CHAPTER 9

Competition and Monopolies

Why It's Important

How do airlines determine airfares? Why do farmers' markets often charge the same price for their produce during the summer? This chapter will explain how competition—or the lack of it—determines the prices you pay.

To learn more about competition, view the **Economics & You** *Chapter 8 video lesson:* **Competition and Monopolies**

ECONOMICS Online

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

SECTION 1

Perfect Competition

Cover Story

Business Week, March 22, 1999

By December, Boston could get a lot closer to New York and Washington—at least by train. That's when Amtrak's new high-speed rail service, dubbed Acela, will start operating. With Acela, some New York–Boston trips will take just 3 hours, vs. 4½ now. And all new trains will have computer jacks and food service. Amtrak aims to compete head-on with airline shuttles.

Reader's Guide

Terms to Know

- market structure
- perfect competition

Reading Objectives

1. What are the five conditions of perfect competition?
2. Why is agriculture often considered an example of perfect competition?
3. How does perfect competition benefit society?

Competition—one of the basic characteristics of our market economic system—is advantageous to consumers for several reasons. First, it provides us with choices. As noted in the *Cover Story* above, people traveling from Boston to New York now have a choice of going by plane or train. Competition is advantageous for another reason as well. Having many competing suppliers of a product leads to a surplus and, thus, lower prices. As you can imagine, for this reason each supplier would like to have as little competition as possible.

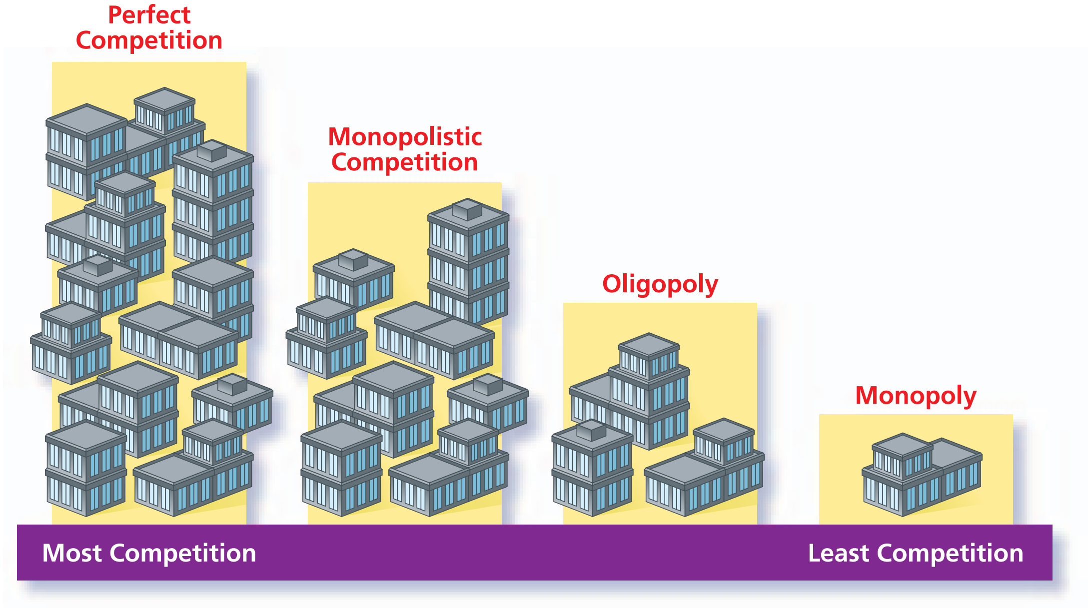
Market Structure

In Chapter 8 you learned that businesses are 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 by the amount of competition they face. **Figure 9.1** on page 234 shows the four basic market structures in

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

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.



the American economy: perfect competition, monopolistic competition, oligopoly, and monopoly. In this section you'll learn about the ideal market structure of perfect competition.

