CHAPTER 7

Planning Guide

Key to Ability Levels	
BL Below level	AL Above level
OL On level	ELL English Language Learners

Key to Teaching Resources	
Print Material	DVD
CD-Rom	Transparency

Levels				Resources		Chapter Opener	Section 1	Section 2	Section 3	Chapter Assess
BL	OL	AL	ELL							
FOCUS										
BL	OL	AL	ELL	Transparency	Daily Focus Skills Transparencies		20, 21	72	22	
TEACH										
BL	OL		ELL	Print	Guided Reading Activities*		p. 19	p. 20	p. 21	
BL	OL	AL	ELL	Print	Economic Content Vocabulary Activities*		p. 7	p. 7	p. 7	
	OL	AL		Print	Critical Thinking Activities		p. 7			
BL	OL		ELL	Print	Reading Essentials and Note-Taking Guide*		p. 55	p. 58	p. 61	
		AL		Print	Enrichment Activities		p. 7			
	OL	AL		Print	Free Enterprise Activities		p. 6		p. 2	
BL	OL	AL	ELL	Print	Primary and Secondary Source Readings				pp. 37, 39	
BL	OL	AL	ELL	Print	Economic Cartoons		p. 11	p. 26	pp. 2, 4	
BL	OL	AL	ELL	Transparency	Economic Concepts Transparencies, Strategies, and Activities		p. 17	p. 21	p. 23	
BL	OL	AL	ELL	Print	Math Practice for Economics		p. 7			
BL	OL		ELL	Print	High School Reading in the Content Area Strategies and Activities	✓	✓	✓	✓	✓
BL	OL	AL	ELL	Transparency	High School Writing Process Transparencies	✓	✓	✓	✓	✓
BL	OL	AL	ELL	Print	Writer's Guidebook	✓	✓	✓	✓	✓
BL	OL	AL	ELL	CD-Rom	StudentWorks Plus CD-ROM	✓	✓	✓	✓	✓
BL	OL	AL	ELL	CD-Rom	Vocabulary PuzzleMaker CD-ROM	✓	✓	✓	✓	✓

*Also available in Spanish

- Interactive Lesson Planner
- Interactive Teacher Edition
- Fully editable blackline masters
- Economics & You videos
- Differentiated Lesson Plans
- Printable reports of daily assignments
- Standards tracking system

Levels				Resources		Chapter Opener	Section 1	Section 2	Section 3	Chapter Assess
BL	OL	AL	ELL							
TEACH *(continued)*										
BL	OL	AL	ELL		**Economics & You Video Program DVD—*Competition and Monopolies***	✓	✓	✓	✓	✓
BL	OL	AL	ELL		**Graph Coach CD-ROM**	✓	✓	✓	✓	✓
Teacher Resources					**Differentiated Instruction Strategies**	✓	✓	✓	✓	✓
					Success with English Learners	✓	✓	✓	✓	✓
					Presentation Plus! CD-ROM	✓	✓	✓	✓	✓
ASSESS										
BL	OL	AL	ELL		**Section Quizzes and Chapter Tests**		p. 81	p. 82	p. 83	pp. 85, 89
BL	OL	AL	ELL		**Authentic Assessment Strategies and Activities**			p. 12		
BL	OL	AL	ELL		***ExamView® Assessment Suite* CD-ROM**		7-1	7-2	7-3	Ch. 7
BL	OL	AL	ELL		**Interactive Tutor Self-Assessment CD-ROM**		7-1	7-2	7-3	
CLOSE										
BL			ELL		**Reteaching Activities***		p. 7	p. 7	p. 7	
BL	OL		ELL		**Reading and Study Skills Foldables**		p. 54			
BL	OL	AL	ELL		**Graphic Organizer Transparencies**		p. 17			

*Also available in Spanish

Activity Using StudentWorks™ Plus

Read and Listen Simultaneously

Technology Product

Glencoe's *StudentWorks™ Plus* CD-ROM contains everything your students need, including the complete Student Edition, text in audio, access to all student workbooks, and links to online activities and resources.

- Students can read chapters with Adobe Acrobat Reader software, which is opened automatically by the *StudentWorks™ Plus* program.
- The complete textbook is available with audio via the *StudentWorks™ Plus* CD-ROM.
- Students can read and listen simultaneously with page-by-page audio, which can improve content comprehension for all your students.
- Use this component with struggling readers or to emphasize an important concept.

Objectives

Using *StudentWorks™ Plus* will help your students

- practice their reading skills;
- improve their listening comprehension.

Steps

Provide students with the following information:

- Launch *StudentWorks™ Plus*.
- Select **Student Edition with Audio** from the launch screen.
- Use the bookmarks along the left side to navigate to the desired chapter or use the **Page Navigator** link in the bookmarks to link to the exact page number in the Student Edition.
- Click on the audio icon located on each page in the upper left corner to launch the audio.
- Read along with the audio.

Economics ONLINE

	Student	Teacher	Parent
Beyond the Textbook	●	●	●
Chapter Overviews	●	●	●
ePuzzles and Games	●		●
Concepts in Motion	●		●
Multi-Language Glossaries	●		●
Online Student Edition	●	●	●
Self-Check Quizzes	●		●
Student Web Activities	●		●
Study Central™	●		●
Time Current Events	●	●	●
Teaching Today		●	
Vocabulary eFlashcards	●		●
Web Activity Lesson Plans		●	

Additional Chapter Resources

- **Timed Readings Plus in Social Studies** helps students increase their reading rate and fluency while maintaining comprehension. The 400-word passages are similar to those found on state and national assessments.
- **Reading in the Content Area: Social Studies** concentrates on six essential reading skills that help students better comprehend what they read. The book includes 75 high-interest nonfiction passages written at increasing levels of difficulty.
- **Reading Social Studies** includes strategic reading instruction and vocabulary support in Social Studies content for both ELLs and native speakers of English. www.jamestowneducation.com

Reading List Generator CD-ROM

Use this database to search more than 30,000 titles to create a customized reading list for your students.

- Reading lists can be organized by students' reading level, author, genre, theme, or area of interest.
- The database provides Degrees of Reading Power™ (DRP) and Lexile™ readability scores for all selections.
- A brief summary of each selection is included.

Leveled reading suggestions for this chapter:

For students at a Grade 10 reading level:
- ***Hearing the Pitch: Evaluating All Kinds of Advertising,*** by Carlienne Frisch

For students at a Grade 11 reading level:
- ***Government and the Environment: Tracking the Record,*** by Thomas G. Aylesworth

For students at a Grade 12 reading level:
- ***Foreign Oil Dependence,*** by James Haley

* Review suggested books before assigning them.

National Council on Economic Education

Voluntary Standards Emphasized in Chapter 7

Content Standard 9 Competition among sellers lowers costs and prices, and encourages producers to produce more of what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

Content Standard 16 There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income.

Resources Available from NCEE

- Virtual Economics®: An Interactive Center for Economic Education Version 3.0
- Capstone: The Nation's High School Economics Course
- Focus: High School Economics, Second Edition
- Advanced Placement Economics: Teacher Resource Manual, Third Edition
- Focus: Institutions and Markets
- Focus: Understanding Economics in U.S. History

To order these materials, or to contact your State Council on Economic Education about workshops and programs, call 1-800-338-1192 or visit the NCEE Web site at store.ncee.net.

The BIG Ideas

As students study the chapter, remind them to consider the chapter-based Big Ideas. The **Essential Question** in the chapter launch activity below ties in to the Big Ideas and helps students think about and understand important chapter concepts. In addition, the Hands-On Chapter Project relates the content from each section to the Big Ideas. The steps in each section build on each other and culminate in the Wrap-Up Activity on the Visual Summary page.

Economics & You Video

To generate student interest and provide a springboard for class discussion, access the Economics & You Topic 7 video, **Competition and Monopolies,** at glencoe.com or on the video DVD.

FOLDABLES™ Study Organizer

Dinah Zike's Foldables are three-dimensional, interactive graphic organizers that help students practice basic writing skills, review key vocabulary terms, and identify main ideas. Have students complete this chapter's Foldable activity or activities in *Dinah Zike's Reading and Study Skills Foldables* booklet. OL

Economics ONLINE

Introduce students to chapter content and key terms by having them access ***Chapter 7—Chapter Overviews*** at glencoe.com.

CHAPTER 7

Market Structures

Why It Matters

A developer has acquired the large piece of vacant land across the street from your house and plans to build a large shopping mall on the property. How might you benefit from the mall? How might it negatively impact your life? Read Chapter 7 to learn about market structures and economic growth.

The BIG Ideas

1. The profit motive acts as an incentive for people to produce and sell goods and services.
2. Economists look at a variety of factors to assess the growth and performance of a nation's economy.
3. Governments strive for a balance between the costs and benefits of their economic policies to promote economic stability and growth.

When many companies offer similar products, each firm tries to differentiate its goods to attract customers.

Economics ONLINE **Chapter Overview** Visit the *Economics: Principles and Practices* Web site at glencoe.com and click on *Chapter 7—Chapter Overviews* to preview chapter information.

Activity: Launching the Chapter

Analyzing Have students select a company that recently opened for business in their area. Ask students to write a brief report on the goods or services that company provides, and note which other businesses provide the same goods and services in the area. Instruct students to conclude their reports by explaining why they think the owners of the business decided to open in that particular location.

Essential Question: How are competition and the profit motive related? *(People open businesses to earn profits. Competition forces entrepreneurs to keep prices low enough to attract customers. However, prices must remain high enough to ensure profits.)* Ask for volunteers to share the names of the companies they selected. Discuss as a class how each new business could affect the market for the goods and services that it sells. OL

SECTION 1

Competition and Market Structures

GUIDE TO READING

Section Preview

In this section, you will learn that market structures include perfect competition, monopolistic competition, oligopoly, and monopoly.

Content Vocabulary

- laissez-faire *(p. 169)*
- market structure *(p. 169)*
- perfect competition *(p. 170)*
- imperfect competition *(p. 172)*
- monopolistic competition *(p. 173)*
- product differentiation *(p. 173)*
- nonprice competition *(p. 173)*
- oligopoly *(p. 174)*
- collusion *(p. 174)*
- price-fixing *(p. 175)*
- monopoly *(p. 175)*
- natural monopoly *(p. 176)*
- economies of scale *(p. 176)*
- geographic monopoly *(p. 176)*
- technological monopoly *(p. 176)*
- government monopoly *(p. 177)*

Academic Vocabulary

- theoretically *(p. 170)*
- equate *(p. 177)*

Reading Strategy

Identifying As you read the section, complete a graphic organizer similar to the one below by identifying the characteristics of different market structures.

Market Structure	Characteristics
Perfect competition	

ISSUES IN THE NEWS

–The Washington Post

Profits, Prices Spur Oil Outrage

Exxon Mobil Corp. reported $8.4 billion in first-quarter profit yesterday, as members of Congress, outraged over high gasoline prices, hastened to propose measures that would boost taxes on oil firms, open new areas to drilling and provide rebates to taxpayers but would not necessarily alter prices at the pumps.

"What you have today is an oligopoly, effectively, and I think it's a disaster for the American people," said Senator Dianne Feinstein.

Federal Reserve Chairman Ben S. Bernanke cautioned Congress on the various proposals being floated. "I would like to let the market system work as much as possible to generate new supplies. . . ." ■

When Adam Smith published *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, the average factory was small, and businesses were competitive. ***Laissez-faire***, the French term that means "allow them to do," was the prevailing philosophy that limited government's role to protecting property, enforcing contracts, settling disputes, and protecting firms against foreign competition.

Conditions are much different today. An industry, or the supply side of the market, has many firms of different sizes producing slightly different products. These conditions help determine **market structure**, or the nature and degree of competition among firms doing business in the same industry. Economists group firms into four different market structures that reflect the competitive conditions in those markets.

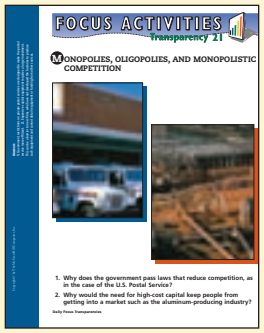
laissez-faire philosophy that government should not interfere with business activities

market structure nature and degree of competition among firms in the same industry

Focus

Bellringer

Daily Focus Transparency 21


FOCUS ACTIVITIES
Transparency 21
MONOPOLIES, OLIGOPOLIES, AND MONOPOLISTIC COMPETITION

GUIDE TO READING

Answers to Graphic:

Perfect competition: large number of well-informed independent buyers and sellers who exchange identical products

Monopolistic competition: same as perfect competition except that products are generally similar

Oligopoly: a few large sellers dominate; products may have distinct features

Monopoly: a single seller of a particular product

Resource Manager

R Reading Strategies	C Critical Thinking	D Differentiated Instruction	W Writing Support	S Skill Practice
Teacher Edition • Inferring, p. 171 • Summarizing, p. 172 • Using Word Parts, p. 174 **Additional Resources** • Guid. Read. Act., p. 19 • Read. Ess. & Note-Taking Guide, p. 55	**Teacher Edition** • Speculating, p. 170 • Ident. Central Issues, p. 173 • Det. Cause/Effect, p. 174 • Form. Quest., p. 178 **Additional Resources** • Crit. Think. Act., p. 7 • Econ. Concepts Trans., Strat. and Act., p. 17	**Teacher Edition** • Special Ed., p. 170 • ELL, p. 171 • Auditory/Musical, p. 173 • Visual/Spatial, p. 176 **Additional Resources** • Econ. Cartoons, p. 11 • Free Ent. Act., p. 6 • Enrichment Act., p. 7	**Teacher Edition** • Personal Writing, p. 172 • Persuasive Writing, p. 174 • Narrative Writing, p. 176 **Additional Resources** • Writer's Guidebook • Reading and Study Skills Fold., p. 54	**Teacher Edition** • Analyzing Graphs, p. 171 • Using Tables and Charts, p. 175 • Evaluating Info., p. 177 **Additional Resources** • Daily Focus Trans. 20 • Graph. Org. Trans., p. 9 • Math Prac. for Econ., p. 7

Teach

D Differentiated Instruction

Special Education Provide students with a partially filled out outline of the chapter. As they read, have students fill in the blanks on the outline. After they finish the chapter, have students compare outlines with partners. BL

C Critical Thinking

Speculating **Ask:** What would happen if consumers did not have easy access to information about products and services? *(Possible answer: Sellers would exploit the consumers' lack of knowledge to raise prices.)* OL

Caption Answer: The products are identical, the buyer is acting independently, and the buyer is free to make a business transaction if he wishes.

perfect competition market structure with many well-informed and independent buyers and sellers who exchange identical products

D Perfect Competition

MAIN Idea Perfect competition is an ideal market situation used to evaluate other market structures.

Economics & You You learned earlier about industries. Read on to find out how perfect competition is the ideal market structure in an industry.

Perfect competition is a market structure characterized by a large number of well-informed independent buyers and sellers who exchange identical products. It represents a **theoretically** ideal situation that is used to evaluate other market structures. In order for a market to have perfect competition, it needs to meet five necessary conditions that other market structures lack.

