chapter 9 Competition and Monopolies

The BIG Idea

The profit motive acts as an incentive for people to produce and sell goods and services.

Why It Matters

Think about the products that you buy most frequently. Are they produced by just one company, or do you have choices about where to buy the items? In this chapter, read to learn how competition—or the lack of it—determines the prices you pay.

Economics ONLINE

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on ***Chapter 9—Chapter Overviews*** to preview chapter information.

section 1 Perfect Competition

GUIDE TO READING

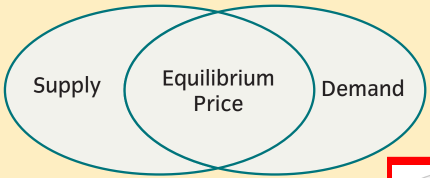
Section Preview
In this section, you will learn about perfect competition and how this market structure benefits consumers.

Content Vocabulary
- market structure *(p. 232)*
- perfect competition *(p. 232)*

Academic Vocabulary
- initial *(p. 233)*
- interact *(p. 233)*
- unique *(p. 234)*

Reading Strategy
Organizing As you read, use a Venn diagram like the one below to explain how the concepts listed affect price under perfect competition.

Prices Under Perfect Competition



Interactive Graphic Organizer

PRODUCTS In ThE NeWS

—from **CNNMoney.com**

COCA-COLA FACES THE COMPETITION [Coca-Cola] CEO Neville Isdell has known for a long time that Coke must change if it is to prosper again. . . . The new Coca-Cola, he promised, will innovate, launching new products with strange-sounding names like Tab Energy (diet energy drink), Coca-Cola Blak (coffee Coke), and Full Throttle Fury (a citrus-flavored energy concoction).

. . . For too long Coke had stayed stubbornly, defiantly rooted in its past, holding on to the belief that its business model was as good as gold: Make cola concentrate for pennies, then sell it for dollars through a global bottling system to a mass market that still pretty much drank what it saw on TV.

. . . [However], it takes a lot more than Coke With Lime to impress the video iPod generation. They want Izzes and Starbucks and Red Bulls. They want choice, not a company telling them "Father knows best."

Competition happens when two or more companies strive against each other to convince consumers to buy their products or services. Competition is advantageous to consumers for several reasons. First, it provides us with choices. Competition is advantageous for another reason as well. Having many competing suppliers of a product, like coffee drinks, leads to lower prices. As you can imagine, for this reason each supplier would like to have as little competition as possible.

Market Structure and Perfect Competition

Main Idea **Market structure refers to the extent of competition within particular markets.**

Economics & You What if you could go to only one university, one doctor, or one grocery store? This situation is known as a monopoly. Read on to learn about this and other types of market structures.

market structure: the extent to which competition prevails in particular markets

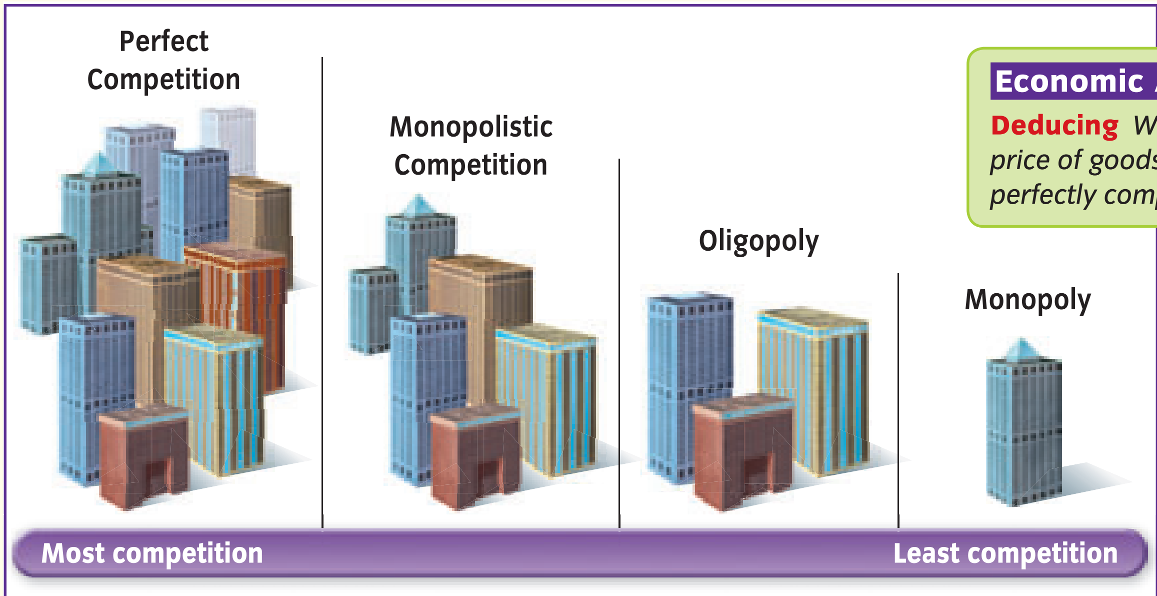
perfect competition: market situation in which there are numerous buyers and sellers, and no single buyer or seller can affect price

In Chapter 8 you learned that businesses are often set up based on the number of owners—sole proprietorship, partnership, corporation. In this chapter, you'll learn that businesses are also categorized by **market structure**—or the amount of competition they face. **Figure 9.1** below shows the four basic market structures in the American economy: perfect competition, monopolistic competition, oligopoly, and monopoly. In this section you'll learn about the ideal market structure of perfect competition.

All businesses must engage in some form of competition as long as other businesses produce similar goods or services. When a market includes so many sellers of a particular good or service that each seller accounts for a small part of the total market, a special situation exists. Economists term it **perfect competition.** For perfect competition, also known as pure competition, to take place, five conditions must be met:

Figure 9.1 **Comparing Market Structures**

Markets that are either perfectly competitive or pure monopolies are rare. Most industries in the United States fit one of the other two forms.



Economic Analysis

Deducing *What determines the price of goods and services in a perfectly competitive market?*

(1) **A Large Market** Numerous buyers and sellers must exist for the product.

(2) **A Nearly Identical Product** The goods or services being sold must be nearly the same.

(3) **Easy Entry and Exit** Sellers already in the market cannot prevent competition, or entrance into the market. In addition, the **initial** costs of investment are small, and the good or service is easy to learn to produce.

(4) **Easily Obtainable Information** Information about prices, quality, and sources of supply is easy for both buyers and sellers to obtain.

(5) **Independence** The possibility of sellers or buyers working together to control the price is almost nonexistent.

Perfect Competition

At a farmers' market, you may see several different stands selling fruit, such as apples. Having a nearly identical product and easy entry into the market—such as fruit stands at farmers' markets do—are two conditions of perfect competition.

No Control Over Price

When the above five conditions are met, the workings of supply and demand, rather than a single seller or buyer, control the price. On the supply side, perfect competition requires a large number of suppliers of a nearly identical product. On the demand side, perfect competition requires a large number of buyers who know exactly what the market price is for the good or service.