Conditions of Perfect Competition

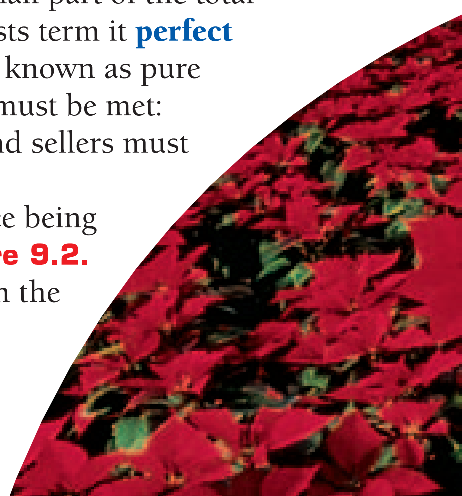
All businesses must engage in some form of competition as long as other businesses produce similar goods or services. When a market includes so many sellers of a particular good or service that each seller accounts for a small part of the total market, a special situation exists. Economists term it **perfect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

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

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

(2) A Similar Product The good or service being sold must be nearly identical. See **Figure 9.2.**

(3) Easy Entry and Exit Sellers already in the market cannot prevent competition, or



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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.

No Control Over Price When the above five conditions are met, the workings of supply and demand control the price, not a single seller or buyer. On the supply side, perfect competition requires a large number of suppliers of a similar product. On the demand side, perfect competition requires a large number of informed 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 charging 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. While information about prices, quality, and sources of supply might have been hard and costly to obtain in the past, that is not true today. Virtually anyone with access to the Internet can find out the lowest prices of just about anything.

FIGURE 9.2

Perfect Competition
Having a similar product and easy entry into the market—such as greenhouses do—are two conditions of perfect competition. ***What three other conditions must be met for perfect competition?***

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Agriculture as an Example

Few perfectly competitive industries exist in the United States. The one that perhaps comes closest is the agricultural market. It is often used as an example of perfect competition because individual farmers have almost no control over the market price of their goods. **Figure 9.3** applies the five conditions of perfect competition to the wheat market.

No Control Over Wheat Prices No single farmer has any great influence on price. The interaction of supply and demand determines the price of wheat. The supply is the total supply of all the wheat that farmers produce. The demand is the total demand for all uses of wheat. The equilibrium price is the price where supply and demand intersect.

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 demand for wheat and other agricultural products is somewhat different from the demand for many other products. People's demand for wheat is, for the most part, inelastic. People can use wheat in only so many ways, and people can eat only so many wheat products. So even if the price of wheat were to increase or drop dramatically, 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, as shown in **Figure 9.4.**

FIGURE 9.3

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 Similar 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 the price is very small.

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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 because it means that consumers 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 such products 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.

FIGURE 9.4

Agricultural Disasters Affect Supply Variations in weather, a crop disease, or a crop-destroying insect can wipe out entire harvests. 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.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 1 Assessment

Understanding Key Terms

1. **Define** market structure, perfect competition.

Reviewing Objectives

2. **Graphic Organizer** Use a diagram like the one below to explain the five conditions of perfect competition.

3. Why is agriculture often considered an example of perfect competition?
4. How does perfect competition benefit society?

Applying Economic Concepts

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

Critical Thinking Activity

6. **Summarizing Information** In this section, you learned that the Internet has made the United States economy more competitive. Use a search engine to find information about the market price of your favorite automobile.

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CRITICAL THINKING SKILLS

Drawing Inferences and Conclusions

To infer *means to evaluate information and arrive at a conclusion. When you make inferences, you "read between the lines," or draw conclusions that are not stated directly in the text.*

- Read carefully for stated facts and ideas.
- Summarize the information and list the important facts.
- Apply related information that you may already know to make inferences.
- Use your knowledge and insight to develop some conclusions about these facts.

LEARNING THE SKILL

To learn how to make inferences and draw conclusions, follow the steps listed on the left.

PRACTICING THE SKILL

Read the passage below, then answer the questions.

"[A] landmark 1996 bill gave farmers the freedom to plant what they wanted, when they wanted. But it also swept away much of the financial safety net of price supports for U.S. crops. . . . The next time agriculture hit a downdraft, would Washington really let the market work?

Dumb question. In 1999, Uncle Sam will dole out some $14.4 billion to farmers. . . .

This is no way to run farm policy. Indeed, it's a simple law of economics that the prospect of bailouts in times of trouble leads farmers to take more risks, such as planting additional, marginal acres. That makes the system less efficient. . . ."

–*Business Week*, June 28, 1999

1. What facts are presented in the passage?
2. What can you infer about the occupation of the passage's author? Is he or she a farmer? Explain.
3. Can you conclude that the agricultural sector is a perfectly competitive market? Explain.

