



Market Structures

Competition

Market Failures

Role of Government

Adam Smith

- Laissez-faire—philosophy (1776)
 - “allow them to do”
 - Role of government limited in the economy
 - Government should be limited to protecting private property, enforcing contracts, settling disputes and protecting businesses from foreign goods



Market Structures

- The nature and degree of competition among firms operating in the same industry
 - Perfect competition
 - Monopolistic competition
 - Oligopoly
 - monopoly



Conditions for perfect competition

- Large number of buyers and sellers
- Identical products—no brand, quality issues
- Buyers/sellers act independently—helps keep prices low
- Buyers/sellers well informed about products and prices
- Buyers/sellers free to enter or get out of business
- Supply and demand set the equilibrium price, each firm then sets output to maximize profit at that price



Monopolistic competition

- Similar to perfect competition, except products aren't identical
- Product differentiation—real or imagined differences between competing products



Oligopoly and Monopoly

- Oligopoly—few very large sellers dominate industry
 - Interdependent behavior
 - Price-fixing—illegal
- Monopoly—one seller
 - Rare in US
 - Types: natural, geographic, technological, governmental

Market Failures

- Occurs when at least one happens:
 - Inadequate competition
 - Inadequate information
 - Resource immobility
 - Externalities
 - Unintended side effects to a third party
 - Negative externality (spillover costs)—harm, cost, or inconvenience
 - Positive externality—benefit
 - Costs/benefits to third party are not reflected in market prices



Public Goods

- Products collectively consumed, whose use by one does not diminish the satisfaction available to others
 - Uncrowded highways
 - National defense
 - Flood control
 - Police/fire protection
- A type of market failure b/c market does not supply them



Role of the Government

- Promote competition, prevent monopolies, regulate industries when a monopoly is best, fulfill need for public goods
- Anti-trust legislation
- Government Regulations
 - Regulates natural monopolies
 - Internalizes Externalities
 - Lessens negative externalities through taxes (increases costs to producer)
- Public Disclosure