In a perfectly competitive market, the market price is the equilibrium price. Total supply and total demand are allowed to **interact** to reach the equilibrium price—the only price at which quantity demanded equals quantity supplied. In a world of perfect competition, each individual seller would accept that price. Because so many buyers and sellers exist, one person attempting to charge a higher or lower price would not affect the market price.

Information Is Key

True perfect competition is rarely seen in the real world. Nonetheless, fierce competition does exist in many sectors of the economy. The ability of consumers to obtain information is key to sustaining competition. Today, virtually anyone with access to the Internet can find out the lowest prices of just about anything.

Reading Check **Analyzing** How is the Internet important to maintaining a competitive market structure?

Agriculture as an Example

Corbis

Main Idea **Agricultural markets come close to a perfectly competitive market structure.**

Economics & You How much does a loaf of bread cost? Does the price ever change much? Read on to learn about how the prices of many agricultural products are determined by the market.

Few perfectly competitive industries exist in the United States. One that comes close is the agricultural market. It is often used as an example of perfect competition because farmers have almost no control over the market price of their goods. (See **Figure 9.2**.)

No Control Over Wheat Prices No single wheat farmer has any great influence on wheat prices. The market price for wheat is determined by the interaction of supply and demand, and individual wheat farmers have to accept the market price. If the price is $3 per bushel, that is the price every farmer receives. Farmers who attempt to raise their price above $3 will find that no one will buy their wheat. Farmers will not be willing to sell their wheat for less than $3 per bushel.

Unique Situation The total demand for wheat and other agricultural products is somewhat different from the demand for many other products. People's demand for wheat is relatively inelastic—even if the price of wheat were to increase or drop, quantity demanded would not change significantly. The supply side of most agricultural markets is also **unique**. It is highly dependent on conditions over which farmers have little or no control, such as weather and crop disease.

Figure 9.2 A Classic Example

Because the wheat market meets all of the conditions needed for perfect competition, as shown in this table, it is often used as an example of a perfectly competitive industry. True perfect competition, though, is rarely seen in the real world.

The Wheat Market as a Perfect Competitor

1. **A Large Market** Thousands of wheat farmers grow wheat, and thousands of wholesalers buy wheat.
2. **A Nearly Identical Product** All wheat is fairly similar.
3. **Easy Entry and Exit** The costs of renting farmland are relatively low, and farming methods can be learned.
4. **Easily Obtainable Information** Information about wheat prices is fairly easy to obtain. Indeed, it can be obtained on the Internet in a few seconds.
5. **Independence** The possibility of thousands of wheat farmers banding together to control prices is very small.

Economic Analysis

Analyzing *Do you agree that the wheat market meets all five of the conditions listed here? Why or why not?*

Benefits to Society

The intense competition in a perfectly competitive industry forces the price down to one that just covers the costs of production plus a small profit. This price is beneficial to consumers because it means that they are paying only for what has been put in to make those products—the opportunity cost of the use of land, labor, capital, and entrepreneurship. The price that consumers pay for products under perfect competition is a correct signal about the value of those products in society.

Perfectly competitive industries yield economic efficiency. All inputs are used in the most advantageous way possible, and society therefore enjoys an efficient allocation of productive resources.

Fritz Hoffmann/The Image Works

Effects on Supply

Variations in weather, including natural disasters like floods, can wipe out entire harvests. So can crop diseases and crop-destroying insects. This means that farmers may have a good harvest one year and a poor harvest the next. As a result, there are widely fluctuating supplies of goods in the agricultural market.

Reading Check **Explaining** What makes the demand for agricultural products unique?

section 1 Review

Vocabulary

1. **Explain** the significance of: market structure, perfect competition.

Main Ideas

2. **Summarizing** In a table like the one below, list the conditions that must be met for perfect competition to exist.

Perfect Competition
1.
2.
3.
4.
5.

Interactive Graphic Organizer

Critical Thinking

3. **The BIG Idea** Explain how perfect competition tends to drive down profits.
4. **Analyzing** Is there any way for a seller in a perfectly competitive market to raise prices?
5. **Deducing** Why is perfect competition such a rare market structure?

Applying Economics

6. **Perfect Competition** Explain how a local fast-food restaurant manager faces almost perfect competition in the demand for high-school employee labor.

section 2

Monopoly, Oligopoly, Monopolistic Competition

GUIDE TO READING

Section Preview

In this section, you will learn about three types of imperfect market structures: monopoly, oligopoly, and monopolistic competition.

Content Vocabulary

- monopoly *(p. 237)*
- barriers to entry *(p. 237)*
- economies of scale *(p. 238)*
- patent *(p. 238)*
- copyright *(p. 238)*
- oligopoly *(p. 240)*
- product differentiation *(p. 241)*
- cartel *(p. 241)*
- monopolistic competition *(p. 242)*

Academic Vocabulary

- revolution *(p. 239)*
- dominate *(p. 240)*

Reading Strategy

Comparing and Contrasting Use a table like the one below to describe how much competition the seller faces and how much control over price he or she has in each type of market structure listed.

	Competition	Control Over Price
Monopoly		
Oligopoly		
Monopolistic Competition		

Interactive Graphic Organizer

ISSUES IN THE NEWS

—from *BusinessWeek*

TAMING THE GIANT For 14 years, one regulator or another has chased after Microsoft—mostly unsuccessfully. In 1990, the Federal Trade Commission launched an investigation into a long list of allegedly predatory practices. The probe was dropped. In 1998, the Justice Dept. tried to prevent Microsoft from using its Windows monopoly to corner the emerging web browser market. Microsoft fought back and got only a slap on the wrist. Now European regulators are taking their shot at restraining the software giant.

▲ Microsoft founder Bill Gates

In its March 24 ruling, the European Union labeled Microsoft an abusive monopolist and issued a sweeping set of penalties. . . . The EU ruled that Microsoft must share their technical information with rivals that will help their server software work better with Windows.

As mentioned in Section 1, perfect competition is an idealized type of market structure. Most industries in the United States, in contrast, represent some form of *imperfect* competition. Economists classify these three types of imperfect market structures as monopoly, oligopoly, or monopolistic competition. In this section, you'll learn how they differ from one another.

Skills Handbook

*See page **R43** to learn about **Comparing and Contrasting.***

Stephen Hird/Reuters/CORBIS

Monopoly

Main Idea **A monopoly exists when a single seller controls the supply of a good or service and largely determines its price.**

Economics & You Have you ever played the board game *Monopoly*? What is the object of the game? Read on to learn the characteristics and objectives of monopolies.

The most extreme form of imperfect competition is a pure **monopoly**, in which a single seller controls the supply of the good or service and thus determines its price. A few such markets do exist in the real world. For example, some local electric utility companies are the sole providers for a community. See **Figure 9.3** below for a description of the four characteristics of a monopoly.

monopoly: market situation in which a single supplier makes up an entire industry for a good or service with no close substitutes

In a pure monopoly, the supplier can raise prices without fear of losing business, because buyers have nowhere else to go to buy the good or service. A monopolist, however, cannot charge outrageous prices, as the law of demand is still operating. As the price of a good or service rises, consumers buy less.