APPLICATION ACTIVITY

Apply the five conditions of perfect competition to the soft drink industry. Would you conclude that it is perfectly competitive? Explain.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 2

Monopoly, Oligopoly, Monopolistic Competition

Cover Story

Business Week, February 1, 1999

When Gillette Co. unveiled Mach3, the world's first triple-blade razor, it took a bold gamble. . . . Mach3 cartridges were to sell for around $1.60 each. Skeptics predicted the personal-care giant would soon be forced to cut that price. But the price is holding and Mach3 has become the No. 1 blade and razor.

What's the secret to pricing power? For starters, a commitment to innovation. Gillette spent nearly $1 billion on the development and initial marketing of Mach3.

Reader's Guide

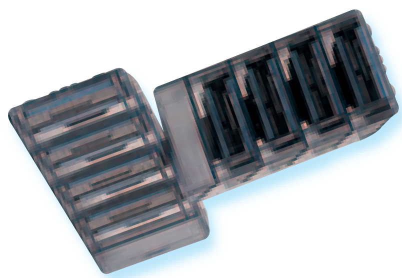
Terms to Know

- monopoly
- barriers to entry
- economies of scale
- patent
- copyright
- oligopoly
- product differentiation
- cartel
- monopolistic competition

Reading Objectives

1. What are four characteristics of a pure monopoly?
2. What characterizes an oligopoly?
3. What are five characteristics of monopolistic competition?

Imagine spending $1 billion on the development and advertising of a razor blade—a common shaving tool. Would that much advertising be worth it? It would if customers paid whatever price you asked for the razors. As you read this section, you'll learn that advertising plays a major role in two types of market structures.



Imperfect Competition

As mentioned in Section 1, perfect competition is an ideal type of market structure. Most industries in the United States, in

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contrast, represent some form of *imperfect* competition. Economists classify these three types of imperfect market structures as monopoly, oligopoly, or monopolistic competition. They differ from one another on the basis of how much competition and control over price the seller has.

FIGURE 9.5

Local Electric Companies

Because some local electric utilities are the sole providers, and the consumer has no other option, they are monopolies.

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

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

Monopoly

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 the price. A few such markets do exist in the real world. As shown in **Figure 9.5,** some local electric utility companies are the sole providers for a community. The consumers have no other option but to purchase electric power from these monopolies.

Characteristics of a Monopoly A monopoly is characterized by four conditions:

(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) No 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.

In a pure monopoly, the supplier can raise prices without fear of losing business to competitors. Unless buyers choose to pay the new price, they have nowhere else to buy the good or service. A monopolist, however, cannot charge outrageous prices. Even in a monopolistic market, the law of demand is still operating. As the price of a good or service rises, consumers buy less.

Barriers to Entry 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? As mentioned above, a monopoly is protected by **barriers to entry**—obstacles that prevent others from entering the market.

The most obvious barrier into a monopolistic market is a legal one. Some state laws, for example, prevent a competing electric, gas, or water company from operating in an area where a public utility company already provides service. The reasoning against competition in public utility industries is the fear that too much competition may lead to wasteful duplication. Imagine the inefficiency of three or four competing water companies all trying to lay water mains along your street.

Another barrier to entry is the cost of getting started. Called "excessive money capital costs," this barrier is found in industries such as cars and steel, in which initial investment is high because of the amount and cost of the equipment. See **Figure 9.6.**

Ownership of essential raw materials can also provide a barrier to entry. A good example is the diamond industry. The DeBeers Company of South Africa controls the marketing of nearly all the world's diamonds.

Types of Monopolies Pure monopolies can be separated into four categories depending on why the monopoly exists. As shown in **Figure 9.7** on page 242, the four types of monopolies are natural, geographic, technological, and government.

In the past it was thought to be more efficient, or natural, to have just one company providing a public good or service. This belief led the government to grant exclusive rights to *natural monopolies*—providers of such things as utilities, bus service, and cable TV. The large size, or scale, of most natural monopolies seemed to give them **economies of scale**—by which they could produce the largest amount for the lowest cost. It is now being realized that advances in technology can make these industries more competitive, however. Government is making moves to deregulate and open them up for competition.

A grocery store in a remote Alaskan village is an example of a monopoly caused by geographic factors. Because the potential for profits is so small, other businesses choose not to enter, thus giving the sole provider a *geographic monopoly.* These types of monopolies are declining, however, as competition arises from mail-order and Internet catalogs and delivery services.