Perfect Competition A farmers' market comes closest to satisfying the conditions for a perfectly competitive market. ***What conditions for perfect competition are met in this photograph, and how?***

Necessary Conditions

The first condition is that there must be a large number of buyers and sellers. No single buyer or seller is large enough or powerful enough to single-handedly affect the price.

The second condition is that buyers and sellers deal in identical products. With no difference in the products, there is no need for brand names and no need to advertise, which keeps prices low. With no differences between products, one seller's merchandise is just as good as another's.

The third condition is that each buyer and seller acts independently. This ensures that sellers compete against one another for the consumer's dollar, and that consumers compete against one another to obtain the best price.

C The fourth condition is that buyers and sellers are reasonably well-informed about products and prices. Well-informed buyers shop at the stores that have the lowest prices. Well-informed sellers match the lowest prices of their competitors to avoid losing customers.

The fifth condition is that buyers and sellers are free to enter into, conduct, or get out of business. This freedom makes it difficult for producers in any industry to keep the market to themselves. Producers have to keep prices competitive, or new firms can take away some of their business. Collectively, these conditions help ensure the competition that is necessary to keep prices low and quality high.

Profit Maximization

Under perfect competition, market supply and demand set the equilibrium price for the product. Because the price is determined in the market, and because each firm by itself is too small to influence the market price, the perfect competitor is often called

Additional Support

Activity: Extending the Content

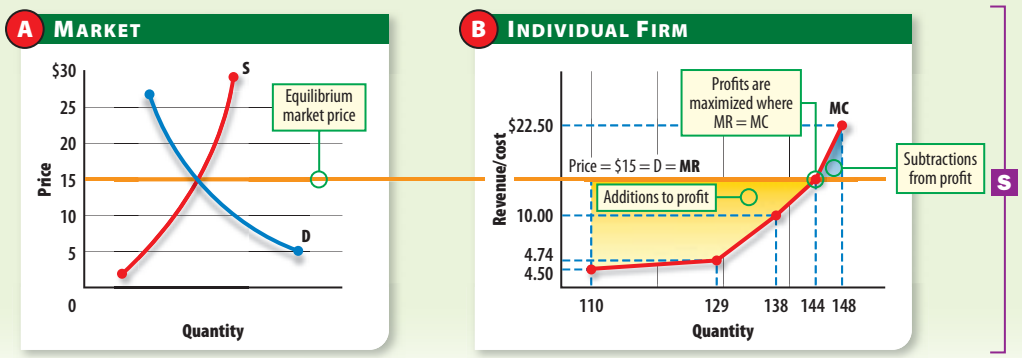
Agriculture and Perfect Competition
Few markets today meet the conditions of the perfectly competitive market model. However, the grain market for number two yellow corn—a standard product that does not vary—closely fits this description. There are many farmers who grow and sell number two yellow corn, as well as a large number of buyers. The farmers do not advertise or band together to control price. There is open communication between buyers and sellers about the market price. The grain market for number two yellow corn, however, falls short of satisfying the fifth condition for perfect competition: ease of access to the market. Entry is limited because it takes a sizeable investment to start a farm focused on the growing of grain.

Figure 7.1 ▶ Perfect Competition and Profit Maximization

Graphs In MOtion
See StudentWorks™ Plus or glencoe.com.

▶ Under perfect competition, the market forces of supply and demand establish the equilibrium price. The perfectly competitive firm treats this price as its demand curve and its marginal revenue (MR) because the firm will receive $15 for each and every unit it sells.

Economic Analysis ***What would happen to total profits if the firm used 10 workers instead of 9?***



a "price taker." The firm then must find the level of output it can produce that will maximize its profits.

To understand how this is done, it helps to examine **Figure 7.1.** This figure shows the relationship between the perfectly competitive firm and its industry. In **Panel A,** supply and demand set the equilibrium market price at $15 per unit of output. Because the firm in **Panel B** receives $15 for the first and every additional unit it sells, the market price is the same as the firm's marginal revenue curve (MR).

In order to show a graphical example, the firm in Figure 7.1 is the same one that appeared earlier in Figure 5.6 on page 134. While the number of workers are not shown in Figure 7.1, the total production, marginal cost, and marginal revenue are the same in both figures.

When it comes to determining the profit maximizing quantity of output in Figure 7.1, the logic of marginal analysis is the same as before. For example, Panel B in the figure above tells us that the firm would make a profit on the 110th unit of output because it would only cost $4.50 to produce and could be sold for $15. As long as the marginal cost of producing one more unit of output is less than the marginal revenue from the sale of that output, the firm would continue to hire more workers and expand its output.

Given its marginal cost and marginal revenue conditions, the firm shown in Figure 7.1 would find it profitable to hire enough workers to expand production until 144 units of output are produced. Of course, total output would continue to go up if the firm hired more workers and expanded production. However, total profits would start to go down because the marginal cost of production would then become increasingly larger than the $15 marginal revenue from sales.

In the end, the profit maximizing quantity of output is found where the marginal cost of production is equal to the marginal revenue from sales, or where MC = MR. This occurs at 144 units of output. Other levels of output may generate equal profits, but none will generate more.

S Skill Practice

Analyzing Graphs **Ask:** What is the difference between marginal cost and marginal revenue at the quantity of 129? *($10.26)* OL

R Reading Strategy

Inferring **Ask:** What would happen if the firm in the graph tried to charge a price greater than $15? *(Consumers would buy from other firms, and sales for the firm in the graph would drop.)* AL

D Differentiated Instruction

English Language Learners
Have students list three words from this spread that they are not familiar with (such as *marginal*). Next, have them exchange lists with a partner. Ask each student to look up the definitions of the words on the list and then explain orally to his or her partner what the words mean. ELL

Economic Analysis
Answer: The firm would hire more workers and increase output.

Analyzing American Market Structures

In this project, students will examine the four market structures by making posters, conducting surveys, and writing laws and policies.

Step 1: Comparing Market Structures. Student groups will compare the different market structures in the American economy.

Directions: Organize the class into at least six different small groups. Tell students that each group will create a large collage-type poster for each of the four market structures in the American economy (perfect competition, monopolistic competition, oligopoly, monopoly). Groups should identify specific businesses and industries that fit with each of the different market structures. Student should then select images, such as company logos, office buildings, and customers buying products, to cut out and place on a large poster board. Posters should also include text describing how the images relate to the specific market structure that they represent.

Hands-On Chapter Project

Step 1

Display the completed posters in the classroom. Have a spokesperson from each group explain the information presented on the group's poster. Allow students from other groups to ask questions about the poster.

Summarizing Have students write a short paper summarizing what they learned about the different market structures from their own work and the work of other groups. OL

(Chapter Project continued in Section 2.)

R Reading Strategy

Summarizing **Tell students:** Use your own words to summarize the reasons why perfect competition keeps prices low. *(Summaries should include the following: no need for advertising; no reason for one seller to charge a higher price; buyers will always purchase from the seller with the lowest price; new sellers can enter easily.)* BL

W Writing Support

Personal Writing Have students write a one-page essay giving their thoughts and feelings about the role of economic competition in a political democracy. Students might attempt to link the freedom of interaction that occurs under perfect competition with the political freedoms granted in a democracy, or they might note that economic competition implies equality of opportunity. AL

✓Reading Check **Answer:** Although perfect competition rarely exists, its advantages serve as a yardstick against which other structures are measured.

imperfect competition market structure that does not meet all conditions of perfect competition

A Theoretical Situation

Few perfectly competitive markets exist because it is difficult to satisfy all five necessary conditions. Local vegetable farming, sometimes called "truck" farming, comes close.

In these markets many sellers offer nearly identical products. Individual sellers are generally unable to control prices, and both buyers and sellers have reasonable knowledge of most products and prices. Finally, anyone who wants to enter the business by growing tomatoes, corn, or other products can easily do so.

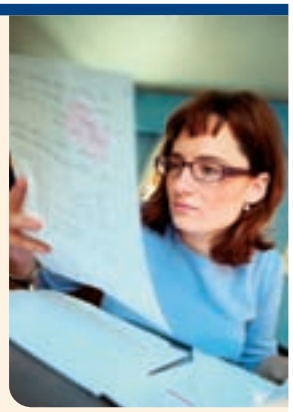
When markets are perfectly competitive, several things combine to keep prices low. For example, when everyone is dealing with identical products, there is no need to advertise, which keeps the cost down. Second, when the products that everyone sells are identical, there is no reason for one seller to charge a price higher than anyone else. If the seller does try to charge a higher price, buyers will simply go elsewhere.

R Third, if there are a large number of independent buyers and sellers, then no single buyer is big enough to push the price down and no single seller is big enough to force the price up. As a result, buyers will always try to purchase from the seller with the lowest price.

Finally, if it is easy for sellers to enter or leave the market, then new sellers can always come in if they think they can make a profit. Likewise, sellers who cannot match the new competition are free to leave.

CAREERS

Market Researcher



The Work

* Gather, record, and analyze facts about products and sales using company or government records, published materials, statistical files, and other sources
* Print and circulate questionnaires or survey people over the phone or door-to-door to help companies forecast future sales trends, design new products, and develop advertising strategies

Qualifications

* Strong analytical and writing skills
* Experience with computerized data
* College courses in marketing, statistics, English composition, speech, psychology, and economics
* Bachelor's degree, with many positions requiring a master's or Ph.D.

Earnings

* Median annual earnings: $53,810

Job Growth Outlook

* Faster than average

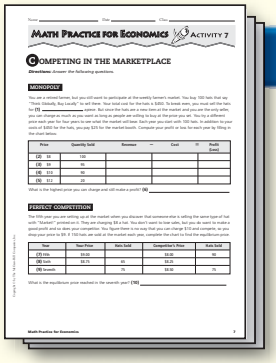
Source: *Occupational Outlook Handbook*, 2006–2007 Edition

Imperfect Competition

Although perfect competition is rare, it is important because economists use it to evaluate other, less competitive, market structures. **Imperfect competition** is the name given to any of three market structures—monopolistic competition, oligopoly, and monopoly—that lacks one or more of the conditions required for perfect competition. Most firms and industries in the W United States today fall into one of these categories. When we examine imperfect competition, we will see that it results in less competition, higher prices for consumers, and fewer products offered. This is why perfectly competitive markets are theoretically ideal situations that can be used to evaluate other market structures.

✓Reading Check **Describing** Why does perfect competition serve as a theoretical market structure?

Differentiated Instruction



Math Practice for Economics, p. 7

Competing in the Marketplace

Objective: Understand how competition affects prices.

Focus: Have students brainstorm current examples of monopolies and competitive markets.

Teach: Have students complete the exercises in the activity.

Assess: Make sure that students have the correct answers and understand the calculations behind them.

Close: Have students write a paragraph explaining how monopolies and competition affect prices.

Differentiated Instruction Strategies

BL Have student groups devise strategies for what the farmer could do to maximize profits in the future.

AL Ask students to create a similar exercise with different products and prices.

ELL Have students write sentences using the words *monopoly*, *competition*, and *equilibrium*.

Product Differentiation Monopolistic competitors must find ways to attract the attention of buyers. ***How does the advertisement on this billboard differentiate this product from other colas?***

Monopolistic Competition

MAIN Idea Monopolistic competition shares all the conditions of perfect competition except the same goods or services.

Economics & You How many stores do you know that offer similar products? Read on to learn how this reflects monopolistic competition.

Monopolistic competition is the market structure that has all the conditions of perfect competition except for identical products. Under monopolistic competition, products are generally similar and include things such as designer clothing, cosmetics, and shoes. The *monopolistic* aspect is the seller's ability to raise the price within a narrow range. The *competitive* aspect is that if sellers raise or lower the price enough, customers will ignore minor differences and change brands.

Product Differentiation

Monopolistic competition is characterized by **product differentiation**—real or perceived differences between competing products in the same industry. Most items produced today—from the many brands of athletic footwear to personal computers—are differentiated.

Nonprice Competition

To make their products stand out, monopolistic competitors try to make consumers aware of product differences. They do this with **nonprice competition**—the use of advertising, giveaways, or other promotions designed to convince buyers that the product is somehow unique or fundamentally better than a competitor's.

In a monopolistically competitive industry, advertising is important. This explains why producers of designer clothes spend so much on advertising and promotion. If a seller can differentiate a product in the mind of the buyer, the firm may be able to raise the price above its competitors' prices. Because advertising is expensive, it raises the cost of doing business for the monopolistic competitor, and hence the price the consumer pays.

Profit Maximization

The profit maximizing behavior of the monopolistic competitor is no different from that of other firms. The firm will expand its production until its marginal cost is equal to its marginal revenue, or where MC = MR. If the firm's advertising convinces consumers that its product is better, then it can charge a higher price. If not, the firm must charge less.

Finally, it is easy for firms to enter the monopolistically competitive industry. Each new firm makes a product only a little different from others on the market. The result is a large number of firms producing a variety of similar products.

✓Reading Check **Comparing** How is profit maximization in a monopolistic firm different from that of a perfect competitor?

monopolistic competition market structure that meets all conditions of perfect competition except identical products

product differentiation real or imagined differences between competing products in the same industry

nonprice competition sales strategy focusing on a product's appearance, quality, or design rather than its price

C Critical Thinking

Identifying Central Issues List the following products on the board: soda, bottled water, perfume, aspirin. Ask students to name their favorite brands of these items and explain their choices. Point out that this is an illustration of product differentiation, because student preferences were based on slight differences among brands. **OL**

D Differentiated Instruction

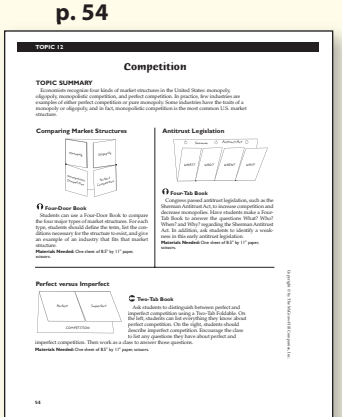
Auditory/Musical Ask students to think of advertising jingles that have influenced them to buy a product. Have each student sing, hum, or identify one such song and explain its effectiveness. **BL**

Caption Answer: It claims that the cola has a new taste.

✓Reading Check **Answer:** It's not; the firm still maximizes profits at the output where marginal cost equals marginal revenue.

Leveled Activities

BL Reading and Study Skills Foldables, p. 54


TOPIC 12

Competition

TOPIC SUMMARY

Economists recognize four kinds of market structures in the United States: monopoly, oligopoly, monopolistic competition, and perfect competition. In practice, few industries are examples of either perfect competition or pure monopoly. Some industries have the traits of a monopoly or oligopoly, and in fact, monopolistic competition is the most common U.S. market structure.

Comparing Market Structures

Antitrust Legislation

Four-Door Book

Students can use a Four-Door Book to compare the four major types of market structures. For each type, students should define the term, list the conditions necessary for the structure to exist, and give an example of an industry that fits that market structure.

Materials Needed: One sheet of 8.5" by 11" paper, scissors.

Four-Tab Book

Congress passed antitrust legislation, such as the Sherman Antitrust Act, to increase competition and to prevent monopolies. Students can use a Four-Tab Book to answer the questions: What? Who? When? and Why? regarding the Sherman Antitrust Act. In addition, ask students to identify a weakness in this early antitrust legislation.