If a monopoly is collecting all the profits in a particular industry, why don't other businesses rush in to get a share of those profits? A monopoly is protected by **barriers to entry**—obstacles that prevent others from entering the market. State laws that prevent competing utility companies from entering the market are one example of a barrier to entry.

barriers to entry: obstacles to competition that prevent others from entering a market

Another barrier to entry is the cost of getting started. Called "excessive money capital costs," this barrier is found in industries such as automobiles and steel.

Figure 9.3 A Monopoly Market Structure

■ A monopoly exists when a single seller controls the supply of a good or service and largely determines its price. Four major characteristics define a monopoly.

Characteristics of a Monopoly

1. **A Single Seller** Only one seller exists for a good or service.
2. **No Substitutes** There are no close substitutes for the good or service that the monopolist sells.
3. **Barriers to Entry** The monopolist is protected by obstacles to competition that prevent others from entering the market.
4. **Almost Complete Control of Market Price** By controlling the available supply, the monopolist can control the market price.

Economic Analysis

Listing *What are some examples of barriers to entry?*

Types of Monopolies Pure monopolies can be separated into four categories depending on why the monopoly exists. The four types of monopolies are natural, geographic, technological, and government, as shown in **Figure 9.4** below.

First, we have *natural monopolies,* where the government grants exclusive rights to companies that provide things like utilities, bus service, and cable TV. The justification for natural monopolies is that a larger firm can often use its factors of production more efficiently. The large size, or scale, of most natural monopolies gives them **economies of scale**—by which they can produce large amounts of their good or service at a relatively low cost.

economies of scale: low production costs resulting from the large size of output

A *geographic monopoly* is another kind of monopoly. A country store in a rural setting is an example of this. Because the setting of the business is isolated and the potential for profits is so small, other businesses choose not to enter the market.

If you invent something, you are capable of having a *technological monopoly* over your invention. A government **patent** gives you the exclusive right to manufacture, rent, or sell your invention for a specified number of years—usually 20. Similarly, a United States **copyright** protects art, literature, song lyrics, and other creative works for the life of the author plus 70 years.

patent: exclusive right to make, use, or sell an invention for a specified number of years

copyright: exclusive right to sell, publish, or reproduce creative works for a specified number of years

(l) Bill Ross/AP/Wide World Photos, (r) Pat & Chuck Blackley

Figure 9.4 Types of Monopolies

Pure monopolies can be separated into four categories depending on why the monopoly exists.

A. Natural Monopoly In many major U.S. cities, bus service is a natural monopoly, granted exclusive rights by local governments to provide this service.

B. Geographic Monopoly A country store in a lightly populated area is an example of a geographic monopoly. Other businesses choose not to enter the market because there is a small customer base and little potential for profits.

Finally, we have *government monopolies*. A government monopoly is similar to a natural monopoly, except the monopoly is held by the government itself. The construction and maintenance of roads and bridges, for example, are the responsibility of local, state, and national governments, who contract this work out to companies. In the United States, the postal service is a common example of a government monopoly.

Monopolies today are far less important than they once were. Geographic monopolies, for example, have much less effect now than they did in the past because of potential competition from mail-order businesses and electronic commerce on the Internet. More and more natural monopolies are being broken up by the introduction of new technologies and government deregulation.

Technological monopolies rarely last longer than the life of the patent—if even *that* long. Why? Competitors can make and patent slight variations in new products quickly. The microcomputer **revolution** in the early 1980s followed such a pattern. One company copied another's product, making changes and adding features to obtain a patent of its own.

Reading Check **Summarizing** What are the four types of monopolies, and what are their major characteristics?

C. Technological Monopoly The Microsoft Windows operating system is an example of a technological monopoly.

D. Government Monopoly In a government monopoly, local, state, and national governments themselves hold exclusive rights to contract out work like highway and bridge construction.

Economic Analysis

Determining Cause and Effect *What factors have led to the decline of the power of monopolies in recent years?*

Oligopoly

Main Idea **An oligopoly exists when an industry is dominated by a few suppliers that exercise some control over price.**

Economics & You How many domestic car companies can you name? How many soft drink companies? Read on to learn more about this type of industry, in which a few sellers dominate the market.

oligopoly: industry dominated by a few suppliers who exercise some control over price

Unlike a monopoly with just one supplier, an **oligopoly** is an industry **dominated** by *several* suppliers who exercise some control over price. See **Figure 9.5** below for a description of the five characteristics of an oligopoly.

Oligopolies are not considered as harmful to consumers as monopolies. Consumers may pay more than if they were buying in a perfectly competitive market, but oligopolistic markets tend to have generally stable prices. They also offer consumers a wider variety of products than would a perfectly competitive industry. (See **Figure 9.6.**)

Skills Handbook

See page ***R44*** *to learn about* ***Detecting Bias.***

Product Differentiation

Oligopolists engage in nonprice competition. What does this mean? Let's use automobiles as an example. Several large auto manufacturers have an oligopoly on the domestic car market. They all make cars, trucks, and sport utility vehicles. They spend millions, if not billions, of advertising dollars per year to differentiate their products in your mind—and to win your consumer dollars.

Figure 9.5 An Oligopoly Market Structure

An oligopoly exists when an industry is dominated by a few suppliers that exercise considerable control over price. Five major characteristics define an oligopoly.

Characteristics of an Oligopoly

1. **Domination by a Few Sellers** Several large firms are responsible for 70 to 80 percent of the market.
2. **Barriers to Entry** Capital costs are high, and it is difficult for new companies to enter major markets.
3. **Identical or Slightly Different Products** The goods and services provided by oligopolists—such as airline travel, domestic automobiles, and kitchen appliances—are very similar.
4. **Nonprice Competition** Advertising emphasizes minor differences and attempts to build customer loyalty.
5. **Interdependence** Any change on the part of one firm will cause a reaction on the part of other firms in the oligopoly.

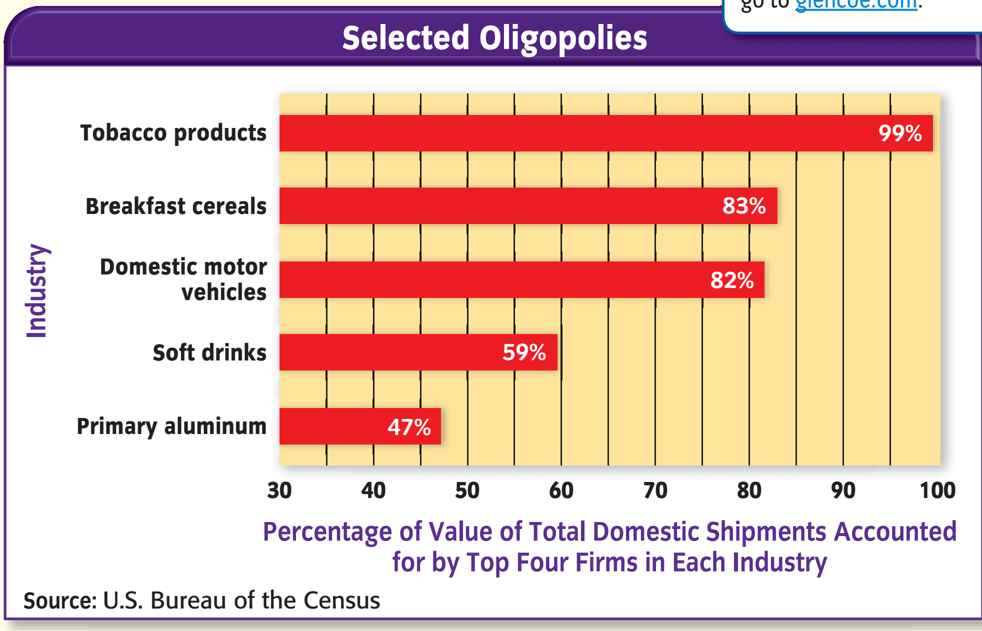
Economic Analysis

Explaining *Why is advertising important in oligopolistic markets?*

Figure 9.6 Oligopolies

Charts In MOtion
See StudentWorks™ Plus or go to glencoe.com.