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.

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.

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

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*

FIGURE 9.6

Barriers to Entry Huge startup costs keep some businesses from entering certain industries.

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FIGURE 9.7

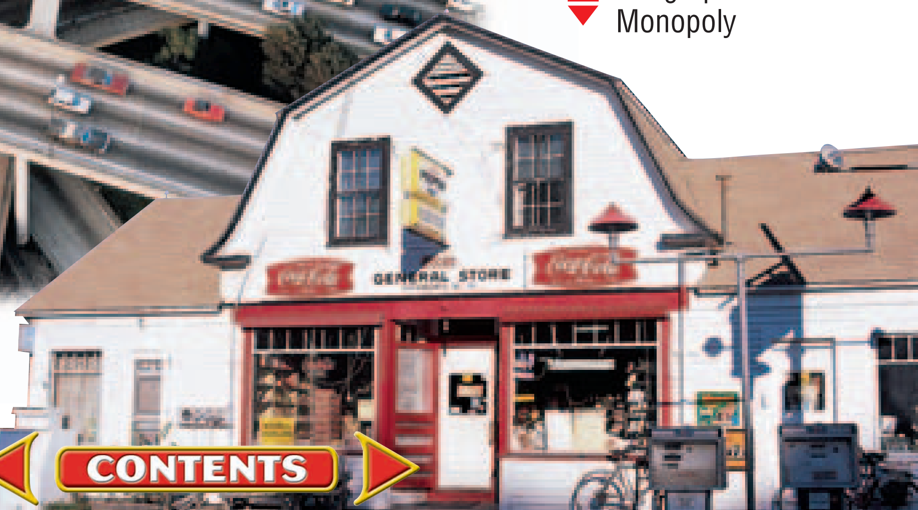
Types of Monopolies Monopolies exist for several reasons. ***Which type of monopoly, if any, do you think is justified? Explain your response.***

B Technological Monopoly

A Natural Monopoly

C Government Monopoly

D Geographic Monopoly



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How Important Are Monopolies Today? Monopolies are far less important than they once were. As noted earlier, geographic monopolies have little effect because of potential competition from mail-order businesses and electronic commerce on the Internet. Natural monopolies are being broken up by technology 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.

Global Economy

Reducing Postal Monopolies

The monopoly that national postal services have enjoyed is now being whittled away by technology. Overnight delivery companies such as Federal Express, Airborne Express, and United Parcel Service (UPS) offer faster delivery but at premium prices. And the widespread use of fax machines and electronic mail (E-mail) has virtually eliminated any remaining monopoly power that national postal services held. ■

Oligopoly

Unlike a monopoly with just one supplier, an **oligopoly** is an industry dominated by *several* suppliers who exercise some control over price. For a market structure to be labeled an oligopoly, it must meet the following conditions:

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

(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.

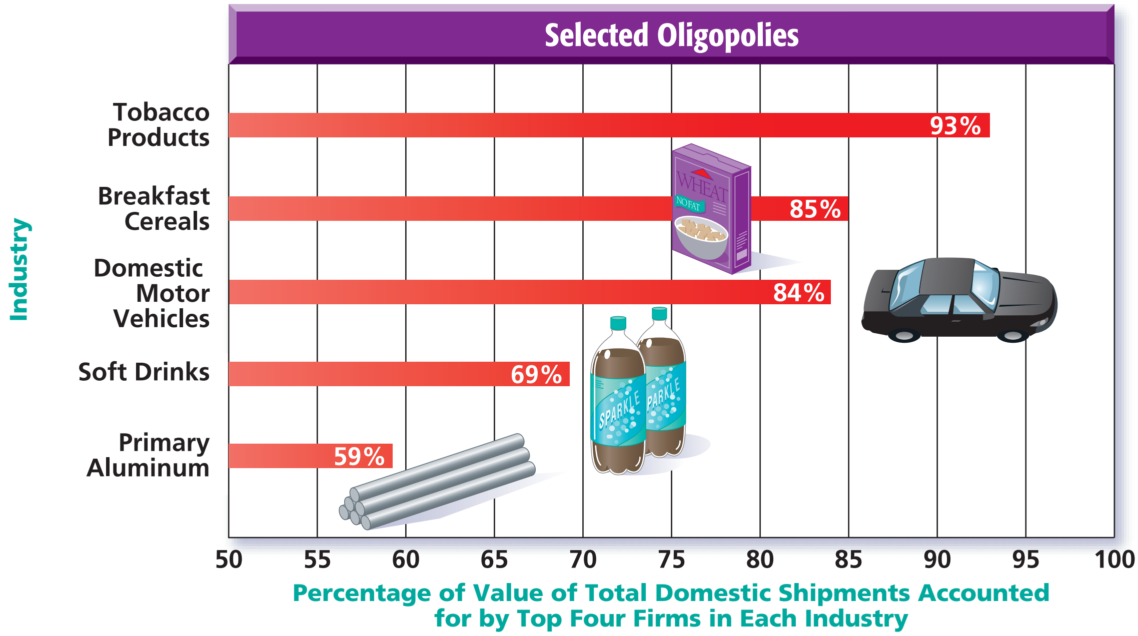
(4) Nonprice Competition Advertising emphasizes minor differences and attempts to build customer loyalty.