Materials Needed: One sheet of 8.5" by 11" paper, scissors.

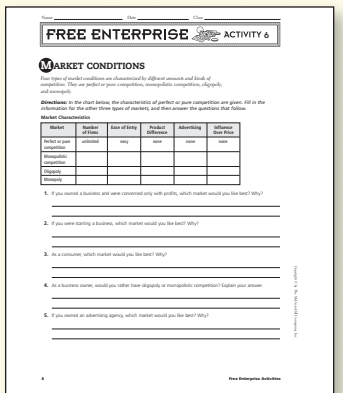
Perfect versus Imperfect

Two-Tab Book

Ask students to distinguish between perfect and imperfect competition using a Two-Tab Foldable. On the left, students can list everything they know about perfect competition. On the right, students can describe imperfect competition. Encourage students to list any questions they have about perfect and imperfect competition. Then work as a class to answer those questions.

Materials Needed: One sheet of 8.5" by 11" paper, scissors.

OL Free Enterprise Activities, p. 6


FREE ENTERPRISE ACTIVITY 6

MARKET CONDITIONS

Four types of market conditions are characterized by different amounts and kinds of competition. They are perfect or pure competition, monopolistic competition, oligopoly, and monopoly.

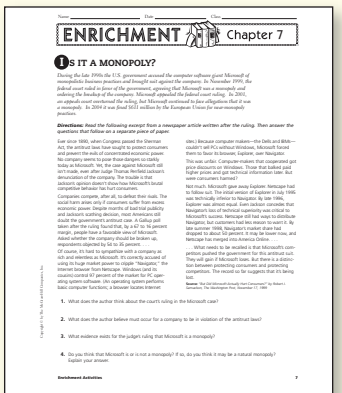
Directions: *In the chart below, the characteristics of perfect or pure competition are given. Fill in the information for the other three types of markets, and then answer the questions that follow.*

Market Characteristics

Market	Number of Firms	Ease of Entry	Product Difference	Advertising	Influence Over Price
Perfect or pure competition	unlimited	easy	none	none	none
Monopolistic competition					
Oligopoly					
Monopoly					

1. If you owned a business and were concerned only with profits, which market would you like best? Why?
2. If you were starting a business, which market would you like best? Why?
3. As a consumer, which market would you like best? Why?
4. As a business owner, would you rather have oligopoly or monopolistic competition? Explain your answer.
5. If you owned an advertising agency, which market would you like best? Why?

AL Enrichment Activities, p. 7


ENRICHMENT Chapter 7

IS IT A MONOPOLY?

During the late 1990s the U.S. government accused the computer software giant Microsoft of monopolistic business practices and brought suit against the company. In November 1999, the federal court ruled in favor of the government, arguing that Microsoft was a monopoly and ordering the breakup of the company. Microsoft appealed the federal court ruling. In 2001, an appeals court overturned the ruling, but Microsoft continued to face allegations that it was a monopoly. In 2004 it was fined $613 million by the European Union for near-monopoly practices.

Directions: *Read the following excerpt from a newspaper article written after the ruling. Then answer the questions that follow on a separate piece of paper.*

Ever since 1890, when Congress passed the Sherman Act, the antitrust laws have sought to protect consumers and prevent the evils of concentrated economic power. Microsoft's critics argue that the company is doing today as Microsoft. Yet, the case against Microsoft still isn't made, even after Judge Thomas Penfield Jackson's denunciation of the company. The trouble is that Jackson's opinion doesn't show how Microsoft's brutal competition between fast hurt consumers.

Companies compete, after all, to deliver their rivals. The mere fact that Microsoft has used its market power to economic power. Despite majorities of bad trial publicity and Jackson's scathing decision, most Americans still doubt the government's antitrust case. A Gallup poll taken after the ruling found that, by a 67 to 16 percent margin, people have a favorable view of Microsoft. Asked whether the company should be broken up, respondents objected by 54 to 36 percent.

Of course, it's hard to sympathize with a company as big and powerful as Microsoft. Critics charge that it used its huge market power to cripple "Navigator," the Internet browser from Netscape. Windows (and its cousins) control 87 percent of the market for PC operating system software. (An operating system performs basic computer functions; a browser locates Internet sites.) Because computer makers—the Dells and IBMs—couldn't sell PCs without Windows, Microsoft forced them to favor its browser, Explorer, over Navigator.

This was unfair. Computer-makers that cooperated got price discounts or Windows. Those that balked paid more. Microsoft withheld technical information later. But were consumers harmed?

Not much. Microsoft gave away Explorer. Netscape had to follow suit. The initial version of Explorer in July 1995 was technically inferior to Navigator. By late 1996, Explorer was almost equal. Even Jackson concedes that Navigator's loss of technical superiority was critical to Microsoft's success. Consumers had a choice between Navigator, but customers had less reason to want it. By late summer 1998, Navigator's market share had dropped to about 50 percent. It may be lower now, and Netscape has merged into America Online . . .

. . . What needs to be recalled is that Microsoft's competitors pushed the government for this antitrust suit. They sell gain if Microsoft loses. But there is a distinction between protecting consumers and protecting competitors. The record so far suggests that it's being lost.

Source: *"But Did Microsoft Actually Hurt Consumers?"* by Robert J. Samuelson, *The Washington Post*, December 12, 1999

1. What does the author think about the court's ruling in the Microsoft case?
2. What does the author believe must occur for a company to be in violation of the antitrust laws?
3. What evidence exists for the judge's ruling that Microsoft is a monopoly?
4. Do you think that Microsoft is or is not a monopoly? If so, do you think it may be a natural monopoly? Explain your answer.

R Reading Strategy

Using Word Parts Have students research the origins and meaning of the two parts of the word *oligopoly* and then explain its meaning. *(It is a Greek word.* Olig *means "few";* poly *means "many." Hence, oligopoly means "few sellers, many buyers.")* AL

W Writing Support

Persuasive Writing Have students choose a product made by an oligopoly and write a brief essay in which they argue for the superiority of their preferred brand. (For example, students may argue that McDonald's has the best cheeseburgers, based on taste, price, and convenience.) OL

C Critical Thinking

Determining Cause and Effect **Ask:** What is the effect of a company in an oligopoly making a product change? *(The other companies in the oligopoly will make the same change.)* BL

The Global Economy & YOU

Poco, Heart, and Wisdom

If you invent a product, remember that an important part of selling it is the brand name. In the global economy, Western brands sometimes get lost in translation. The real genius in selling overseas is to capture foreign consumers' attention with a Western product, but relate it to their lives and culture in a familiar way.

PepsiCo, for example, sells its popular Lays potato chips in China. It also introduced a local brand of potato chips called Poco. In addition to changing the name of the chips, PepsiCo adjusted the flavor to satisfy local tastes.

German carmaker Volkswagen used its slogan, "For the love of the automobile," as a springboard for the Asian market. Savvy marketing gurus took this catchy slogan and attached it to the Chinese-language written character for *heart.* The VW brand campaign includes 16 total characters, including those for *compassion, loyalty,* and *wisdom,* and associates the characters with VW automobiles. The VW Golf model represents *loyalty,* for example, whereas the Passat is a blend of *heart* and *goal.*

R **oligopoly** market structure in which a few large sellers dominate the industry

collusion agreement, usually illegal, among producers to fix prices, limit output, or divide markets

Personal Finance Handbook
See pages R30–R31 for more information on buying a car.

Oligopoly

MAIN Idea Oligopoly describes a market in which a few sellers dominate an industry.

Economics & You What products can you think of that are sold by a small number of sellers? Read on to learn about oligopolies.

Oligopoly is a market structure in which a few very large sellers dominate the industry. The product of an oligopolist may have distinct features, as do the many makes and models of cars in the auto industry; or it may be standardized, as in the steel industry. As a result, oligopoly is further from perfect competition than monopolistic competition.

W In the United States, many markets are already oligopolistic, and many more are becoming so. For example, Burger King, McDonald's, and Wendy's dominate the fast-food industry. A few large corporations control other industries, such as the domestic airline and automobile industries.

Interdependent Behavior

C Because oligopolists are so large, whenever one firm acts, the other firms in the industry usually follow—or they run the risk of losing customers. For example, when Chrysler introduced the first minivan, other companies soon followed.

The tendency of oligopolists to act together often shows up in their pricing behavior, such as copying a competitor's price reduction in order to attract new customers. For example, if Ford or General Motors announces zero-interest financing or thousands of dollars back on each new car purchased, its competitors will match the promotion almost immediately. In extreme cases this can lead to a price war, or a series of price cuts that result in unusually low prices.

Because oligopolists usually act together when it comes to changing prices, many firms prefer to compete on a nonprice basis by enhancing their products with new or different features. Automobile companies do this every year when they introduce models. If an oligopolist finds a way to enhance a product, its competitors are at a disadvantage for a period of time. After all, it takes longer to develop a new physical attribute for a product than it does to match a price cut.

Sometimes the interdependent behavior takes the form of **collusion**, a formal agreement to set specific prices or to otherwise behave in a cooperative manner. One form

Additional Support

Activity: Collaborative Learning

Local Oligopolies Divide students of mixed abilities into groups of four. Have them identify a business in the community that is part of an oligopoly. Have students observe the business as well as research it through print and online resources. Then have groups present an oral report describing the competitive strategies employed by the business. For their reports, student might look for advertisements and evaluate them for effectiveness and purpose. (For example, does the ad seek to expand market share by product differentiation, or does it seek to increase overall demand for the product?) Students might evaluate product quality of their producer vs. that of other producers, or they might observe strategies such as location and price. Students should evaluate the business's place in the oligopoly. For example, does it distribute a good made under oligopoly conditions? (car dealership, gas station) Or does it actually produce a good or service under oligopoly conditions? (one of two or three doctors in town; one of two or three Italian restaurants in town) OL

of collusion is **price-fixing**, or agreeing to charge the same or similar prices for a product. In almost every case these prices are higher than those determined under competition. The firms also might agree to divide the market so that each is guaranteed to sell a certain amount. Because collusion usually restrains trade, it is against the law.

Profit Maximization

The oligopolist, like any other firm, maximizes its profits when it finds the quantity of output where its marginal cost is equal to its marginal revenue, or where MC = MR. The oligopolist will then charge the price consistent with this level of sales.

Because of all the nonprice competition, the product's final price is likely to be higher than it would be under monopolistic competition, and much higher than it would be under perfect competition. Nonprice competition is always expensive for a firm, and these expenses usually come back to the consumer in the form of higher prices.

✓Reading Check **Explaining** Why do oligopolists frequently appear to act together?

Monopoly

MAIN Idea A monopoly is a market with only one seller for a particular product.

Economics & You Did you ever play the game of Monopoly? Read on to learn how this game reflects the problems caused by having one seller in the market.

At the opposite end of the spectrum from perfect competition is monopoly. A **monopoly** is a market structure with only one seller of a particular product. This situation—like that of perfect competition—is an extreme case. In fact, the American economy has very few, if any, cases of pure monopoly—although the local cable TV operator or telephone company may come close.

Even the telephone company, however, faces competition from other communication companies, from the United States Postal Service, and from Internet providers that supply e-mail and telephone services. Local cable providers face competition from video rental stores, satellite cable systems, and the Internet. Consequently, when people talk about monopolies, they usually mean near-monopolies.

price-fixing agreement, usually illegal, by firms to charge the same price for a product

monopoly market structure with a single seller of a particular product

Figure 7.2 ▶ **Characteristics of Market Structures**

	Number of firms in industry	Influence over price	Product differentiation	Advertising	Entry into market	Examples
Perfect competition	Many	None	None	None	Easy	Perfect: None Near: Truck farming
Monopolistic competition	Many	Limited	Fair amount	Fair amount	Easy	Gas stations Women's clothing
Oligopoly	Few	Some	Fair amount	Some	Difficult	Automobiles Aluminum
Pure monopoly	One	Extensive	None	None	Almost impossible	Perfect: None Near: Water

S

▶ The term *market structure* refers to the nature and degree of competition among firms operating in the same industry. Individual market structures, listed on the left, are determined by the five characteristics listed in the columns above.

Economic Analysis ***In which market structure does nonprice competition play a major role?***

S Skill Practice

Using Tables and Charts

Ask: In which market structures is product differentiation important? *(monopolistic competition and oligopoly)* In which market structure do firms have limited influence over price? *(monopolistic competition)* BL

Did You Know?

The game of Monopoly was invented by an unemployed engineer named Charles Darrow. Hoping to profit from his idea, Darrow presented his game to Parker Brothers in 1934. The company rejected it but eventually reconsidered and bought the rights to Darrow's game.

✓Reading Check **Answer:** Because they are so large, they must follow the actions of other firms or risk losing customers.

Economic Analysis

Answer: monopolistic competition and oligopoly

Additional Support

Activity: Hands-On Economics

Technology and Monopoly In this activity, students will explore the relationship between technology and monopolies. Ask students to take notes on at least one way that they use modern technology. Then have students write a report explaining how this interaction relates to the economic concept of monopoly. Examples that students could write about include: placing an order with Amazon.com (weakens the geographic monopoly of a local bookstore); using a computer with Windows (strengthens the Microsoft monopoly); paying for and downloading a song onto an iPod (abiding by the song's copyright protection). OL

W Writing Support

Narrative Writing Have students write a fictional story describing a futuristic society in which there is only one university, doctor, and grocery store—in fact, there is only one of everything. Stories should focus on how living among such monopolies impacts the daily lives of individuals. **OL**

D Differentiated Instruction

Visual/Spatial Have students contribute to a list of natural monopolies that you write on the board. Then have students choose one of the monopolies and draw a picture or make a collage that illustrates what the community would look like if the product or service was supplied by competitors instead of a regulated monopoly. **ELL**

Caption Answer: There are no other sellers in the area.

Monopolies A geographic monopoly exists when there is only one seller of a product in a particular area. ***What would indicate that this gas station has a geographic monopoly?***

natural monopoly market structure where average costs of production are lowest when a single firm exists

economies of scale situation in which the average cost of production falls as a firm gets larger

geographic monopoly market structure in which one firm has a monopoly in a geographic area

technological monopoly monopoly based on a firm's ownership or control of a production method, process, or other scientific advance

We have few monopolies today because Americans traditionally have disliked them and have tried to outlaw them. Another reason is that new technologies often introduce products that compete with existing monopolies. The development of the fax machine allowed businesses to send electronic letters that competed with the U.S. Postal Service. Later, e-mail became even more popular than the fax. Today, telephone service over the Internet is yet another technology challenging phone monopolies.

Types of Monopolies

Sometimes the nature of a good or service dictates that society would be served best by a monopoly. A **natural monopoly**—a market situation where the costs of production are minimized by having a single firm produce the product—is one such case.

Natural monopolies often can provide services more cheaply than several competing firms could. For example, two or more competing telephone companies serving the same area would be inefficient if each company needed its own telephone poles and lines. Public utility companies fall into this category because it would be wasteful to duplicate the networks of pipes and wires that distribute water, gas, and electricity throughout a city. To avoid these problems, the government often gives a public utility company a *franchise*—the exclusive right to do business in a certain area without competition. By accepting such franchises, the companies also accept a certain amount of government regulation.