Oligopolies exist in a few industries throughout the United States. Here several industries and their control of markets are highlighted. Economists would classify the top three as oligopolies.



Economic Analysis

Contrasting *How are oligopolies different from monopolies?*

The price you pay for brand names is not just based on supply and demand. Rather, it is based on **product differentiation**—the real or perceived differences in the good or service that make it more valuable in consumers' eyes.

product differentiation: manufacturers' use of minor differences in quality and features to try to differentiate between similar goods and services

Interdependent Behavior

With so few firms in an oligopoly, whatever one does, the others are sure to follow. When one domestic airline cuts its airfares to gain market share, for example, the other major domestic airlines lower theirs even more. Although this type of price war is initially good for consumers in the form of lower prices, it may force an airline out of business if prices drop too much. Fewer airlines leads to less competition, which may raise prices in the long run.

In contrast, if competing firms in an oligopoly secretly agree to raise prices or to divide the market, they are performing an illegal act called *collusion.* Heavy penalties, such as fines and even prison terms, are levied against companies found guilty of collusion in the United States. One significant form of collusion is the cartel. A **cartel** is an arrangement among groups of industrial businesses, often in different countries, to reduce international competition by controlling price, production, and the distribution of goods. Such firms seek monopolistic power.

cartel: arrangement among groups of industrial businesses to reduce international competition by controlling the price, production, and distribution of goods

Reading Check **Predicting Consequences** What is a price war? What are its effects on the consumer?

Monopolistic Competition

Main Idea **Monopolistic competition exists when a large number of sellers offer similar but slightly different products, and each firm has some control over price.**

Economics & You What makes you buy one brand of toothpaste over another brand that costs the same? Read on to learn about the role that advertising plays in monopolistic competition.

monopolistic competition: market situation in which a large number of sellers offer similar but slightly different products and in which each has some control over price

The most common form of market structure in the United States is **monopolistic competition**, in which a relatively large number of sellers offer similar but slightly different products or services. Obvious examples are brand-name items such as toothpaste, cosmetics, and designer clothes. See **Figure 9.7** below for a description of the five characteristics of monopolistic competition.

Many of the characteristics of monopolistic competition are the same as those of an oligopoly. The major difference is in the number of sellers of a product. As you recall, in an oligopoly a few companies dominate an industry, and control over price is interdependent. In contrast, monopolistic competition has many firms, no real interdependence, and some slight difference among products. In this market structure, if a company succeeds in building brand loyalty for a product, the company gains a certain amount of influence over the market. It can raise the price of the product slightly without losing a great many customers.

Figure 9.7 Market Structure of Monopolistic Competition

Monopolistic competition exists when a large number of sellers offer similar but slightly different products, and each firm has some control over price. Five major characteristics define monopolistic competition.

Characteristics of Monopolistic Competition

1. **Numerous Sellers** No single seller or small group dominates the market.
2. **Relatively Easy Entry** Entry into the market is easier than in a monopoly or oligopoly. One drawback is the high cost of advertising.
3. **Differentiated Products** Each supplier sells a slightly different product to attract customers.
4. **Nonprice Competition** Businesses compete by using product differentiation and by advertising.
5. **Some Control Over Price** By building a loyal customer base through product differentiation, each firm has some control over the price it charges.

Economic Analysis

Identifying *What is the main way companies achieve product differentiation?*

Because of the need to build brand loyalty, competitive advertising is even more important in monopolistic competition than it is in oligopolies. Advertising attempts to persuade consumers that the product being advertised is different from, and superior to, any other. When successful, advertising enables companies to charge more for their products. That's why companies like Nike, The Gap, and Procter & Gamble pour millions of dollars into their advertising budgets every year.

The heavy advertising required by monopolistic competition has both critics and defenders. Critics claim that it induces consumers to spend more on products than they normally would just because of the name associated with them. Defenders argue that brand names can represent a guarantee of quality, and that advertising helps reduce the cost to consumers of weighing the trade-offs of numerous competing brands.

Glencoe photo

Competitive Advertising

Advertising leads to product differentiation and competition for consumer dollars. It is more important in monopolistic competition than in any other market structure.

Careers Handbook

*See pages **R76–R80** to learn about becoming an **advertising manager.***

Reading Check **Contrasting** How is monopolistic competition different from an oligopoly?

section 2 Review

Vocabulary

1. **Explain** the significance of: monopoly, barriers to entry, economies of scale, patent, copyright, oligopoly, product differentiation, cartel, monopolistic competition.

Main Ideas

2. **Describing** Copy the diagram below, and under each box, write a characteristic that fits the type of monopoly listed.

Interactive Graphic Organizer

Geographic	Natural	Gov't	Tech
↓	↓	↓	↓

Critical Thinking

3. **The BIG Idea** Profits are determined by price. Explain how product differentiation is used to try to increase profits.
4. **Identifying** Name two barriers to entry that keep potential competitors out of a market.

Applying Economics

5. **Product Differentiation** Give three examples of products you bought recently because advertising convinced you to buy them. What was it about these products that convinced you to buy them rather than other, similar products?

People and Perspectives

ENTREPRENEUR
(1955–)

Bill Pugliano/Getty Images

Bill Gates

● **Cofounder and chairman of Microsoft Corporation**

- Named the richest man in America by *Forbes* magazine
- Along with his wife, started the Bill & Melinda Gates Foundation, the largest charitable foundation in the world, to promote global health and learning
- Author of *Business @ the Speed of Thought* (1999), a best-seller translated into 25 languages

Bill Gates dropped out of Harvard in his junior year. He did so in order to devote all his time to the company he'd recently founded with his old school pal, Paul Allen. That company was Microsoft Corporation.

Gates and Allen became friends at Lakeside School in Seattle, Washington. Bill wasn't sure he wanted to attend that particular school:

"In those days, Lakeside was an all-boys school where you wore a jacket and tie, called your teachers 'master,' and went to chapel every morning. For a while, I even thought about failing the entrance exam [on purpose]."

But he decided to do his best and was admitted into the seventh grade. This was in the late 1960s, and there was no such thing as a personal computer. Nevertheless, Gates and Allen became early computer enthusiasts. Not only did the two learn more than anyone about the fundamentals of computing programming, but they invented it as they went along.