(5) Interdependence Any change on the part of one firm will cause a reaction on the part of other firms in the oligopoly.

Figure 9.8 on page 244 shows a number of industries in which the four largest firms produce more than 80 percent of the total industry output. All of these industries are oligopolies.

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

FIGURE 9.8 **Oligopolies** Oligopolies exist in a number of industries throughout the United States. Here several industries are highlighted.



Source: U.S. Bureau of the Census

Product Differentiation We mentioned earlier that 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. However, they spend millions, if not billions, of advertising dollars per year to differentiate their products in your mind—and to win your consumer dollars.

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 airline cuts its airfares to gain market share, for example, the other major 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 lead to less competition, which raises prices in the long run.

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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.

Cartels An important 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*

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 large number of sellers offer similar but slightly different products. Obvious examples are brand-name items such as toothpaste, cosmetics, and designer clothes. To be a monopolistic competitor, five conditions must be met:

(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.

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. Monopolistic competition has many firms, no real interdependence, and some slight difference among products.

CAREERS

Graphic Designer

Job Description

- Create art using print, electronic, and film media to meet client's needs
- Create promotional displays, marketing brochures, and television graphics

Qualifications

- Bachelor's and/or master's degree in fine arts
- Training in computer design techniques

Median Salary: $34,570

Job Outlook: Good

—*Occupational Outlook Handbook,* 2002–03

Advertising Competitive advertising is even more important in monopolistic competition than it is in oligopolies. As shown in **Figure 9.9,** 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.

FIGURE 9.9

Advertising Ads lead to product differentiation and competition for consumer dollars. Businesses also compete for shelf space—space on store shelves for displaying their products and attracting buyers.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 2 Assessment

Understanding Key Terms

1. **Define** monopoly, barriers to entry, economies of scale, patent, copyright, oligopoly, product differentiation, cartel, monopolistic competition.

Reviewing Objectives

2. What are the four characteristics of a pure monopoly?
3. What characteristics of an oligopoly allow it to have a limited control over price?
4. **Graphic Organizer** Use a chart like the one in the next column to compare a monopolistic competitor to an oligopoly in regard to these categories: number of sellers, difficulty of market entry, product differentiation, nonprice competition, and amount of control over price.

Category	Monopolistic Competition	Oligopoly

Applying Economic Concepts

5. **Product Differentiation** Give three examples of products you have bought recently based on advertising, not price. How does your consumer behavior justify product differentiation?

Critical Thinking Activity

6. **Synthesizing Information** Develop a print or video advertisement using yourself as the hardworking product. Use product differentiation to explain why an employer should "purchase" you.

BusinessWeek

SPOTLIGHT ON THE ECONOMY

Celebrity Can Really Be a Gas

Check It Out! In this chapter, you learned that oligopolists and monopolistic competitors use product differentiation to attract customers. In the following article, read to learn how one celebrity puts nonprice competition to work for him.

Mario Andretti

Air Jordan shoes. Martha Stewart towels. Now, how's this for the latest in celebrity branding? Mario Andretti unleaded. Yes, the 58-year-old retired racing legend is licensing his name to Texaco gas stations on the West Coast in the hopes of eventually taking the Andretti gas brand nationwide.