The justification for the natural monopoly is that a larger firm can often use its personnel, equipment, and plant more efficiently. This results in **economies of scale**, a situation in which the average cost of production falls as the firm gets larger. When this happens, it makes sense for the firm to be as large as is necessary to lower its production costs.

Sometimes a monopoly exists because of a specific location. A drugstore operating in a town too small to support two or more such businesses becomes a **geographic monopoly**. This is a monopoly based on the absence of other sellers in a certain geographic area. Similarly, the owner of the only gas station on a lonely interstate highway exit also has a type of geographic monopoly.

A **technological monopoly** is a monopoly that is based on ownership or control of a manufacturing method, process, or other scientific advance. The government may grant a *patent*—an exclusive right to manufacture, use, or sell any new and useful invention for a specific period—to the inventor. Inventions are covered for 20 years; however, a product's design can be patented for shorter periods, after which it becomes public property available for the benefit of all. Art and literary works are protected through

Additional Support

Teacher Tip

Researching Supreme Court Cases Students might find Supreme Court opinions online. Suggest that they visit the Legal Information Institute (www.law.cornell.edu) or the U.S. Supreme Court (www.supremecourt.us.gov).

Activity: Interdisciplinary Connection

Civics Tell students that in early 2007, the Supreme Court heard arguments in a case in which AT&T sued Microsoft for patent infringement. Software patents in general are a significant issue in the case. Have students research this case or other similar cases, such as *MercExchange* v. *eBay* or *NTP* v. *Research in Motion*. Students should examine why the judicial system is necessary for maintaining patents and write reports on their findings. Reports should include analysis of the importance to progress and growth of maintaining intellectual property rights. **AL**

a *copyright*—the exclusive right of authors or artists to publish, sell, or reproduce their work for their lifetime plus 50 years. S

Still another kind of monopoly is the **government monopoly**—a monopoly owned and operated by the government. Government monopolies are found at all three levels of government—national, state, and local. In most cases they involve products or services that private industry cannot adequately supply.

Many towns and cities have monopolies that oversee water use. Some states control alcoholic beverages by requiring that they be sold only through state stores. The federal government controls the processing of weapons-grade uranium for military and national security purposes.

Profit Maximization

Monopolies maximize profits the same way other firms do: they **equate** marginal cost with marginal revenue to find the profit-maximizing quantity of output. Even so, there are differences between the monopolist and other profit-maximizing firms—especially the perfect competitor.

First, the monopolist is much larger than the perfect competitor. This is because there is only one firm—the monopolist—supplying the product, rather than thousands of smaller ones. Second, both because of its large size and the lack of meaningful competition, the monopolist is able to behave as a "price maker." This differs from the perfect competitor, who faces competition and is a price taker.

Because there are no competing firms in the industry, there is no equilibrium price facing the monopolist. In order for the monopolist to maximize its profits, it will do exactly as all the other firms have done: it will equate MC with MR because this method always shows the level of output that produces the highest total profits. The result will be a very high price—higher than would be charged under conditions of perfect competition, monopolistic competition, or oligopoly.

✓Reading Check **Analyzing** Why do natural monopolies sometimes result in economies of scale?

government monopoly
a monopoly owned and operated by the government

Skills Handbook
*See page **R41** to learn about **Drawing Conclusions.***

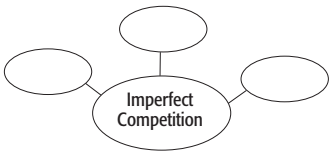
SECTION 1 Review

Vocabulary

1. **Explain** the significance of laissez-faire, market structure, perfect competition, imperfect competition, monopolistic competition, product differentiation, nonprice competition, oligopoly, collusion, price-fixing, monopoly, natural monopoly, economies of scale, geographic monopoly, technological monopoly, and government monopoly.

Main Ideas

2. **Explaining** Why is the perfect competitor often called a "price taker"?
3. **Identifying** Use a graphic organizer like the one below to identify the characteristics of imperfect competition.



Critical Thinking

4. **The BIG Idea** Describe the four basic market structures and explain how they differ from one another.
5. **Differentiating** Which characteristics of firms selling designer clothing are monopolistic? Which are competitive? Write a brief paragraph explaining your answer.
6. **Inferring** If Americans traditionally dislike monopolies, why do some monopolies exist today? What types of monopolies are they, and what are their characteristics?
7. **Analyzing Visuals** Compare the photos of the farmers on page 170 and the gas station on page 176. How do market conditions differ for these sellers?

Applying Economics

8. **Product Differentiation** Search your local newspaper for local clothing stores ads. You should find at least two different ads. Describe how the advertisements succeed or fail to differentiate the products.

S Skill Practice

Evaluating Information

Ask: Do you think it is fair for copyrights to last for the lifetime of the author plus 70 years? Explain. *(Answers will vary but will likely reference the importance of art and literature to the public vs. the individual rights of each author.)* OL

✓Reading Check **Answer:** Sometimes a larger firm can use its personnel, equipment, and plant more efficiently.

Assess

Use the Interactive Tutor Self-Assessment CD-ROM to review Section 1, and then assign the Section 1 Review as homework or as an in-class activity.

Close

Identifying Have students list three specific companies that operate in each of the three market structures described in this chapter. OL

Review SECTION 1

Answers

1. All definitions can be found in the section and the Glossary.
2. because there are so many buyers and sellers that none can influence price; they must take the price that the market gives
3. few firms; less competition; higher prices; fewer products
4. perfect competition: many buyers and sellers acting independently, identical products, good information; monopolistic competition: many sellers, product differentiation, nonprice competition; oligopoly: few sellers, identical or differentiated products, interdependent behavior; monopoly: single seller
5. Answers will vary but should include the fact that the designer's name cannot be copied but that the consumer may switch products if the designer charges too high of a price or falls out of fashion.
6. Sometimes monopolies can achieve economies of scale; they are natural monopolies, which the government regulates. There can also be geographic monopolies, where a firm is the only seller within a large geographic area, and there can be technological monopolies on new inventions. These are protected by patents and exist to make sure that innovators reap the rewards of their efforts.
7. More firms result in little influence over price; one firm, however, results in extensive influence over price.
8. Answers will vary but should reflect analysis of the advertisements.

Teach

C Critical Thinking

Formulating Questions
Have students come up with three questions that they would like to ask Bill Gates if he visited their school. Call on students at random to read one of their questions. Then discuss as a class how Gates might answer the questions. OL

Examining the Profile

Answers:
1. Gates understands the needs of average computer users and makes sure his products are user-friendly. He is thorough and committed and expects employees to be the same.
2. Students will likely say that Microsoft would have had more competition, with other PC companies developing their own systems rather than licensing MS-DOS from Microsoft.

ENTREPRENEUR

Profiles in Economics

Personal computers had appeared in the marketplace by 1975, but they were still a novelty. Many people saw them as science fiction gadgets from the set of Star Trek. *But Seattle teenagers Bill Gates and Paul Allen had a vision to "put a computer on every desktop and in every home."*

Bill Gates (1955–)

C
- co-founder and chairman of Microsoft Corporation
- ranked the richest man in the world for 12 years in a row

Early Start

Bill Gates was not the first computer geek, but he was probably the most passionate. In high school, he designed a class-scheduling program so that he could take courses with the prettiest girls in his school. He also started Traf-O-Data, a computer traffic analysis company. At Harvard University, he and his friend Paul Allen wrote an operating-system language that they licensed to a computer manufacturer. With this early success, at age 19 Gates dropped out of Harvard and, with Allen, established Microsoft Corporation in 1975.

Five years later, computer industry giant IBM asked Gates to develop an operating system for its new personal computer. Gates modified a system he had bought from a small company and called it MS-DOS, for Microsoft Disk Operating System. Gates decided to license rather than sell it to IBM. This allowed him to market MS-DOS to other companies. By 1993 Microsoft's Windows operating system ran nearly 90 percent of the world's PCs.

Gates and the Average Computer User

Much of Gates's success came from understanding the needs of average computer users. His software encompasses a range of programs integrated to work together seamlessly for everyday users and businesses. Gates made sure that all programs were written to be user-friendly to make computing fun. As a result, computers became accessible to non-techies worldwide.

Gates is also known for his business stance. "He expects energy and commitment from his employees," said one Microsoft employee. "He insists on a thoughtful, thorough, complete analysis." Even Gates admits his tenacity. "In the early days, I liked to review every line of code, to interview every job applicant," he said. "I've had to lighten up in both of those areas."

Examining the Profile

1. **Analyzing** What characteristics made Gates a successful entrepreneur?
2. **Predicting Consequences** How might the Microsoft story have been different if Gates had sold MS-DOS to IBM rather than licensing it?

Additional Support

Teacher Tip

Choosing a Book Suggest that students make a list of possible titles and then conduct an Internet search to find reviews of the books. Students can then quickly learn what the books are about and decide on one to read.

Activity: Interdisciplinary Connection

Literature Have students choose and then read a book written by or about Bill Gates or a book about Microsoft. Ask students to write a three-page report on the book they selected. In their reports, students should answer the following questions: What made Bill Gates a successful entrepreneur? How did America's economic system contribute to Gates's success?

Remind students that a book report should identify the subject of the book and summarize its main points. Students should also include their opinions on the book, including what they found most interesting and how well they thought the author presented the material. AL

SECTION 2

Market Failures

GUIDE TO READING

Section Preview

In this section, you will find out that inadequate competition, inadequate information, immobile resources, public goods, and externalities can lead to market failures.

Content Vocabulary

- market failure *(p. 180)*
- public goods *(p. 181)*
- externality *(p. 181)*
- negative externality *(p. 182)*
- positive externality *(p. 182)*

Academic Vocabulary

- collude *(p. 180)*
- sustain *(p. 181)*

Reading Strategy

Listing As you read the section, think about why maintaining adequate competition is a worthwhile goal. Use a graphic organizer like the one below to list some of the effects of competition.

If markets are competitive . . .	→	Effects

COMPANIES IN THE NEWS

—USA Today

Enron

A federal judge in Houston sentenced Richard Causey, former chief accounting officer of Enron, to 5 1/2 years in prison Wednesday, bringing an end to the government's prosecution of top managers at what was once the nation's seventh-largest company. . . .

Enron collapsed into bankruptcy five years ago after acknowledging that [Andrew] Fastow, the CFO, had entered into numerous business deals with the company that helped prop up Enron's earnings. Fastow later admitted that he embezzled close to $30 million from the company. Enron's market capitalization, which at one point exceeded $60 billion, was wiped out in the ensuing sell-off of stock.

In January 2002, the Department of Justice formed the Enron Task Force. Since then, prosecutors induced 16 former executives to plead guilty to related crimes, while several others were convicted at trial. . . . [W]ith Causey's sentencing, the last of the big Enron cases has been disposed of. ■

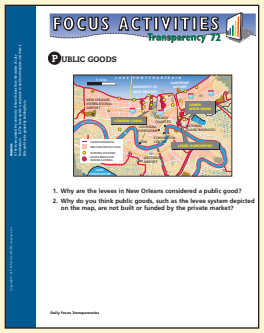
The story about Enron reminds us of a serious fact of economic life—that markets sometimes fail. In fact, the Enron scandal was not the only accounting scandal dominating the news in the early 2000s. WorldCom, a telecommunications company, had to declare bankruptcy in 2002 amid charges of breaking the law.

These news stories showed clearly that a competitive free enterprise economy works best when several conditions, including adequate information, are met. If we want to avoid problems like this in the future, we need to be able to identify and then deal with different types of market failures.

Focus

Bellringer

Daily Focus Transparency 72


FOCUS ACTIVITIES
Transparency 72
PUBLIC GOODS

1. Why are the levees in New Orleans considered a public good?
2. Why do you think public goods, such as the levee system depicted on the map, are not built or funded by the private market?

GUIDE TO READING

Answers to Graphic:

Effects: lower prices; higher quality; innovation; efficiency

Resource Manager

R Reading Strategies	C Critical Thinking	D Differentiated Instruction	W Writing Support	S Skill Practice
Teacher Edition • Act. Prior Know., p. 180 • Monitoring, p. 182 **Additional Resources** • Guid. Read. Act., p. 20 • Read. Ess. & Note-Taking Guide, p. 58	**Teacher Edition** • Making Connections, p. 182 **Additional Resources** • Econ. Concepts Trans., Strat. and Act., p. 21	**Teacher Edition** • Logical/Math., p. 180 • Special Ed., p. 181 **Additional Resources** • Econ. Cartoons, p. 26 • Econ. Content Vocab. Act., p. 7	**Teacher Edition** • Narrative Writing, p. 183 **Additional Resources** • High School Writing Process Trans.	**Teacher Edition** • Drawing Con., p. 181 • Using Tables and Charts, p. 184 **Additional Resources** • Authentic Assess., p. 12 • Quizzes and Tests, p. 82

Teach

R Reading Strategy

Activating Prior Knowledge

Ask: What are the conditions necessary for perfect competition? *(many buyers and sellers acting independently; identical products; good information; freedom of entry into industry)* OL

D Differentiated Instruction

Logical/Mathematical Have students use the Internet to find the interest rates being offered on five different credit cards. Based on a bill of $1,000, have students identify the rate that is best for the borrower and the rate that is most profitable for the lender. Have students report to the class on why the information is important and how difficult it was to find. Suggest that students use a visual to display the information during the presentation. OL

market failure condition that causes a competitive market to fail

Types of Market Failures

MAIN Idea Markets can sometimes fail because of inadequate competition, inadequate information, resource immobility, public goods, and externalities.

Economics & You Have you ever been affected by something that somebody did to another person? Read on to learn how this can also happen in the economy.

R Unfortunately markets sometimes fail. A **market failure** occurs whenever one of the conditions necessary for competitive markets does not exist. As you will learn, five main causes of market failures exist.

Inadequate Competition

Over time, mergers and acquisitions result in larger and fewer firms dominating various industries. The decrease in competition tends to reduce the efficient use of scarce resources—resources that could be put to other, more productive uses if they were available. For example, why would a firm with few or no competitors have the incentive to use its resources carefully?

Inadequate competition can occur on both the demand and supply sides of the market. If we consider the supply side of the market, there is no competition when a monopolist dominates. In an oligopolistic market, the temptation to **collude** is strong.

If we look at the demand side of the market, there is little or no competition if the government is the only buyer for space shuttles, hydroelectric dams, super computers, M-1 tanks, or high-technology fighter jets.

A firm that does not face adequate competition could easily spend its profits on huge salaries and bonuses, executive jets, country club memberships, and generous retirement plans. This is one of the reasons that public utilities such as electricity are regulated by the government—to make sure that the firms do not use their monopoly status to waste or abuse resources.

Inadequate competition also may enable a business to influence politicians in order to get special treatment that enriches its managers and owners. In fact, some of the players in the huge Enron energy scandal were accused of doing just that—lobbying administration and Energy Department officials for favorable treatment on policy issues that benefited Enron executives.

Inadequate Information

If resources are to be allocated efficiently, everyone—consumers, businesspeople, and government officials—must have adequate information about market conditions. A secretary or an accountant may receive a competitive wage in the automobile industry, but wages for the same skills might be higher in the insurance or banking industry.