Even back then they were certain there was a future in personal computers, and together they wrote the first ever microcomputer BASIC program. They had guessed right, and 30 years after its founding, their once-tiny company had annual revenues of nearly $40 billion. Does Gates see an end in sight? Not at all.

> **"[S]oftware has moved to the center . . . for communications, for creativity, and for visualization, and it's amazing to see how far software has come and yet how much more we need to do."**

Checking for Understanding

1. **Explaining** What does Gates mean when he talks about "visualization" in the software industry?
2. **Speculating** Do you believe there is still a place for innovators in the software industry?

section 3

Government Policies Toward Competition

GUIDE TO READING

Section Preview

In this section, you will learn about steps the government has taken to regulate business practices.

Content Vocabulary

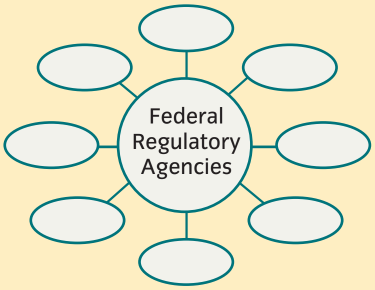
- interlocking directorate *(p. 246)*
- antitrust legislation *(p. 246)*
- merger *(p. 247)*
- conglomerate *(p. 247)*
- deregulation *(p. 248)*

Academic Vocabulary

- prohibit *(p. 246)*
- promote *(p. 248)*

Reading Strategy

Organizing As you read the section, complete a diagram like the one below by listing examples of federal regulatory agencies.



Interactive Graphic Organizer

ISSUES IN THE NEWS

—from the ***Columbus Dispatch***

AIRLINE BAILOUTS In most industries, it works this way: The successful thrive, and the sick don't survive.

But in the airline business, it isn't as simple. The sick take refuge in bankruptcy court—sometimes more than once—and survive in a smaller, usually weaker form, to fly another day.

That's the potential scenario behind [a] coincidence in which Delta Airlines and Northwest Airlines filed for Chapter 11 [bankruptcy] protection, becoming the third and fourth major carriers to file for bankruptcy even as the overall economy is healthy.

There are some economists and restructuring experts who look at the phenomenon of airline bankruptcies and argue that the U.S. court system isn't doing the industry any favors by intervening in what should be a Darwinian process. . . . The cash grants and loan guarantees simply [allow] struggling carriers to postpone the day of reckoning.

Historically, one of the goals of government in the United States has been to encourage competition in the economy. Does the federal government's bailout of various airlines work toward that goal? Should the government intervene in such cases? In this section, you'll learn about the federal laws and regulatory agencies that attempt to force monopolies to act more competitively.

Alan Wycheck/Getty Images

Antitrust Legislation and Mergers

Myrleen Ferguson Cate/PhotoEdit

Main Idea **The goal of antitrust legislation is to encourage competition in the economy and to prevent unfair trade practices.**

Economics & You How do you think people in your community would react to an oil monopoly today? Why? Read on to learn about how public pressure caused the government to take the first steps to regulating business over a hundred years ago.

Economics ONLINE

Student Web Activity Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on ***Chapter 9—Student Web Activities*** to learn more about antitrust legislation.

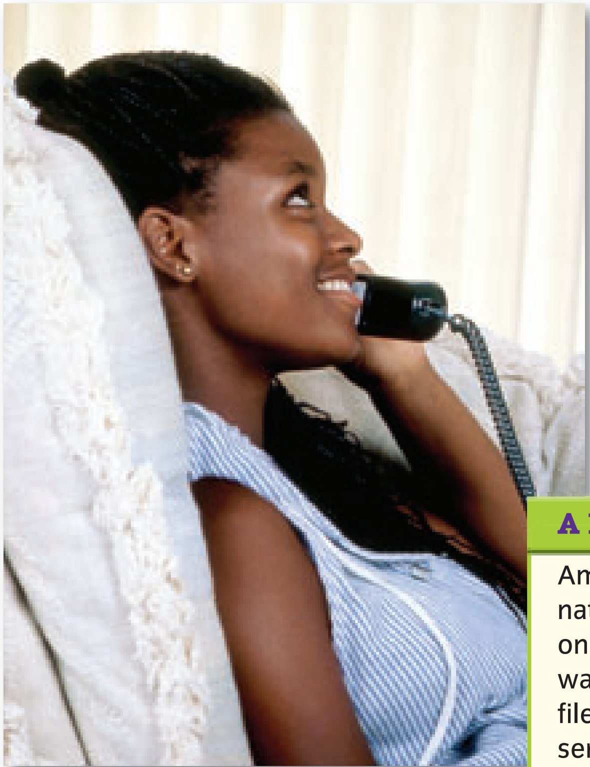
The industrial expansion after the Civil War fueled the rise of big businesses. John D. Rockefeller's Standard Oil Company at the end of the nineteenth century was the most notorious for driving competitors out of business and pressuring customers not to deal with rival oil companies. He also placed members of Standard Oil's board of directors onto the board of a competing corporation. Because the same group of people, in effect, controlled both companies, it was less tempting for them to compete with one another. This practice of creating **interlocking directorates** was perfected by Rockefeller.

interlocking directorate: a board of directors, the majority of whose members also serve as the board of directors of a competing corporation

Public pressure against Rockefeller's monopoly, or trust, over the oil business led Congress to pass the *Sherman Antitrust Act* in 1890. The law sought to protect trade and commerce against unlawful restraint and monopoly. This act was important **antitrust legislation,** or laws to prevent new monopolies or trusts from forming and to break up those that already exist.

antitrust legislation: federal and state laws passed to prevent new monopolies from forming and to break up those that already exist

Because the language of the Sherman Act was so vague, a new law was passed in 1914 to sharpen its antitrust provisions. The *Clayton Act* **prohibited** or limited a number of very specific business practices that lessened competition substantially. The Clayton Act, however, does not state what the term *substantially* means. As a result, it is up to the federal courts and agencies to make a subjective decision as to whether the merging of two corporations would substantially lessen competition.