The first 37,000-square-foot Andretti mega-station opened in San Francisco in January. It has 10 gas pumps, as well as a Burger King and Starbucks, which lease space from Mario Andretti Petroleum LP. In coming months, Texaco will put the Andretti label on five existing California gas stations, adding "Winning Finish" car washes and "Quick Pit" service bays, branding exclusive to Andretti.

Celebrity evidently sells well. Sales at the San Francisco flagship already total 80% of first-year projected revenues of $5 million, says the partnership. The gas isn't any better than rivals', admits Andretti. But he boasts that the service is. The Indy 500 champ regularly visits his namesake station to make sure. He sometimes even lends a hand to surprised motorists. "I'll pump your gas and clean your windshield, no problem," he says. Now, if he would only drive folks home in the evening rush . . .

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Think About It

1. **Are goods or services more important at Andretti's mega-station?**
2. **How does Andretti differentiate his products from others?**

SECTION 3

Government Policies Toward Competition

Reader's Guide

Terms to Know

- interlocking directorate
- antitrust legislation
- merger
- conglomerate
- deregulation

Reading Objectives

1. What is the difference between interlocking directorates and mergers?
2. What is the purpose of federal regulatory agencies?
3. How has some regulation hurt consumers?

Cover Story

Bergen Record, April 23, 1999

The Federal Trade Commission (FTC) reviews mergers to ensure that they do not substantially lessen competition. The agency certainly was busy in 1998. In that year, the number of announced mergers involving American companies exceeded 7,750. A survey conducted in 1999 suggests that the FTC's workload will not dwindle in the near future. Of the companies polled in the survey, more than one third said that they intended to acquire other companies within the year.

Historically, one of the goals of government in the United States has been to encourage competition in the economy. In this section, you'll learn about the federal laws and regulatory agencies—including the Federal Trade Commission mentioned above—that attempt to force monopolies to act more competitively.

Antitrust Legislation

The industrial expansion after the Civil War fueled the rise of big businesses. John D. Rockefeller's Standard Oil Company 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*

Sherman Antitrust Act 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. The Sherman 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*

Clayton Act Because the language in 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 government to make a subjective decision as to whether the merging of two corporations would substantially lessen competition. **Figure 9.10** on page 250 details the Clayton Act and other antitrust legislation.

Mergers

Most antitrust legislation deals with restricting the harmful effects of mergers. A **merger** occurs when one corporation joins

merger: *a combined company that results when one corporation buys more than half the stock of another corporation and, thus, controls the second corporation*

Economic Connection to... *Literature*

Muckrakers

The rise of monopolies in the late 1800s contributed to the development of a new kind of journalism—muckraking. The muckrakers wrote stories exposing corruption in business and politics. One of the most famous muckrakers was Ida Tarbell. She wrote a series of articles that attacked John D. Rockefeller's monopoly, the Standard Oil Company.

In great detail, Tarbell showed how Rockefeller used unfair practices to drive his competitors out of business. She even likened Rockefeller to a crooked gambler: "Mr. Rockefeller has systematically played with loaded dice. . . . Business played in this way . . . is fit only for tricksters." Tarbell's words led to a government investigation of Standard Oil's business practices. ■

FIGURE 9.10 Antitrust Legislation

Federal Law	Function
Sherman Antitrust Act (1890)	Outlawed agreements and conspiracies that restrain interstate trade. Made it illegal to monopolize or even attempt to monopolize any part of interstate commerce.
Clayton Act (1914)	Restricted *price discrimination*—the practice of selling the same good to different buyers at different prices. Prohibited sellers from requiring that a buyer not deal with a competitor. Outlawed interlocking directorates between competitors. Outlawed mergers that lessen competition substantially.
Federal Trade Commission Act (1914)	Established the Federal Trade Commission (FTC) as an independent antitrust agency. Gave the FTC power to bring court cases against private businesses engaging in unfair trade practices.
Robinson-Patman Act (1936)	Strengthened the law against charging different prices for the same product to different buyers. An amendment to the Clayton Act of 1914.
Celler-Kefauver Antimerger Act (1950)	Strengthened the law against firms joining together to control too large a part of the market. An amendment to the Clayton Act of 1914.
Hart-Scott-Rodino Antitrust Improvements Act (1976)	Restricted mergers that would lessen competition. Required big corporations planning to merge to notify the Federal Trade Commission (FTC) and the Department of Justice, who would then decide whether to challenge the merger under the terms of the Clayton Act of 1914.

with another corporation. As shown in **Figure 9.11,** three kinds of mergers exist: horizontal, vertical, and conglomerate.