D Some information is easy to find in the classified ads in the newspaper or on the Internet. Other information is more difficult to find. If this knowledge is important to buyers and sellers but is difficult to obtain, then it is an example of a market failure.

The consequences of inadequate information may not always be immediately visible, but in the long run it will put a slow drain on the economy, lowering the rate of growth and the overall standard of living.

Resource Immobility

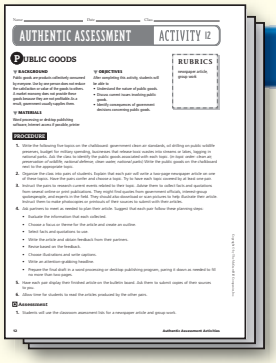
A difficult problem in any economy is that of resource immobility. This means that land, capital, labor, and entrepreneurs

Did You Know?

Expensive Memories The first law to fight monopolies, the Sherman Antitrust Act, was enacted in 1890 as a response to growing concern over the power of trusts. Enforcement was left to the courts, and judges considered the language of the act too vague to make big companies change the way they did business. As a result, the number of trusts increased following passage of the act. It took another 14 years before the first major lawsuit, *Northern Securities* v. *the United States,* was filed.

Laws have become stronger since then, but price collusion still is a problem. In May 2006 three computer memory chip manufacturers were accused of fixing prices over a three-year period. This increased the price of chips for computer manufacturers, and thus the price of computers for consumers. The chipmakers agreed to pay $160 million to settle the case.

Differentiated Instruction


AUTHENTIC ASSESSMENT ACTIVITY 12

PUBLIC GOODS

RUBRICS

Authentic Assessment Strategies and Activities, p. 12

Public Goods

Objective: Understand public goods and current issues pertaining to them.

Focus/Teach: Discuss how students personally benefit from the public goods described in the activity. Then have pairs complete the activity.

Assess: Check students' articles against their sources.

Close: Create an oral class "blog," where one student comments on an article and then others build on each previous statement.

Differentiated Instruction Strategies

BL Have students write down two ideas or facts that they learned from the activity.

AL Ask students to suggest solutions for the problem at the center of their assigned topic.

ELL Have students create a visual of public goods and their characteristics.

Public Goods Funding floodwalls is expensive, but failing to keep up with maintenance can have catastrophic results, as the photo of New Orleans after Hurricane Katrina shows. ***Why does the market not provide more public goods?***

do not move to markets where returns are the highest. Instead they tend to stay put and sometimes remain unemployed.

What happens, for example, when a large auto assembly plant, steel mill, or mine closes, leaving hundreds of workers without employment? Certainly some workers can find jobs in other industries, but not all can. Some of the newly unemployed may not be able to sell their homes. Others may not want to move away from friends and relatives to find new jobs in other cities.

Public Goods

Another form of market failure shows up in the form of public goods. **Public goods** are products that are collectively consumed by everyone. Their use by one individual does not diminish the satisfaction or value available to others. Examples of public goods are uncrowded highways, flood-control measures, national defense, and police and fire protection.

When left to itself, the market either does not supply these items at all, or it supplies them inadequately. This is because a market economy produces only those items that can be withheld if people refuse to pay for them. It would be difficult, for example, to deny one person the benefits of national defense while supplying it to others. Because it is so difficult to have all individuals pay for their fair share of a public good, private markets produce too few of them.

In the aftermath of Hurricane Katrina, it was evident that the floodwalls in New Orleans could not **sustain** the onslaught of the hurricane. Floodwalls are public goods that are normally funded out of government expenditures; they are not built by the private sector because there is little profit to be gained by building them. A related problem is that government does not always see the need to spend tax dollars on public goods. In the case of the floodwalls, it was all too easy to postpone the necessary expenditures because they would have resulted in higher taxes or in not building other public goods.

Externalities

Many activities generate some kind of **externality**, or unintended side effect that either benefits or harms a third party not involved in the activity that caused it.

public goods goods or services whose benefits are available to everyone and are paid for collectively

externality economic side effect that affects an uninvolved third party

D Differentiated Instruction

Special Education For students who have problems with reading, practice a focused reading exercise. Have students read the subsection on public goods. When they have finished, have them write in their notebooks what they remember of the subsection. Then have them reread the subsection to look for answers to the following questions: What is a public good? Why doesn't the market supply public goods? BL

S Skill Practice

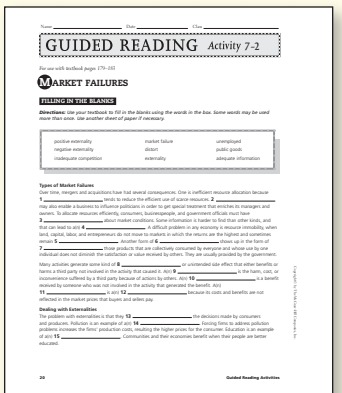
Drawing Conclusions

Ask: **Why do you think that politicians might want to avoid higher taxes?** *(Possible answer: Higher taxes are unpopular and may hurt a politician's chances of reelection.)* OL

Caption Answer: because they are not profitable

Leveled Activities

BL Guided Reading Activities, p. 20



GUIDED READING Activity 7-2

MARKET FAILURES

FILLING IN THE BLANKS

Directions: *Use your textbook to fill in the blanks using the words in the box. Some words may be used more than once. Use another sheet of paper if necessary.*

positive externality	market failure	unemployed
negative externality	distort	public goods
inadequate competition	externality	adequate information

Types of Market Failures

Over time, mergers and acquisitions have had several consequences. One is inefficient resource allocation because 1. _____ tends to reduce the efficient use of scarce resources. 2. _____ may also enable a business to influence politicians in order to get special treatment that enriches its managers and owners. To allocate resources efficiently, consumers, businesspeople, and government officials must have 3. _____ about market conditions. Some information is harder to find than other kinds, and that can lead to a(n) 4. _____. A difficult problem in any economy is resource immobility, when land, capital, labor, and entrepreneurs do not move to markets in which the returns are the highest and sometimes persist. 5. _____. Another form of 6. _____ shows up in the form of 7. _____ those products that are collectively consumed by everyone and whose use by one individual does not diminish the satisfaction or value received by others. They are usually provided by the government.

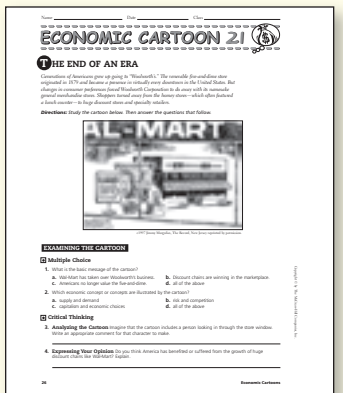
Many activities generate some kind of 8. _____, or unintended side effect that either benefits or harms a third party not involved in the activity that caused it. A(n) 9. _____ is the harm, cost, or inconvenience suffered by a third party because of actions by others. A(n) 10. _____ is a benefit received by someone who was not involved in the activity that generated the benefit. A(n) 11. _____ is an action that causes 12. _____ because its costs and benefits are not reflected in the market prices that buyers and sellers pay.

Dealing with Externalities

The problem with externalities is that they 13. _____ the decisions made by consumers and producers. Pollution is an example of a(n) 14. _____. Forcing firms to address pollution problems increases the firms' production costs, resulting the higher prices for the consumer. Education is an example of a(n) 15. _____. Communities and their economies benefit when their people are better educated.

20 Guided Reading Activities

OL Economic Cartoons, p. 26



ECONOMIC CARTOON 21

THE END OF AN ERA

Generations of Americans grew up going to "Woolworth's." The venerable five-and-dime store originated in 1879 and became a presence in virtually every downtown in the United States. But changes in consumer preferences forced Woolworth Corporation to do away with its namesake general merchandise stores. Shoppers turned away from the homey stores—which often featured a lunch counter—to huge discount stores and specialty retailers.

Directions: *Study the cartoon below. Then answer the questions that follow.*

©1997 Steve Sheppelle, The Herald, Non-Sequitur reprinted by permission

EXAMINING THE CARTOON

Multiple Choice

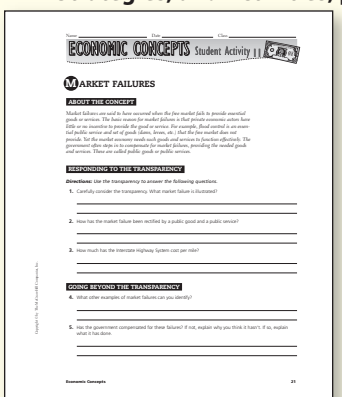
1. What is the basic message of the cartoon?
   a. Wal-Mart has taken over Woolworth's business.
   b. Discount chains are winning in the marketplace.
   c. Americans no longer value the five-and-dime.
   d. All of the above
2. Which economic concept or concepts are illustrated by the cartoon?
   a. supply and demand
   b. risk and competition
   c. capitalism and economic choices
   d. All of the above

Critical Thinking

3. **Analyzing the Cartoon** Imagine that the cartoon includes a person looking in through the store window. Write an appropriate comment for that character to make.
4. **Expressing Your Opinion** Do you think America has benefited or suffered from the growth of huge discount chains like Wal-Mart? Explain.

26 Economic Cartoons

AL Economic Concepts Transparencies, Strategies, and Activities, p. 21



ECONOMIC CONCEPTS Student Activity 11

MARKET FAILURES

ABOUT THE CONCEPT

Market failures are said to have occurred when the free market fails to provide essential goods or services. The basic reason for market failures is that private economic actors have little or no incentive to provide the good or service. For example, flood control is an essential public service and set of goods (dams, levees, etc.) that the free market does not provide. Yet the market economy needs such goods and services to function effectively. The government often steps in to compensate for market failures, providing the needed goods and services. These are called public goods or public services.

RESPONDING TO THE TRANSPARENCY

Directions: *Use the transparency to answer the following questions.*

1. Carefully consider the transparency. What market failure is illustrated?
2. How has the market failure been rectified by a public good and a public service?
3. How much has the Interstate Highway System cost per mile?

GOING BEYOND THE TRANSPARENCY

4. What other examples of market failures can you identify?
5. Has the government compensated for these failures? If not, explain why you think it hasn't. If so, explain what it has done.

Economic Concepts 21

R Reading Strategy

Monitoring **Ask:** What is an example of a negative externality that you have encountered? *(Possible answer: being woken up by construction on a neighbor's house)* A positive externality? *(Possible answer: the neighbor's landscaping)* BL

C Critical Thinking

Making Connections Have students use print or online resources to find five specific examples of pollution (for example, the smog in Los Angeles, the Cuyahoga River bursting into flame, and so on). OL

Caption Answer: They can pass laws against pollution and then fine or imprison those who break the laws. They can also regulate businesses, inducing them to reduce pollution.

✓Reading Check **Answer:** Students may say negative externalities because they are actively harmful and hard to control.

Externalities Air pollution is a negative externality that affects those who did not cause it. ***How can government action lead to the cleanup of pollution?***

negative externality harmful side effect that affects an uninvolved third party

positive externality beneficial side effect that affects an uninvolved third party

A **negative externality** is the harm, cost, or inconvenience suffered by a third party because of actions by others. The classic case of a negative externality is the noise and inconvenience some people suffer when an airport expands.

A **positive externality** is a benefit someone receives who was not involved in the activity that generated the benefit. For example, people living on the other side of town may benefit from the additional jobs generated by the airport expansion, or a nearby restaurant may sell more meals and hire more workers. Both the restaurant owners and the new workers gain from the airport expansion even though they had nothing to do with the expansion in the first place. R

Externalities are market failures because their costs and benefits are not reflected in the market prices that buyers and sellers pay. For example, airlines do not compensate homeowners for the diminished value of properties located near a new runway extension. Nor does a restaurant owner share any additional profits with the airport. As a result, the prices that travelers pay for air travel will not reflect the external costs and benefits that an airport expansion generates.

✓Reading Check **Analyzing** What type of market failure do you think is most harmful to the economy?

Dealing with Externalities

MAIN Idea Externalities indicate a market failure and can be corrected with government action.

Economics & You Have you ever been affected by someone else's pollution? Read on to learn how this can be remedied.

The problem with externalities is that they distort the decisions made by consumers and producers. Overall this makes the economy less efficient.

Correcting Negative Externalities

A classic example of pollution sheds some light on the distortions caused by negative externalities. Firms historically located near rivers because transportation was convenient. However, the firms also used the rivers as a giant waste disposal system, which helped keep their production cost low. This led to lower market prices for the final product, and consumers were able to buy more. C

The negative externality of pollution generated several problems. Firms had the incentive to pollute because it was the most profitable way to produce. The low prices also encouraged more sales, and hence

Hands-On Chapter Project

Step 2

Analyzing American Market Structures

Step 2: Doing Business in Different Market Structures. Students will survey local businesses to find out how they operate under different market structures.

Directions: Have students reassemble into the groups that were formed in Step 1. Have each group choose one of the four market structures on which they made posters. Make sure that all market structures are chosen by at least one group. Have groups identify local businesses that exhibit characteristics of their chosen market structure. Have groups prepare a list of questions and then survey managers by phone or e-mail regarding product differentiation, ease of entry into the market, number of competitors, ability of firms to influence price, successful advertising strategies, and so on.

Comparing Have groups summarize their results and present them to the class. After all the presentations, have the class compare one another's businesses. OL

(Chapter Project continued in Section 3.)

more pollution. Finally, people living downstream from the polluting firms were, in effect, paying for some of the production costs even if they did not necessarily buy the products.

Suppose the government decided to force the firms to clean up their pollution by putting a $1 "pollution tax" on every unit of output sold. The firms, of course, would try to pass some of this expense on to the consumer in the form of higher prices. While higher prices might at first seem to be a problem, they would force the people who bought the products to pay for the increase in production costs.

The tax would help alleviate pollution problems. First, all firms would have less incentive to pollute because the tax drives up the price of their products. Second, higher prices would reduce the quantity demanded, so firms would produce less and therefore generate less pollution. Third, the people living downstream of the affected rivers would face less pollution.

Correcting Positive Externalities

Externalities can be positive as well as negative. You have learned that negative externalities lead to distortions. Yet even when externalities are positive, so that uninvolved third parties experience beneficial side effects, distortions can occur.

A classic example is education. We know that people generally earn more when they have more education. In addition, a community with a well-educated workforce will attract more industry, have more economic development, and enjoy a higher standard of living. For these and other reasons, it makes sense for the government to subsidize the cost of public education.

This is exactly what happens when local governments pay for the cost of primary and secondary public education. When it comes to the higher education offered by state universities, however, state governments only pay for part of the cost, leaving students to pick up the rest in the form of tuition payments. W

Given education's value to the community, many experts feel that the government subsidies should be larger than they are. This is expensive, however, so government tends to underfund higher education even though more subsidies are warranted.

✓Reading Check **Explaining** If externalities are positive, why should they be corrected?

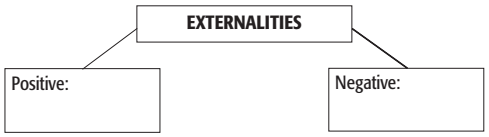
SECTION 2 Review

Vocabulary

1. **Explain** the significance of market failure, public goods, externality, negative externality, and positive externality.