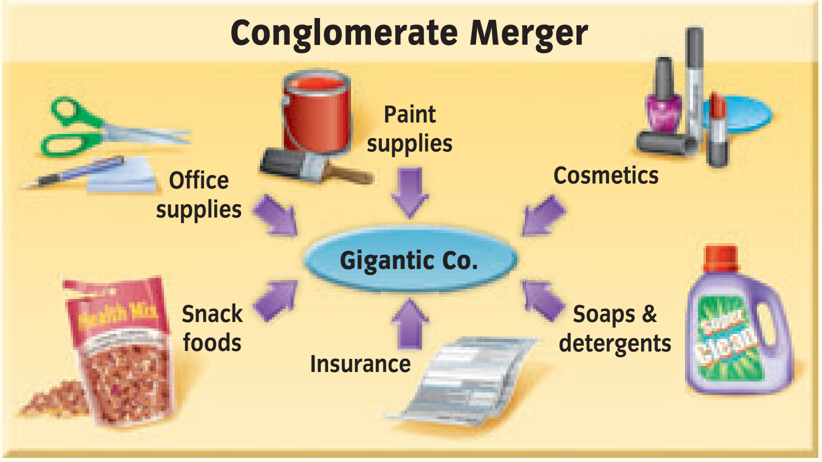


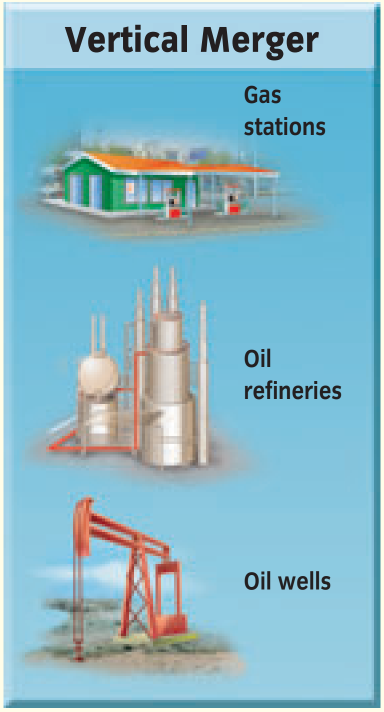
A Former Monopoly

American Telephone & Telegraph (AT&T) was once the nation's largest corporation and held a natural monopoly on telephone service. In 1984, "Ma Bell," as the company was called, was broken up after the settlement of a lawsuit filed by the federal government. Today, the telephone service industry is highly competitive, especially since cell and digital phones have entered the market.

Figure 9.8 Mergers

Horizontal mergers involve businesses that make the same product or provide the same service. **Vertical mergers** take place when firms taking part in different steps of manufacturing come together. A **conglomerate** is a firm that has many businesses, each providing unrelated products or services.





Economic Analysis

Extending *In what ways might mergers benefit corporations?*

Most antitrust legislation deals with restricting the harmful effects of mergers. A **merger** occurs when two or more companies combine into one corporation. As shown in **Figure 9.8** above, three kinds of mergers exist: horizontal, vertical, and conglomerate.

When the corporations that merge are in the same business, a *horizontal merger* has occurred. An example of a horizontal merger occurs when DVD Store A buys DVD Store B. When corporations involved in a "chain" of supply merge, this is called a *vertical merger*. An example would be a paper company buying the lumber mill that supplies it with pulp or buying the office supply business that sells its paper. Another type of merger is the conglomerate merger. A **conglomerate** is a huge corporation involved in at least four or more unrelated businesses. Procter & Gamble, for example, is a multinational conglomerate, with operations in more than 160 countries.

merger: the legal combination of two or more companies that become one corporation

conglomerate: large corporation made up of smaller corporations dealing in unrelated businesses

Reading Check **Contrasting** Explain the difference between horizontal and vertical mergers.

Government Regulation

Main Idea **The aim of government regulatory agencies is to promote efficiency, competition, fairness, and safety.**

Economics & You When you apply for a job, can an employer turn you down because of your race, gender, or ethnicity? Why or why not? Read on to learn about the government's regulatory agencies.

Besides using antitrust laws to foster a competitive atmosphere, the government uses direct regulation of business pricing and product quality. The chart below lists several regulatory agencies that oversee various industries and services. These agencies exist at the federal, state, and even local levels.

deregulation: reduction of government regulation and control over business activity

Although the aim of government regulations is to **promote** efficiency and competition, recent evidence indicates that something quite different has occurred. In the 1980s and 1990s, many industries were **deregulated**—the government reduced regulations and control over business activity. It was found that in trying to protect consumers from unfair practices, government regulations had actually *decreased* the amount of competition in the economy.

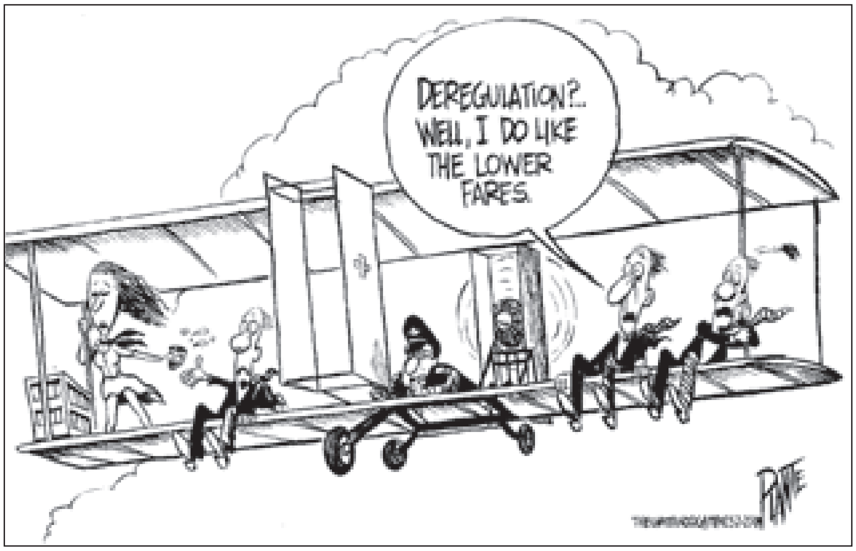
As an example, the Federal Communications Commission (FCC) had for years regulated the basic channels in the television market. With deregulation came the entry of competitive pay-TV, cable, and satellite systems.

Federal Regulatory Agencies

Agency	Function
Federal Trade Commission (FTC) (1914)	Regulates product warranties, unfair methods of competition in interstate commerce, and fraud in advertising.
Food and Drug Administration (FDA) (1927)	Regulates purity and safety of foods,drugs, and cosmetics.
Federal Communications Commission (FCC) (1934)	Regulates television, radio, telegraph, and telephone; grants licenses, creates and enforces rules of behavior for broadcasting; most recently, partly regulates satellite transmissions and cable TV.
Securities and Exchange Commission (SEC) (1934)	Regulates the sale of stocks, bonds, and other investments.
Equal Employment Opportunity Commission (EEOC) (1964)	Responsible for working to reduce workplace discrimination based on religion, gender, race, national origin, or age.
Occupational Safety and Health Administration (OSHA) (1970)	Regulates workplace environment; makes sure that businesses provide workers with safe and healthful working conditions.
Environmental Protection Agency (EPA) (1970)	Develops and enforces environmental standards for air, water, and toxic waste.
Nuclear Regulatory Commission (NRC) (1974)	Regulates the nuclear power industry; licenses and oversees the design, construction, and operation of nuclear power plants.

Bruce Plante/The Chattanooga Times

Many economists speculate about what would happen if the government removed its watchdog responsibility toward mergers in general. Economists assume prices would rise. If, however, the price increases caused profits to be excessive, other sellers would find ways to enter the market. Consumers would benefit eventually from a competitive supply of goods and services. Also, with increased global competition, domestic firms cannot raise prices without attracting foreign rivals. Indeed, global competition has become the biggest competitive threat to many American companies. The few domestic car producers have been battered by foreign competitors. Toyota, Honda, and others have created financial problems for General Motors and Ford.



Bruce Plante, The Chattanooga Times

Government deregulation of the airline industry was designed to lower the price of air travel, but the cartoonist believes this deregulation also had negative consequences.

