, and entrepreneurs do not move to markets where they can make the most money. Instead they tend to stay put and sometimes remain unused or unemployed. For example, when a large steel mill shuts down, many of the unemployed steel workers may not be able to move to a place where they can get new jobs.

4. Suppose workers have lost their jobs when a large auto plant closed. Why might these workers not move away to find new jobs?

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Externalities *(page 175)*

Externalities are economic side effects that either benefit or harm people who are not directly involved in the activities that caused the side effect. A ***negative externality*** is a harmful side effect. For example, if a neighborhood convenience store shuts down, you experience a negative externality because you have to travel farther to buy things like bread and milk. A ***positive externality*** is a helpful side effect. For example, the closing of that same convenience store might help another convenience store by providing it with new customers. Externalities are considered market failures because their costs and benefits are not reflected in the prices of the activities that caused the side effects.

5. What are negative externalities that people in a community suffer when a convenience store closes?

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Public Goods *(page 176)*

A market economy often fails to provide ***public goods,*** which are products used by everyone, such as schools and water-purification plants. That is because a market economy produces only those things that it can stop producing if people do not pay for them. The government, not the market economy, usually supplies public goods.

6. Do you think that roads are usually made by private businesses, or are they constructed by the government? Explain.

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Name ______________________ Date ________________ Class ______________________

STUDY GUIDE Chapter 7, Section 3

For use with textbook pages 178–183

THE ROLE OF GOVERNMENT

KEY TERMS

trust Legally formed combination of corporations or companies *(page 178)*

price discrimination The practice of charging customers different prices for the same product *(page 179)*

cease and desist order A Federal Trade Commission ruling requiring a company to stop an unfair business practice, such as price-fixing, that reduces or limits competition among firms *(page 179)*

public disclosure The requirement that businesses reveal information to the public *(page 181)*

DRAWING FROM EXPERIENCE

How does government affect you on a daily basis at home? At school? When you play sports? When you go shopping? In the last section, you learned about market failures. This section focuses on how government in a capitalist economy keeps competition alive.

ORGANIZING YOUR THOUGHTS

Use the chart below to help you take notes as you read the summaries that follow. Think about how the United States government has acted to protect competition.

Year of Legislation	Description of Legislation
1890	
1914	
1936	

READ TO LEARN

Antitrust Legislation *(page 178)*

The Sherman Antitrust Act of 1890 was passed to restrict monopolies and other relationships that limit competition. One such relationship is a ***trust,*** which is a combination of companies.

A. The Clayton Antitrust Act of 1914 outlawed price discrimination. ***Price discrimination*** occurs when companies charge different prices to different customers, rather than charging all customers the same price.

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B. Also in 1914, the Federal Trade Commission Act set up the Federal Trade Commission. The Federal Trade Commission and can issue cease and desist orders. A ***cease and desist order*** makes a company stop doing something that unfairly limits competition.

C. The Robinson-Patman Act of 1936 made the rules against price discrimination even stronger.

1. How does the Federal Trade Commission encourage competition?

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Government Regulation *(page 179)*

The government may let a natural monopoly grow so the company can take advantage of lower production costs. Then the government regulates the monopoly's activities so it cannot take advantage of consumers. The government passes laws to make sure that consumers get the same prices and service that they would get under competition.

The government also uses the tax system to regulate businesses. To pay the taxes, the industry must raise its prices. The higher prices may mean that the industry will lose some customers.

2. How do you think the government should use the taxes it collects from industries that pollute?

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Public Disclosure *(page 181)*

The government helps competition by requiring public disclosure. ***Public disclosure*** means that businesses have to make sure that people can obtain certain kinds of information about what the businesses do. Any corporation that sells its stock publicly, for example, is required to supply financial reports to its investors and the Securities and Exchange Commission.

3. Which condition of a competitive free enterprise economy does public disclosure promote?

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Indirect Disclosure *(page 182)*

The government has made it easier for consumers to obtain information through its support for the Internet. Government documents and business information are available on the Internet.

4. How has the government supported the growth of the Internet?

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Modified Free Enterprise *(page 183)*

Government takes part in economic affairs to encourage competition. The economy is a mix of different market structures, business organizations, and government regulation.

5. Which do you think benefits consumers more—a system with a laissez-faire philosophy or a modified free enterprise system with government regulation? Explain your answer.

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