Main Ideas

2. **Explaining** Why do markets need both adequate competition and adequate information?
3. **Identifying** Use a graphic organizer like the one below to identify and describe both types of externalities.



Critical Thinking

4. **The BIG Idea** List and explain the reasons why markets fail.
5. **Understanding Cause and Effect** Describe some of the positive and negative externalities that could result from the closing of a military base.
6. **Making Inferences** Under what circumstances would a private firm be willing to build private toll roads?

Applying Economics

7. **Negative Externality** Identify a situation in your community that resulted in a negative externality. How would you advise the government to reduce these negative effects? Write a short paper outlining your suggestions.

W Writing Support

Narrative Writing Have students write a short story about two teenagers living in a community where education is available only to those who can pay for it. One teenager's family should be able to pay and the other's should not. Students can choose to have the characters defeated by the situation or triumphant over it. OL

✓Reading Check **Answer:** As long as there are externalities, the market is not providing the amount of the good that consumers would want if all benefits and costs were reflected in the price.

Assess

Use the Interactive Tutor Self-Assessment CD-ROM to review Section 2, and then assign the Section 2 Review as homework or as an in-class activity.

Close

Summarizing Have students list the types of market failures and an example of each. OL

Review SECTION 2

Answers

1. All definitions can be found in the section and the Glossary.
2. Without adequate competition, producers have no incentive to use resources efficiently or to innovate. Without adequate information, consumers and workers cannot make informed decisions about what is best to buy or where it is best to work.
3. **Positive:** have benefits that uninvolved third parties receive, such as education. **Negative:** have costs that are not born by the seller or buyer, such as pollution.
4. Inadequate competition removes incentives for firms to be efficient or innovative; consumers or workers lack information necessary to make buying and working decisions; resources are immobile and cannot or will not move to their best uses; public goods are not provided by the market; externalities distort consumer decisions.
5. Answers will vary, but positive externalities might be a reduction in crowding and noise and negative externalities might be losses to local businesses from the decrease in population.
6. Since a toll road is a good that can be withheld from people who don't pay for it, a private firm would be willing to build it if there were enough potential users to make the business profitable.
7. Answers will vary but should indicate an understanding of negative externalities and what might be done to deal with them.

BusinessWeek

Teach

S Skill Practice

Using Tables and Charts

Ask: What are the two strategies that communications companies might follow? *(price wars or mergers)* Which strategy is more desirable to companies? *(mergers)* BL

BusinessWeek ONLINE

To find up-to-date news and analysis on the economy, business, technology, markets, entrepreneurs, investments, and finance, have students search feature articles and special reports on the BusinessWeek Web site, www.businessweek.com.

Examining the Newsclip

Answers:

1. AT&T has cut prices to get new customers and bought other companies to eliminate competition.
2. If consumers do not have an alternative, they have to pay a higher price if they want the good.

Additional Support

BusinessWeek NEWSCLIP

In 1984 concerns over a telecommunications monopoly led to the breakup of AT&T into eight different companies. Just a little over 20 years later, AT&T mergers seem to recreate the former corporation. When such mergers result in larger and fewer firms dominating an industry, some economists worry.

Lord of the Rings

Competition in communications seems cutthroat. Companies are invading each other's turf, and prices are falling. You can make a video-phone call to Australia via the Internet, chat for three hours, and never pay a penny. Citing all this hubbub, AT&T Inc. argues that there's no threat of re-monopolization even as it bids to reunite five of the eight companies that emerged from the 1984 breakup of the Bell System.

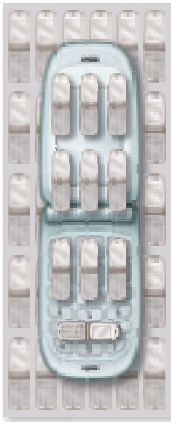
Look out, though. The competition we're seeing is just a phase, and an unstable one at that. The key thing about communications networks is that they're very costly to build, but once they're built, it's cheap to add customers to them. This industry structure has special economic properties. At times it produces price wars. At other times it leads to merger waves, resulting in a small number of competitors with the ability to raise prices and garner big profits. . . .

In this delicate situation, [communications companies] have used two main strategies over the years. One has been to cut prices to fill up their networks. Remember, additional customers are cheap to serve, so there's room to cut. . . .

The alternative strategy, which [the CEO of AT&T] and others have also pursued, is consolidation. As long as regulators permit, the strong buy the weak and extinguish the excess capacity. As competition eases, the survivors can raise prices and restore their profitability. (Good for shareholders; bad for customers.)

—Reprinted from *BusinessWeek*

S



Fragile Competition

Communications companies may be shifting strategies from battling to consolidating.

Strategy 1	Strategy 2
Price War Companies need lots of traffic to cover the costs of their expensive networks, so they cut prices. That forces other companies to reciprocate. Eventually profits vanish.	**Merger Wave** Companies merge, with the strong buying the weak. As competition diminishes, profits rise. This strategy is more desirable to the companies, but may be banned by regulators.

Examining the Newsclip

1. **Summarizing** What two strategies has AT&T used in recent years to gain new business, and why?
2. **Determining Cause and Effect** How does lack of competition increase prices for the consumer?

Extending the Content

The Merger of AT&T and Cingular

Mergers in the communications industry require more than approvals and contracts. Because companies develop their technologies separately, blending them together is also a technological process. AT&T's purchase of Cingular was approved by the federal government in 2004, but it was not until 2007 that the two brands were publicly combined. Both billing systems and support platforms for services such as voice mail had to be integrated. Thousands of cell sites had to be integrated, and new sites had to be built. The integration cost hundreds of millions of dollars in 2006 alone. However, as fewer calls were dropped and connections improved, usage by consumers rose significantly.

SECTION 3

The Role of Government

GUIDE TO READING

Section Preview

In this section, you will learn that one of the economic functions of government in a market economy is to maintain competition.

Content Vocabulary

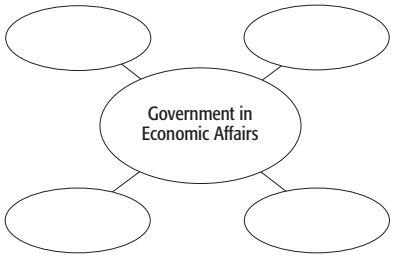
- trust *(p. 186)*
- price discrimination *(p. 186)*
- cease and desist order *(p. 186)*
- public disclosure *(p. 188)*

Academic Vocabulary

- restrained *(p. 186)*
- intervention *(p. 189)*

Reading Strategy

Describing As you read the section, complete a graphic organizer like the one below by describing how governments try to avoid market failures.



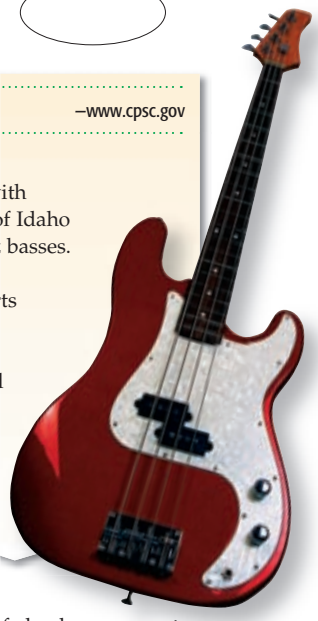
PRODUCTS IN THE NEWS

—www.cpsc.gov

Electric Bass Recalled

The U.S. Consumer Product Safety Commission, in cooperation with Hoshino USA Inc., of Bensalem, Pa., and Chesbro Music Company, of Idaho Falls, Idaho, today announced a voluntary recall of about 700 Ibanez basses. If the battery is improperly installed, the bass can overheat, causing internal damage and a fire hazard. The firm has received three reports of the bass not working due to improper battery installation. There have been no reports of injuries or property damage.

This recall involves 2005 and 2006 Ibanez Soundgear, Roadgear and Gary Willis series basses. Model numbers are located on the back of the headstock. Consumers should stop using the basses immediately and contact their local Ibanez dealer for a free inspection and repair. Dealers will remedy the hazard by having affected basses updated with a new battery snap connector. ■



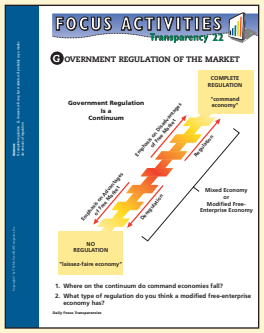
We know that resources are scarce, and because of scarce resources we have to make careful choices if we are to satisfy our many wants and needs. We also know that competitive markets are one of the best ways to make this happen. At the same time, markets can fail. When they do, the government can step in and fix the problem.

One way in which the federal government acts is by protecting the public from unreasonable risks of serious injury or death. For that task, it created the U.S. Consumer Product Safety Commission (CPSC), which oversees the safety of more than 15,000 types of consumer products. When necessary, the CPSC orders a recall of products for repair or replacement, as in the news story.

Focus

Bellringer

Daily Focus Transparency 22


FOCUS ACTIVITIES
Transparency 22
GOVERNMENT REGULATION OF THE MARKET
Government Regulation is a Continuum
COMPLETE REGULATION
"command economy"
Mixed Economy or Modified Free-Enterprise Economy
NO REGULATION
"laissez-faire economy"
1. Where on the continuum do command economies fall?
2. What type of regulation do you think a modified free-enterprise economy has?

GUIDE TO READING

Answers to Graphic:
maintaining competition; regulating monopolies; promoting transparency; providing public goods

Resource Manager

R Reading Strategies	C Critical Thinking	D Differentiated Instruction	W Writing Support	S Skill Practice
Teacher Edition • Act. Prior Know., p. 186 • Taking Notes, p. 187	**Teacher Edition** • Analyzing Visuals, p. 186	**Teacher Edition** • Interpersonal, p. 189 • Visual/Spatial, p. 190	**Teacher Edition** • Expository Writing, p. 188	**Teacher Edition** • Drawing Con., p. 187 • Interpreting Political Cartoons, p. 188 • Using Tables and Charts, p. 190
Additional Resources • Guid. Read. Act., p. 21 • Read. Ess. & Note-Taking Guide, p. 61	**Additional Resources** • Econ. Cartoons, pp. 2, 4 • Econ. Concepts Trans., Strat. and Act., p. 23	**Additional Resources** • Pri./Sec. Source Read., pp. 37, 39 • Free Ent. Act., p. 2	**Additional Resources** • High School Reading in the Content Area Strat. and Act.	**Additional Resources** • Reteaching Act., p. 7

Teach

R Reading Strategy

Activating Prior Knowledge

Tell students: The late nineteenth century was a time when giant corporations dominated much of the American economy. **Ask:** Aside from Standard Oil, what were two other industrial giants in the late 1800s? *(Possible answers: Carnegie Steel; American Tobacco Company; Union Pacific)* AL

C Critical Thinking

Analyzing Visuals Have students create a web diagram to express the information in the visual. The inner circle should say "Anti-Monopoly Legislation." Bubbles from the inner circle should list the four acts, and then each of those bubbles should have a connecting bubble explaining the act. BL

Economic Analysis

Answer: to regulate unfair methods of competition in interstate commerce

trust illegal combination of corporations or companies organized to hinder competition

price discrimination practice of selling the same product at different prices to different buyers

cease and desist order ruling requiring a company to stop an unfair business practice that reduces or limits competition

Maintain Competition

MAIN Idea The government exercises its power to maintain competition within markets.

Economics & You When you play sports, a referee regulates the game to make sure both sides are playing fairly. Read on to learn how the government can regulate the economy to do the same thing.

There are two ways that government can maintain competitive markets. One is by prohibiting market structures that are not competitive. The other is by regulating markets where full competition is not possible.

Antitrust Legislation

R In the late 1800s, the United States passed laws to restrict monopolies and **trusts**—combinations of firms designed to restrict competition or control prices in a particular industry. Since then, several laws have been passed that allow the government to either prevent or break up monopolies and trusts, thus preventing market failures due to inadequate competition.

In 1890 Congress passed the Sherman Antitrust Act "to protect trade and commerce against unlawful restraint and monopoly." The Sherman Act, described in **Figure 7.3,** was the nation's first significant law against monopolies. It sought to do away with monopolies and restraints that hindered competition. By the early 1900s, a number of businesses, including the Standard Oil Company, had been convicted of restraint of trade under the Sherman Act.

The Sherman Act laid down broad foundations for maintaining competition. However, the act was not specific enough to stop many other practices that **restrained** competition. As a result, Congress passed the Clayton Antitrust Act in 1914 to give the government more power over monopolies. This outlawed **price discrimination**—the practice of selling the same product to different consumers at different prices if it substantially lessens competition.

The Federal Trade Commission Act was passed in the same year to enforce the Clayton Antitrust Act. The act set up the Federal Trade Commission (FTC) and gave it the authority to issue cease and desist orders. A **cease and desist order** is an FTC ruling requiring a company to stop an unfair business practice, such as price-fixing, that reduces or limits competition among firms.

In 1936 Congress passed the Robinson-Patman Act in an effort to strengthen the Clayton Act, particularly the provisions that dealt with price discrimination. Under this act, companies could no longer offer special discounts to some customers while denying them to others.

Government Regulation

Not all monopolies are bad, and for that reason not all should be broken up. In the case of a natural monopoly, it makes sense to let the firm expand to take advantage of

Figure 7.3 ▶ Anti-Monopoly Legislation

C

Sherman Antitrust Act 1890
Outlawed all contracts "in restraint of trade" to halt the growth of trusts and monopolies

Clayton Antitrust Act 1914
Strengthened the Sherman Act by outlawing price discrimination

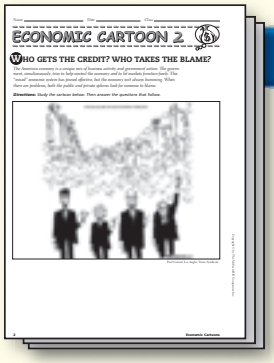
Federal Trade Commission Act 1914
Established the Federal Trade Commission to regulate unfair methods of competition in interstate commerce

Robinson-Patman Act 1936
Forbade rebates and discounts on the sale of goods to large buyers unless the rebates and discounts were available to all

▶ The federal government passed four major legislative acts to curb monopolistic practices.

Economic Analysis ***What is the purpose of the Federal Trade Commission?***

Differentiated Instruction



Economic Cartoons, p. 2

Who Gets the Credit? Who Takes the Blame?

Objective: Understand how the government may seek to deflect blame for economic problems.

Focus/Teach: Discuss with students ways that the current presidential administration responds to criticism about the economy. Then have students study the cartoon and answer the questions.

Assess: Review the answers as a class.

Close: Have students evaluate how well the cartoon portrayed its message.

Differentiated Instruction Strategies

BL Have students research to identify the presidents shown in the cartoon.

AL Ask students to write a brief essay explaining how a mixed economy might create conflict between government and business.

ELL Have students draw a cartoon that conveys a similar message.

lower production costs, and then regulate its activities so that it cannot take advantage of the consumer.

Local and state governments regulate many monopolies, such as cable television companies, and water and electric utilities. For example, if a public utility wants to raise rates, it must argue its case before a public utility commission or other government agency.