Reading Check **Determining Cause and Effect** What is one potentially negative result of government regulations?

section 3 Review

Vocabulary

1. **Explain** the significance of: interlocking directorate, antitrust legislation, merger, conglomerate, deregulation.

Main Ideas

2. **Comparing and Contrasting** Complete the chart below by listing some advantages and disadvantages of government control of business.

Interactive Graphic Organizer

	Regulation	Deregulation
Advantages		
Disadvantages		

Critical Thinking

3. **The BIG Idea** Explain how the Sherman Antitrust Act and the Clayton Act limited profits for some businesses.
4. **Determining Cause and Effect** How might a merger help a business be more efficient and increase profits?

Applying Economics

5. **Conglomerates** Type "conglomerate" into an Internet search engine. Research one of the conglomerates that you find, and list all of the businesses or products owned by that conglomerate.

BusinessWeek SPOTLIGHT on the Economy

JENS WOLF/dpa /Landov

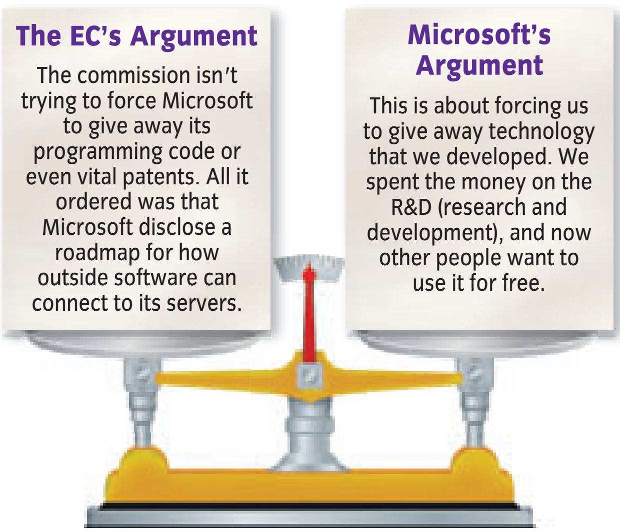
A WINDOW INTO MICROSOFT'S BATTLE

Antitrust rulings aim to open Microsoft's Windows to competitors' products.

Check It Out! In this chapter you learned about monopolies. This article discusses the technological monopoly that Microsoft holds and the antitrust cases trying to change that.

The long-running antitrust battle between Microsoft and the European Commission (EC) revolves around two separate issues: Microsoft's bundling of its Media Player into Windows, and whether the company must disclose secret software protocols to rivals. . . .

Microsoft's argument is analogous to shoes and shoelaces. While consumers can and do buy shoelaces separately, they also expect at least one pair to be included when they buy new shoes. The company will argue that modern consumers similarly now demand a media player built into the operating system. . . .



High-end Windows operating system

The arguments over server interoperability are more complex. . . . Microsoft claims it shouldn't be forced to disclose its server interface information because the software makers who want to use it aim to enhance their existing products to compete against Microsoft.

Microsoft's rivals, naturally, take a different view. While courts largely lean towards protecting the intellectual property rights of inventors, things change when the holder of the copyright or patent is a monopolist with the ability to shape markets.

—Reprinted from *BusinessWeek*

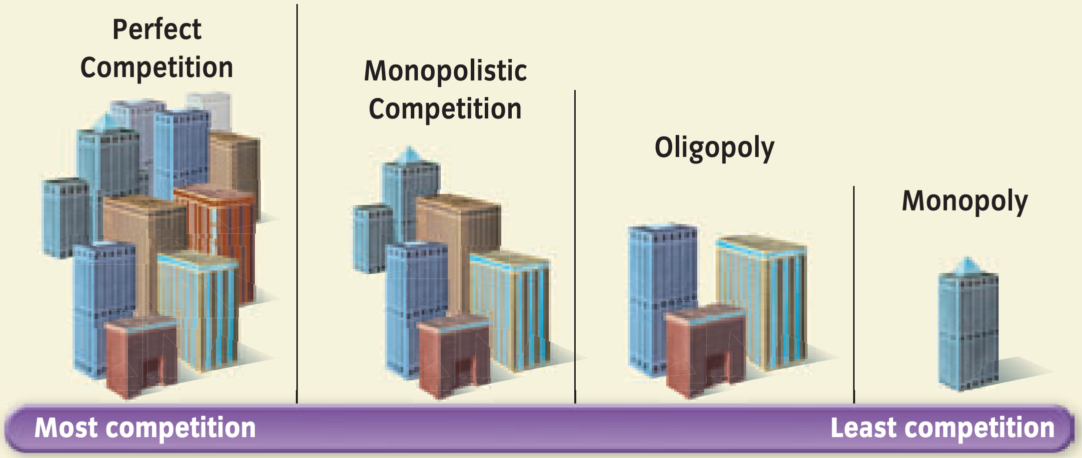
Think About It

1. **Discussing** What arguments does Microsoft use to justify its technological monopoly?
2. **Assessing** According to the article, why might the intellectual property of Microsoft not be protected?

chapter 9 Visual Summary

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

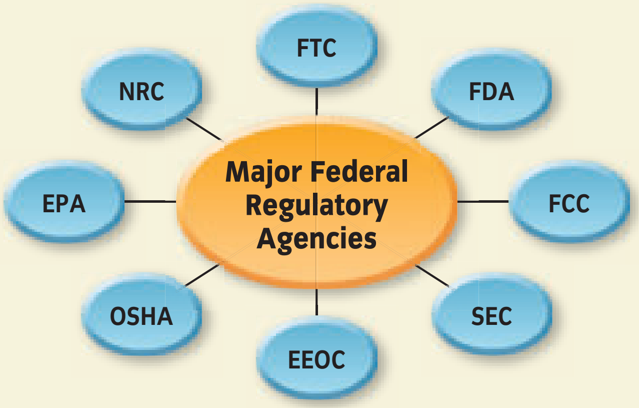
■ Of the **four basic market structures**, perfect competition and monopolies are rare, while monopolistic competition and oligopolies are much more common.



■ The **level of competitiveness** in a particular market is determined by several factors.

Factors of Competitiveness in Markets	
1	Size of the market
2	Number of sellers in the market
3	Whether or not there are barriers to entry
4	How differentiated the products are
5	How much control over price the sellers have
6	Whether or not substitutes exist for the product

■ **Government regulatory agencies** seek to promote efficiency, competition, fairness, and safety.



chapter 9 Assessment & Activities

Review Content Vocabulary

1. *Write a paragraph or two explaining market structures and their characteristics. Use all of the following terms.*

market structure	monopolistic competition
perfect competition	cartel
monopoly	barriers to entry
oligopoly	economies of scale

2. *Now write a paragraph summarizing how the government tries to regulate unfair business practices. Use all of the following terms.*

antitrust legislation	conglomerate
merger	deregulation

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. initial	e. dominate
b. interact	f. prohibit
c. unique	g. promote
d. revolution	

3. A completely ________ business would have no competition because there would be nothing else like it in the marketplace.
4. In perfect competition, there is nothing to ________ the entry of new sellers in a market.
5. Supply and demand ________ to reach an equilibrium price.
6. New sellers have easier entry into a market when the ________ costs of investment are small.
7. An oligopoly exists when a small number of companies ________ an industry.
8. The government tries to ________ competition through regulation.
9. Every few years, a new technological ________ spurs fresh competition in the marketplace.

