Name ____________________ Date ____________________ Class ____________________

STUDY GUIDE Chapter 7, Section 1

For use with textbook pages 163–171

COMPETITION AND MARKET STRUCTURES

LT 2.2

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)*

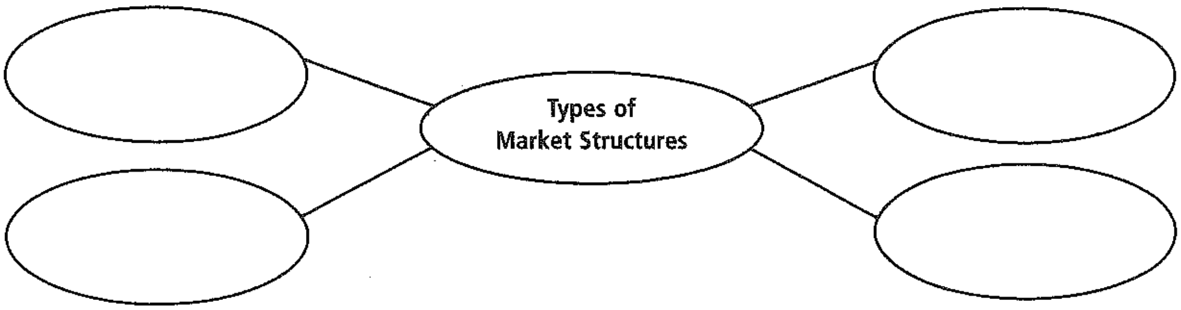
DRAWING FROM EXPERIENCE

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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