Agencies of the federal government, such as those listed in **Figure 7.4,** regulate many different kinds of businesses. However, as you can see from the dates in the figure, in recent years the government has been less inclined to set up new regulatory bodies. Instead, the emphasis has shifted to promoting efficiency. S

Skills Handbook
*See page **R37** to learn about **Making Generalizations.***

✓Reading Check **Describing** Why are some government regulations beneficial for consumers?

Figure 7.4 ▶ Federal Regulatory Agencies

Agency	Tasks
Food and Drug Administration (FDA), 1906	Enforces laws to ensure purity, effectiveness, and truthful labeling of food, drugs, and cosmetics; inspects production and shipment of these products
Federal Trade Commission (FTC), 1914	Administers antitrust laws forbidding unfair competition, price fixing, and other deceptive practices
Federal Communications Commission (FCC), 1934	Licenses and regulates radio and television stations and regulates interstate telephone and telegraph rates and services
Securities and Exchange Commission (SEC), 1934	Regulates and supervises the sale of listed and unlisted securities and the brokers, dealers, and bankers who sell them
National Labor Relations Board (NLRB), 1935	Administers federal labor-management relations laws; settles labor disputes; prevents unfair labor practices
Federal Aviation Administration (FAA), 1958	Oversees the airline industry
Equal Employment Opportunity Commission (EEOC), 1964	Investigates and rules on charges of discrimination by employers and labor unions
Environmental Protection Agency (EPA), 1970	Protects and enhances the environment
Occupational Safety and Health Administration (OSHA), 1970	Investigates accidents in the workplace; enforces regulations to protect employees at work
Consumer Product Safety Commission (CPSC), 1972	Develops standards of safety for consumer goods
Nuclear Regulatory Commission (NRC), 1974	Regulates civilian use of nuclear materials and facilities
Federal Energy Regulatory Commission (FERC), 1977	Supervises transmission of various forms of energy

R

▶ The government has created a number of federal regulatory agencies to oversee the economy. Because of government's involvement in the economy, we have a modified free enterprise system.

Economic Analysis ***Which agencies listed in the table are familiar to you? Which affect you directly? Why?***

S Skill Practice

Drawing Conclusions

Ask: Why do you think that the government has recently set up fewer agencies and spent more time promoting efficiency?

(Possible answer: The majority of taxpayers probably support making the current agencies more efficient before they support the creation of new agencies.) OL

R Reading Strategy

Taking Notes Have students write the name of each federal agency on a separate note card. Next, ask students to take notes about the functions of the agencies on the back of the note cards. Have students find a partner and use their note cards to quiz each other about the functioning of the agencies. BL

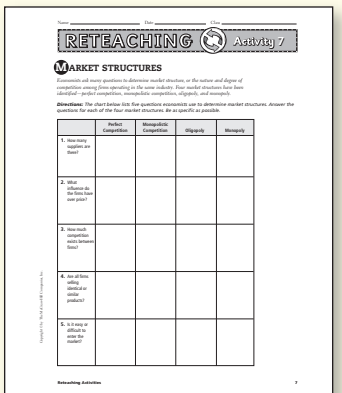
✓Reading Check **Answer:** They result in lower prices, better quality, and improved safety for the consumer.

Economic Analysis

Answer: Students will likely be most affected by the FDA, FCC, and CPSC.

Leveled Activities

BL Reteaching Activities, p. 7


RETEACHING Activity 7

MARKET STRUCTURES

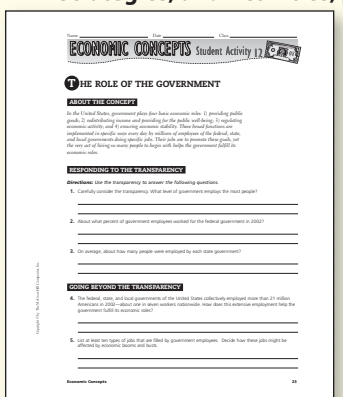
Economists ask many questions to determine market structure, or the nature and degree of competition among firms operating in the same industry. Four market structures have been identified—perfect competition, monopolistic competition, oligopoly, and monopoly.

Directions: *The chart below lists five questions economists use to determine market structures. Answer the questions for each of the four market structures. Be as specific as possible.*

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
1. How many suppliers are there?				
2. What information do the firms have over price?				
3. How much competition exists between firms?				
4. Are all firms selling identical or similar products?				
5. Is it easy or difficult to enter the market?				

Reteaching Activities 7

OL Economic Concepts Transparencies, Strategies, and Activities, p. 23


ECONOMIC CONCEPTS Student Activity 17

THE ROLE OF THE GOVERNMENT

ABOUT THE CONCEPT

In the United States, government plays four basic economic roles: 1) providing public goods; 2) redistributing income and providing for the public well-being; 3) regulating economic activity; and 4) ensuring economic stability. These broad functions are implemented in specific ways every day by millions of employees of the federal, state, and local governments doing specific jobs. Their jobs are to promote these goals, yet the very act of hiring so many people to begin with helps the government fulfill its economic roles.

RESPONDING TO THE TRANSPARENCY

Directions: *Use the transparency to answer the following questions.*

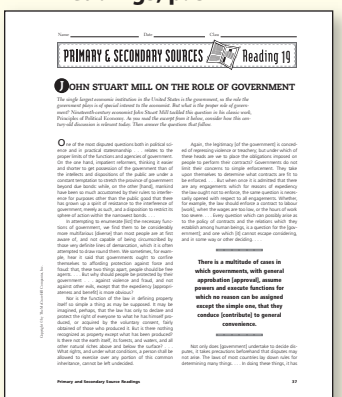
1. Carefully consider the transparency. What level of government employs the most people?
2. About what percent of government employees worked for the federal government in 2002?
3. On average, about how many people were employed by each state government?

GOING BEYOND THE TRANSPARENCY

4. The federal, state, and local governments of the United States collectively employed more than 21 million Americans in 2002—about one in seven workers nationwide. How does this extensive employment help the government fulfill its economic roles?
5. List at least ten types of jobs that are filled by government employees. Decide how these jobs might be affected by economic booms and busts.

Economic Concepts 23

AL Primary and Secondary Source Readings, p. 37


PRIMARY & SECONDARY SOURCES Reading 19

JOHN STUART MILL ON THE ROLE OF GOVERNMENT

The single largest economic institution in the United States is the government, so the role the government plays is of special interest to the economist. But what is the proper role of government? Nineteenth-century economist John Stuart Mill tackled this question in his classic work, Principles of Political Economy. As you read the excerpt from it below, consider how this century-old discussion is relevant today. Then answer the questions that follow.

One of the most disputed questions both in political science and in practical politics relates to the proper limits of the functions and agencies of government. On the one hand, impatient reformers, thinking it easier and shorter to get possession of the government than of the intellects and dispositions of the public are under a constant temptation to stretch the province of government beyond due bands; while, on the other [hand], mankind are so much accustomed to see the government employed even for purposes other than the public good that there has grown up a spirit of resistance to the interference of government, merely as such, and a disposition to restrict its sphere of action within the narrowest bounds.

In attempting to enumerate [list] the necessary functions of government, we find them to be considerably more numerous than most persons would at first sight be aware of, and not capable of being circumscribed by those very definite lines of demarcation, which it is often attempted to draw round them. We sometimes, for example, hear it said that governments ought to confine themselves to affording protection against force and fraud; that these two things apart, people should be free to do what they pleased, and should depend upon their exertions [effort] — against violence and fraud, and not against other evils, except that the expediency [appropriateness and benefit] is more obvious?

Nor is the function of the law in defining property limited to this, or to any thing which it can be, in any intelligible sense, perhaps, that the law has only to declare and protect the right of everyone to what he has himself produced, or acquired by the voluntary consent, fairly obtained of those who produced it. But is there nothing recognized as property except what has been produced? Is there not the earth itself, its forests, and waters, and all the spontaneous [natural] products of nature, land, for instance? What rights, and under what conditions, a person shall be allowed to exercise over any portion of this common inheritance, cannot be left undecided.

Again, the legitimacy [of the government] is conceded, and the necessity asserted, of enforcing certain duties of these heads are we to place the obligations imposed on people to perform their contracts? Governments do not limit their concerns to simple enforcement. They take upon themselves to determine what contracts are fit to be enforced. . . . But when once it is admitted that there are any engagements which for reasons of expediency should be enforced, the question of expediency is immediately opened with respect to all engagements. Intuitive, for example, the law should enforce a contract to labour [work], when the wages are too low, or the hours of work too severe. . . . Every question which can possibly arise as to the policy of contracts and the relations which they establish among human beings, is a question for the [government] to decide, and which it cannot escape considering, and in some way or other decide.

There is a multitude of cases in which governments, with general approbation [approval], assume powers and execute functions for which no reason can be assigned except the simple one, that they conduce [contribute] to general convenience.

Not only does [government] undertake to decide disputes, it takes precautions beforehand that disputes may not arise. The laws of most countries lay down rules for determining many things. . . . In doing these things, it has

Primary and Secondary Source Readings 37

S Skill Practice

Interpreting Political Cartoons **Ask:** How do you think the artist views government regulation? Explain. *(The artist probably supports government regulation, as the cartoon is very critical of corporate behavior.)* OL

W Writing Support

Expository Writing Have students visit www.sec.gov and read the section that introduces the SEC. Then have them choose a company, find it in the EDGAR database, and record five pieces of information that they learn there. OL

Caption Answer: public disclosure for businesses and consumer lending

Reading Check Answer: Companies could pretend to be profitable to attract investors; lenders could hide how much interest they were charging; companies could hide harmful products and actions.

public disclosure requirement that a business reveal information about its products or its operations to the public

S Personal Finance Handbook

*See page **R14-R15** for more information on loans.*

Improve Economic Efficiency

MAIN Idea Providing public goods and promoting transparency can improve economic efficiency.

Economics & You Can you name some public goods in your community? Read on to learn why public goods must be provided by the public sector.

Fortunately, the government has the ability to correct two market failures that interfere with competitive markets: inadequate information and public goods.

Promote Transparency

Efficient and competitive markets need adequate information. *Transparency* is a term used to indicate that information and actions are not hidden and instead are easily available for review.

Public disclosure, the requirement that businesses reveal certain information to the public, is an important way to do this. For example, all corporations that sell stock to the public must disclose financial and operating information on a regular basis to both their shareholders and the Securities and Exchange Commission (SEC). This data is stored in a free database that can be accessed by anyone on the Internet.

Disclosure requirements also exist for consumer lending. If you obtain a credit card or borrow money to buy a car, the lender will explain in writing the method for computing the monthly interest, the length of the loan, the size of the payments, and other lending terms. This is not an act of kindness on the lender's part because federal law requires these disclosures. Finally, "truth-in-advertising" laws prevent sellers from making false claims about their products.

Most government documents, studies, and reports are available on the Internet. This includes the annual budget of the U.S. government, the *Statistical Abstract of the United States,* Census Bureau reports, and nearly every other publication that you can find in the government documents section of your local public library.

Transparency Governments require disclosure to prevent companies from providing misleading information. ***What requirements protect you as a borrower?***

www.CartoonStock.com

"This isn't rocket science, folks. One, we substitute code words for substantive ideology. Two, we create misleading advertising. Three, we issue bold pronouncements on phony profit margins. It's all right here in the corporate training manual."

Provide Public Goods

A free enterprise economy does not produce public goods in sufficient quantity because such efforts usually do not result in direct financial gain. This means that many of the things society values—good roads and highways, museums and libraries, and education—must be provided by government.

Public goods are important because they make the economy more productive. For example, businesses need reliable transportation so that they can move their raw materials and final products. In addition, their employees need to be able to easily communite to and from work. Firms also need an educated workforce that is both productive and able to purchase the products that are produced.

Reading Check Interpreting What negative things could happen in a market without disclosure?

Hands-On Chapter Project

Step 3

Analyzing American Market Structures

Step 3: Examining How Government Influences the Different Market Structures. Student groups will formulate policies to regulate the different markets.

Directions: Have students reassemble into their same groups and recall the market structures and industries that they investigated in Step 2. Tell students that they are now government officials in charge of regulating their industry. Ask each group to devise a set of policies/laws to regulate (or deregulate) interactions that involve their industry. Remind students to consider the market structure of their industry. For example, students dealing with an oligopoly may write a law to set punishments for collusion; students dealing with monopolistic competition may write a policy to set quality standards.

Have each group present their laws and policies to the class. Invite other students to speculate on the effects these policies might have on the market involved.

Assessing Have students write a short paper assessing how government policies can affect businesses in the different market structures. OL

(Chapter Project continued in Visual Summary.)

Modified Free Enterprise

MAIN Idea Because the government is involved in certain aspects of our economy, it is a modified version of free enterprise.

Economics & You What role does government play in your life? Read on to learn why some government regulation is desirable.

The U.S. economy has changed dramatically over the years. One of the outcomes of this evolution is the rise of the modified free enterprise economy.

In the late 1800s, the freedom to pursue self-interests led some people to seek economic gain at the expense of others. Under the label of competition, many larger firms used their power to take advantage of smaller ones. In some markets, less competitive market structures such as monopoly replaced competition, and the economy became less efficient.

Because of these developments, Congress passed laws to prevent "evil monopolies" and to protect the rights of workers. It also passed food and drug laws to protect people from false claims and harmful products. Even public utilities faced significant government regulation to prevent the price gouging of consumers. Collectively, these actions have resulted in a modification of free enterprise.

More recently, concern has shifted to economic efficiency and the role of the government in promoting it. Markets have become increasingly important, and we recognize that markets can fail in several different ways. When this happens, the government can take steps to remedy the situation.

In addition to occasional interventions to keep markets reasonably competitive, the government can make the economy more efficient by supplying public goods and promoting transparency. People will continue to debate the proper role of government, but it turns out that markets alone cannot provide all of our wants and needs.

Over the years, government's role in the economy has slowly evolved from concern over consumer protection to the promotion of economic competition and efficiency. As a result of this government **intervention,** we now have a modified private enterprise economy, or an economy based on markets with varying degrees of government regulation. D

Reading Check **Summarizing** Why do we use the term *modified* to describe the American free enterprise economy?

Economics ONLINE
Student Web Activity Visit the *Economics: Principles and Practices* Web site at glencoe.com and click on *Chapter 7–Student Web Activities* for an activity on the government's role in promoting fair business practices.

Skills Handbook
See page ***R45*** *to learn about* ***Synthesizing Information.***

SECTION 3 Review

Vocabulary

1. **Explain** the significance of trust, price discrimination, cease and desist order, and public disclosure.

Main Ideas

2. **Identifying** Use a graphic organizer similar to the one below to identify how the federal government can maintain competition and improve economic efficiency.

Action	Purpose
Antitrust legislation	

3. **Explaining** Why is the United States considered to have a modified free enterprise economy?

Critical Thinking

4. **The BIG Idea** Why is the government involved in economic affairs?
5. **Making Inferences** Why do governments regulate monopolistic cable companies and not prohibit them?
6. **Synthesizing Information** Identify at least two instances where you have personally benefited from government regulations. Explain the benefits.

Applying Economics

7. **Public Disclosure** Obtain literature describing the computation of interest and conditions for withdrawal on various savings accounts from a local bank. Summarize the information in a short paragraph. Why do you think the bank is so forthcoming with this information?