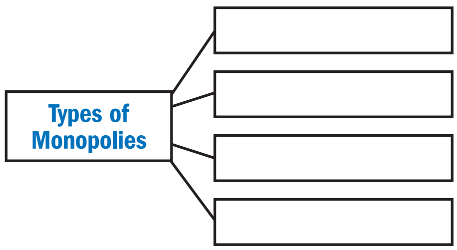
Review the Main Ideas

Section 1 (pp. 231–235)

10. What five conditions are necessary for perfect competition to exist?
11. In a perfectly competitive market structure, how much control does a single seller have over market price?
12. What is one example of an almost perfectly competitive market?

Section 2 (pp. 236–243)

13. What are the three types of market structures with imperfect competition?
14. Fill in a graphic organizer like the one below to list and describe the four categories of pure monopolies.



15. How much control does an oligopoly have over price? Why?
16. What are the differences between an oligopoly and monopolistic competition?

Section 3 (pp. 245–249)

17. What is the difference between a horizontal merger and a vertical merger?
18. What two methods does the federal government use to keep businesses competitive?

Thinking Like an Economist

List some industries that are regulated by government (common examples include electricity providers, broadcast television, airlines). Choose one, and then fill in a chart like the one below to help you analyze the advantages and disadvantages of government regulation of this industry. Then answer the questions that follow.

Regulation	
Advantages	**Disadvantages**

19. In your opinion, should this industry be regulated by the government? Why or why not?
20. What would happen if this industry were to be completely deregulated? Justify your opinion with logical arguments and examples.

Economics ONLINE

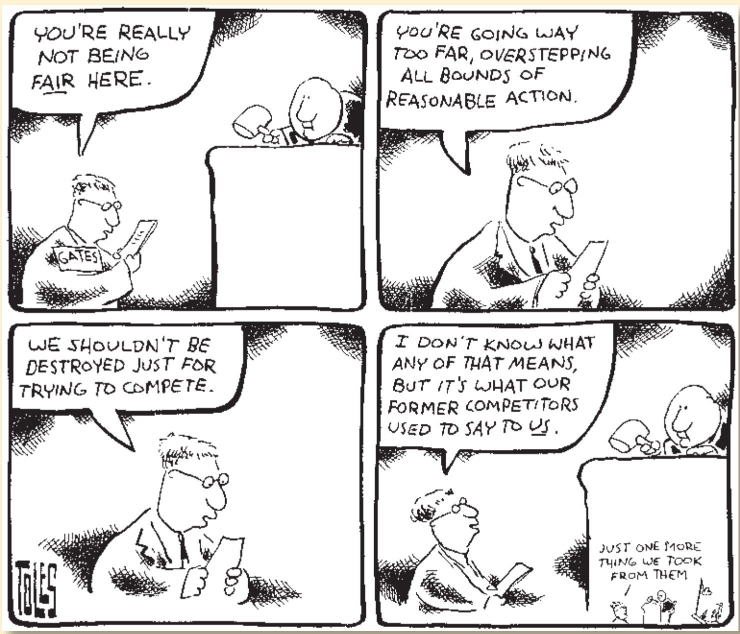
Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on ***Chapter 9—Self-Check Quizzes*** to assess your knowledge of chapter content.

Critical Thinking

21. **The BIG Idea** Why is more competition generally good for consumers? What effect does competition have on suppliers?
22. **Explaining** Why are oligopolies typically interdependent?
23. **Contrasting** What are the basic differences between the goals of antitrust legislation and the goals of federal government regulatory agencies?
24. **Predicting** In a situation of perfect competition, what would happen if barriers to entry in the market suddenly sprang up?

Analyzing Visuals

25. Study the cartoon on the right, and then answer the following questions.
    a. Who do the two men pictured in this cartoon represent?
    b. What has happened to the speaker's competition?
    c. With what crime does the cartoon imply the man has been charged?



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Debating Economic Issues

Should price gougers be punished?

"Price gouging" is what happens when businesses sharply raise the prices of essential goods such as food, clothing, shelter, medicine, gasoline, and equipment needed to preserve lives and property during emergencies. After Hurricane Katrina in 2005, oil companies hiked the average price of gasoline by one-third or more, blaming damage to refineries in the Gulf of Mexico and increases in the price they paid for crude oil. Consumers complained that the price increases amounted to unjustifiable profits for the oil companies. In some states, price gouging is a felony, but few companies are actually penalized. Should laws against price gouging be toughened and enforced?

NO! All prices should be determined by supply and demand

Prices are not just arbitrary numbers plucked out of the air. Nor are the price levels that you happen to be used to any more special or "fair" than other prices that are higher or lower. . . . The new prices make as much economic sense under the new conditions as the old prices made under the old conditions.

What do prices do? They not only allow sellers to recover their costs, they force buyers to restrict how much they demand. . . . What if [hotel] prices were frozen where they were before [Katrina] happened?. . . . At higher prices, a family that might have rented one room for the parents and another for the children will now double up in just one room because of the "exorbitant" prices. That leaves another room for someone else. It is essentially the same story when stores are selling ice, plywood, gasoline, or other things for prices that reflect today's supply and demand, rather than yesterday's supply and demand. Price controls will not cause new supplies to be rushed in nearly as fast as higher prices will.

—Thomas Sowell, economist

Getty Images

YES! The health of the nation's economy depends on regulating gas prices

At best, 10 percent of production was shut down [after Hurricane Katrina hit]. . . . That's 10 percent of one-fourth of U.S. demand—a tiny amount . . . while gas prices rose 25–35 percent and even more in some areas. Not often mentioned . . . was the fact that the world price of oil actually *fell* by almost 10 percent over the same period.

. . . When the per barrel price of crude falls, the price at the pump hangs at its high level, sometimes for weeks, but if crude goes up, so does the pump price. Consumers can't shop for bargains, because all gas stations behave the same way. For the most part, though, it's not the stations that are doing this gouging . . . but rather the oil companies themselves.

. . . If Congress and the White House were serious about combating price rigging, coordinated production slowdowns, and artificial scarcities, they would be changing the anti-trust laws so that the objective existence of anti-competitive pricing and production alone would be illegal, not just [the current requirement of] deliberate conspiring to fix prices.

—Dave Lindorff, author, *This Can't Be Happening: Resisting the Disintegration of American Democracy*

Price gouging might happen after a natural disaster, such as a flood or hurricane.

Debating the Issue

1. **Explaining** How do high gasoline prices affect American families?
2. **Choosing Sides** Do you believe oil companies should be allowed to charge whatever people will pay for gasoline? Why or why not?

Find Out More!

3. **Analyzing** Using the Internet or other resources, learn more about alternatives to paying high prices for gasoline. Which solution or solutions do you think would best solve the problem?

Rick Wilking/Reuters/Corbis