D Differentiated Instruction

Interpersonal Select teams of students to debate the following proposition: *The government is too involved in regulating our economy.* Have teams develop their stances using information in Section 3 and research that they do in the library or on the Internet. AL

Reading Check **Answer:** We have made changes, or modifications, to the free enterprise system.

Assess

Use the Interactive Tutor Self-Assessment CD-ROM to review Section 3, and then assign the Section 3 Review as homework or as an in-class activity.

Close

Summarizing Have students write a paragraph summarizing the U.S. government's policies, both historical and current, toward economic competition. OL

Review SECTION 3

Answers

1. All definitions can be found in the section and the Glossary.
2. **Antitrust legislation:** maintain competition. **Regulatory agencies:** promote consumer welfare, correct externalities. **Public disclosure laws:** promote transparency. **Provide public goods:** correct market failure.
3. because the government has an active, though limited, role in the U.S. economy
4. The government is involved in economic affairs to correct market failures such as lack of competition, lack of information, externalities, or lack of public goods.
5. **Possible answer:** Cable companies are natural monopolies and can deliver lower costs to consumers if regulated.
6. Answers will vary but should demonstrate knowledge of some of the ways that the government regulates business.
7. Answers will vary but should reference government regulations that require banks to fully disclose their financial terms.

CASE STUDY

Focus

D Differentiated Instruction

Visual/Spatial Ask students to describe traditional Disney movies as a class. Students should address the style of animation and type of story line. Then ask students who have seen *Toy Story* to describe how the movie was a departure from typical Disney animation. OL

Teach

S Skill Practice

Using Tables and Charts

Ask: Which Pixar movie earned the most money? (Finding Nemo) Which movie's receipts were not all counted when the chart was written? (Cars) BL

Analyzing the Impact

Answers:

1. Disney hoped to solidify its relationship with Pixar and raise its stock price.
2. It could reduce competition in the movie industry.

Additional Support

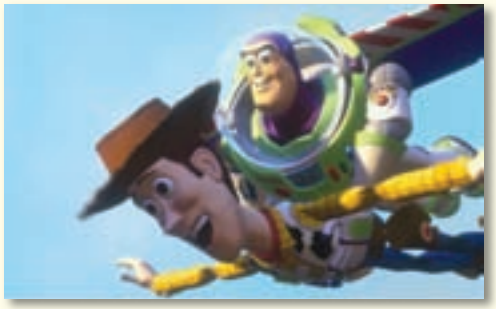
CASE STUDY

Pixar and Disney D

Birth of Pixar

The short, happy tale of Pixar began when John Lasseter left Walt Disney studios in 1984 to join Lucasfilm, Ltd. Two years later, Steve Jobs, CEO of Apple Computer Inc., bought the computer graphics division of Lucasfilm for $10 million and renamed it Pixar.

After winning numerous awards for short films and commercials, Pixar, with just 44 employees, teamed up with mega-studio Disney in 1991 to co-produce major films.



Box Office Magic, Stock Ticker Woes

Toy Story, the first collaboration by Disney and Pixar, was a box office home run, earning $358 million in box office receipts around the world as the highest-grossing film of 1995.

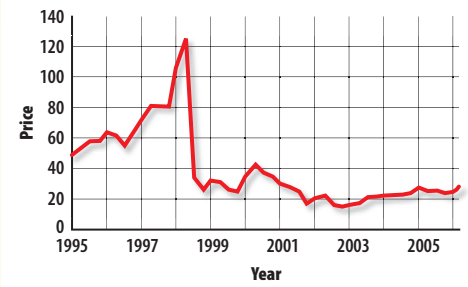
The dynamic duo produced six more commercial hits, but Disney's other work did not please moviegoers. Nor did its stock price satisfy stockholders.

S

Box Office Receipts

Toy Story	$358.1 million
A Bug's Life	$357.9 million
Toy Story 2	$485.7 million
Monster's Inc.	$528.9 million
Finding Nemo	$865.0 million
The Incredibles	$624.0 million
Cars	$367.6 million (and counting)

Disney Stock Prices, 1995–2006



Disney's management hoped to boost its stock price and remedy the sometimes tumultuous relationship between Disney and Pixar by entering into merger negotiations.

Animation Merger

By that time, Pixar had grown to a company of hundreds of employees, and federal regulatory authorities reviewed the merger for possible anti-trust problems.The two companies finally merged in 2006 when Disney paid $7.5 billion for Pixar.

As hoped, the price of Disney stock started to increase. A few months later, *Cars* zoomed into theaters, bringing in more than $60 million its first weekend. If you think stock prices follow ticket sales, though, think again. Despite that impressive showing, Disney's stock fell slightly when the movie missed its $70 million goal.

Analyzing the Impact

1. **Summarizing** How did Disney expect to gain from the merger with Pixar?
2. **Drawing Conclusions** Why might federal regulators be concerned about the merger of these two movie companies?

Extending the Content

Pixar: Making Art a Team Sport

Unlike paintings or novels, which are usually produced by single artists, a movie requires an entire team to produce it. As a company, Pixar works to make all employees contributors. It hires outsiders, even if they might not fit in. It runs Pixar University, which offers employees four- to sixteen-week classes on subjects such as sculpture and improvisational comedy. Each Pixar film reveals an advance in photorealism, but all movies are built around the story, not technology. The company has imitated Disney's work process for animated films, but it refuses to rest on its laurels. When *Toy Story 2* was proclaimed "terrible" just eight months before it was due at the distributor, the company strained itself to overhaul the movie. Pixar's corporate culture demands that they produce only high-quality movies. So far, the company has won 17 Oscars and picked up 42 patents.

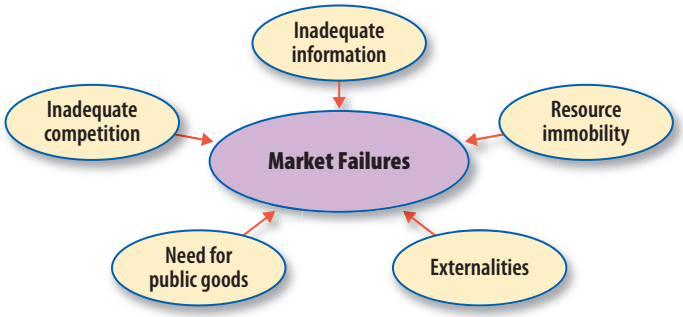
Visual Summary

Study anywhere, anytime! Download quizzes and flash cards to your PDA from glencoe.com.

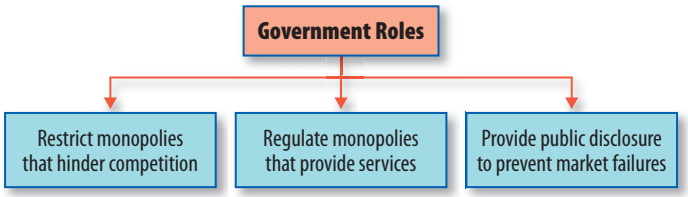
Market Structures We can differentiate among four different market structures. One is called perfect competition; the other three are different kinds of imperfect competition.

Perfect Competition	Imperfect Competition		
Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Large number of well-informed independent buyers and sellers who freely exchange identical products	Has all characteristics of perfect competition except product differentiation	A few very large sellers dominate the industry	Only one seller for a particular product

Market Failures When one of the conditions necessary for competitive markets does not exist, market failures can occur. Markets usually fail because of five factors.



Government Roles In order to carry out its legal and social obligations, the government can encourage competition and regulate monopolies.



Visual Summary

Simulating Divide the class into four groups (or eight groups if the class is large). Assign each (or two) of the groups one of the four basic market structures. Tell groups that their task is to write a 45-second to 1-minute radio advertisement that explains the benefits of their assigned market structure. Suggest that groups listen to examples of radio ads before undertaking the task. Call on groups to "broadcast" their advertisements to the class. **OL**

Surveying Have students conduct an informal survey of family members, friends, students, and teachers on government's role in the economy. Suggest that they ask such questions as the following: Is there too much or not enough government regulation? Which regulatory agencies, if any, should be curtailed, expanded, or abolished? Have students share their survey results with the class. **BL**

Hands-On Chapter Project

Step 4: Wrap Up

Analyzing American Market Structures

Step 4: Complete the Analysis. Student teams will summarize what they learned in Steps 1–3.

Directions: Have the students on each team write papers summarizing what they learned about the market system they represented in Steps 2 and 3. Students will work alone on this activity—each student will write a summary paper. Students should describe the strengths and weaknesses of their market system, including an assessment of what the system's proper role in the American economy should be. Encourage students to use the example of the business they explored in Step 2 to support their positions. Have students representing each of the three different market systems read their summary papers to the class. Finally, discuss as a class the strengths, weaknesses, and possible proper role of the fourth market system—perfect competition. **OL**

This easy-to-use software includes extensive question banks and allows you to create fully customized tests that can be administered in print or online.

Review Content Vocabulary

1.–10. Students' paragraphs will vary but should demonstrate understanding of each term's meaning in an economic context.

Review Academic Vocabulary

11.–16. Students' sentences will vary but should demonstrate understanding of each term's meaning in an economic context.

Review the Main Ideas

17. because its conditions are virtually never met in real life

18. **Natural monopoly:** can provide goods or services more cheaply than competing firms. **Geographic monopoly:** no competitors within a certain geographic area. **Technological monopoly:** the government grants a patent to new inventions. **Government monopoly:** single sellers owned and run by the government.

19. inefficient use of resources, misuse of profits, and higher prices

20. benefits or costs that go to third parties who are not participants in a transaction

21. because they cannot be withheld from those who do not pay for them and therefore are not profitable

CHAPTER 7

Assessment & Activities

Review Content Vocabulary

Use all of the terms below to write a paragraph about each of the four types of markets. Underline the terms within your paragraphs.

1. market failure
2. geographic monopoly
3. imperfect competition
4. monopolistic competition
5. natural monopoly
6. oligopoly
7. product differentiation
8. trust
9. price-fixing
10. nonprice competition

Review Academic Vocabulary

Use each of these terms in a sentence that reflects the term's meaning in the chapter.

11. theoretically
12. equate
13. collude
14. sustain
15. restrained
16. intervention

Review the Main Ideas

Section 1 *(pages 169–177)*

17. **Explain** why perfect competition is a theoretical situation.
18. **Describe** the four types of monopolies by using a graphic organizer similar to the one below.

Type of Monopoly	Description

Section 2 *(pages 179–183)*

19. **Explain** what happens when markets do not have enough competition.
20. **Describe** what is meant by *externalities*.
21. **Explain** why the private sector is reluctant to produce public goods.

Section 3 *(pages 185–189)*

22. **Identify** the purpose of antitrust legislation.
23. **Explain** how public disclosure is used as a tool to prevent market failures.
24. **Describe** the characteristics that make the U.S. economy a "modified free enterprise" economy.

Critical Thinking

25. **The BIG Idea** Why does the federal government attempt to preserve competition among business enterprises? What different methods does the government have available for this task?
26. **Making Inferences** Do you think there would be any advantages to making monopolies or near monopolies break up into smaller, competing firms? Explain your answer.
27. **Comparing and Contrasting** Why are monopolies faced with more government regulations than other market structures?
28. **Making Generalizations** To what extent do you think government should be involved in the free enterprise economy? Defend your answer.

Analyzing Visuals

29. Look at Figure 7.2 on page 175. Analyze the columns labeled "Influence over price" and "Entry into market." How do the various types of market structures influence the results, and why? Present your answer and reasons in a short paragraph.

22. to maintain competition

23. Public disclosure increases the flow of information and therefore increases consumer and market welfare.

24. It relies on free enterprise, markets, prices, and the profit motive, with some government intervention.

Critical Thinking

25. because competition is the police force in a capitalist economy; antitrust legislation laws

26. Students should realize that the advantages depend on the type of monopoly.

27. Unlike other market structures, monopolies are not policed by competition.

28. Answers will vary but should discuss government involvement in the economy.

Analyzing Visuals

29. Answers should note that ease of entry will result in more firms and more competition. This reduces influence on price.

Economics ONLINE **Self-Check Quiz** Visit the *Economics: Principles and Practices* Web site at glencoe.com and click on *Chapter 7—Self-Check Quizzes* to prepare for the chapter test.

Math Practice

30. The table below shows the price, market demand, market supply, and the surplus and shortage for a firm providing a product under perfect competition. Study the information in the table, and then answer the questions below.

Price	Market demand	Market supply	Surplus/ Shortage
10	600	1550	950
9	----	1500	780
8	850	1450	----
7	990	1400	----
6	----	1350	210
5	1300	----	0
4	1470	----	–220
3	1650	1200	----
2	1840	1150	–690

a. Some of the information is missing from the table. Calculate the correct information.

b. What is the equilibrium price? How can you tell?

c. What price(s) will produce a surplus?

d. What price(s) will produce a shortage?

Applying Economic Concepts

31. Product Differentiation Choose a product offered by several producers that is advertised in newspapers or magazines. Then follow the steps below:

a. Clip and save at least three different advertisements.

b. In a journal, evaluate each advertisement and write why you would or would not buy a particular brand.

c. Based on the evaluations, develop an advertisement for a product of your choice.

d. Present your ad to the class and have other students evaluate how effectively you were able to differentiate your product from that of "competitors."

Thinking Like an Economist

32. Profit Maximization Economists like to analyze decisions incrementally, taking small steps and analyzing the costs and benefits of the steps as they are made. How is this way of thinking similar to the profit maximization logic illustrated in Figure 7.1 on page 171?

Writing About Economics

33. Expository Writing Select any five of the regulatory agencies described in Figure 7.4 on page 187 that relate directly to you. Write a short essay that discusses these agencies and evaluates whether they have a positive or negative effect on your life.

Interpreting Cartoons

34. Critical Thinking Look at the cartoon below. What does the cartoon imply about monopolies? What can the government do to prevent such business practices?

'"Freddie, the Little Merger Mogul, didn't expect to have a monopoly right away. He planned to start small by rigging markets, restraining trade, and suppressing competition—then..."'

Economics ONLINE

Have students visit the Web site at glencoe.com to review Chapter 7 and take the **Self-Check Quiz.**

Applying Economic Concepts

31. Answers will vary but should indicate that students understand the concept of product differentiation and how it might affect marketing strategy.

Thinking Like an Economist

32. The profit maximization logic compares the costs and returns from each increment of output. This is thinking at the margin, which is what economists do.

Writing About Economics

33. Answers will vary but should demonstrate an understanding of how government regulation impacts the lives of consumers.

Interpreting Cartoons

34. Answers will vary but should demonstrate an understanding of what can happen in the absence of competition.

Math Practice

30. a.

Quantity Demanded	Quantity Supplied
price = 9	demand = 720
price = 8	surplus = 600
price = 7	surplus = 410
price = 6	demand = 1140
price = 5	supply = 1300
price = 4	supply = 1250
price = 3	shortage = –450

b. The equilibrium price is 5, as that is where quantity demanded equals quantity supplied. There is no surplus or shortage.

c. Prices from 6 through 9 will produce a surplus. Prices below 4 will produce a shortage.

d. Answers will vary, but students should illustrate their decisions in a decision-making grid.