When the two corporations that merge are in the same business, a *horizontal merger* has occurred. An example of a horizontal merger occurs when Video Store A buys Video 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.

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

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 is a multinational conglomerate. With operations in more than 160 countries, it produces or has acquired such businesses as Cover Girl cosmetics, Pert Plus shampoo, Clearasil skin care, Folgers coffee, Pringles potato chips, Jif peanut butter, Crest toothpaste, NyQuil cough medicine, Dawn dish soap, Cheer and Tide laundry detergent, Pampers diapers, and Charmin toilet paper.

Regulatory Agencies

Besides using antitrust laws to foster a competitive atmosphere, the government uses direct regulation of business pricing and product quality. **Figure 9.12** on page 252 lists several regulatory agencies that oversee various industries and services. These agencies exist at the federal, state, and even local levels.

FIGURE 9.11

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 at least four businesses, each making unrelated products.

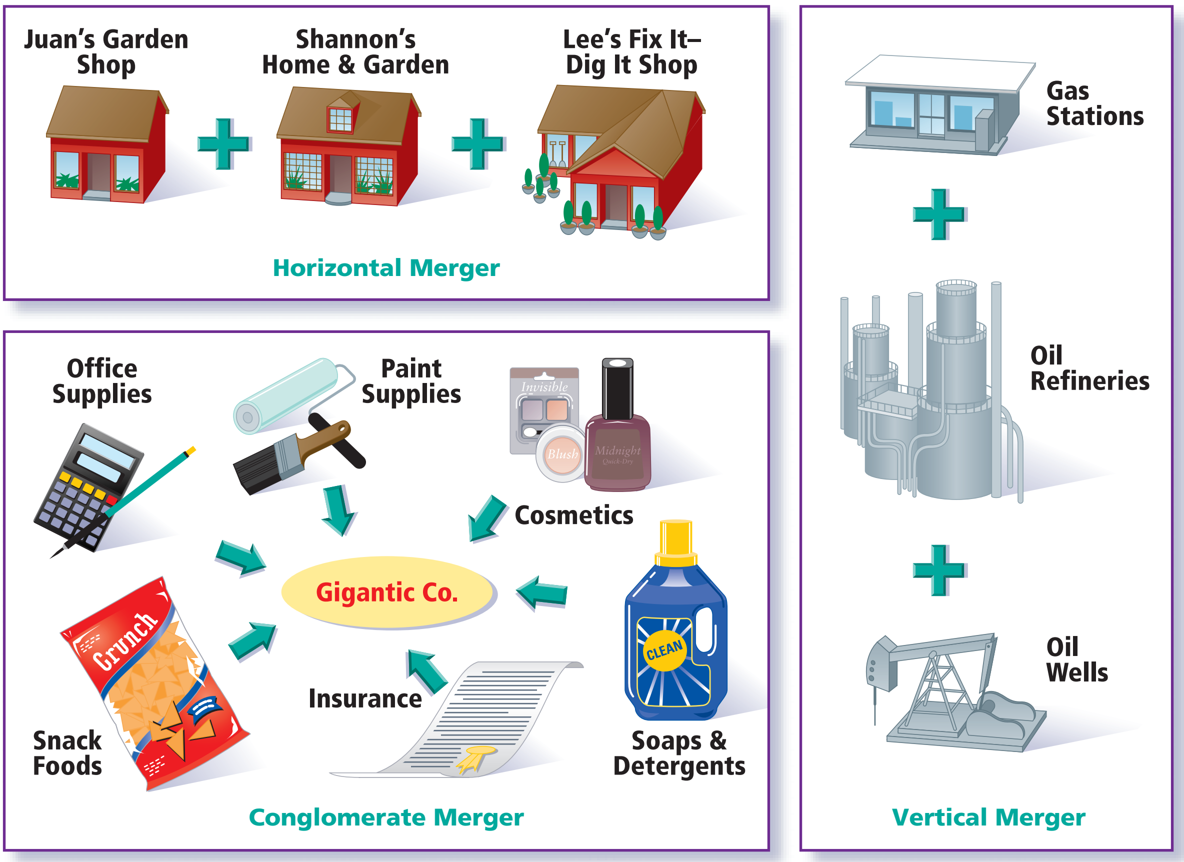

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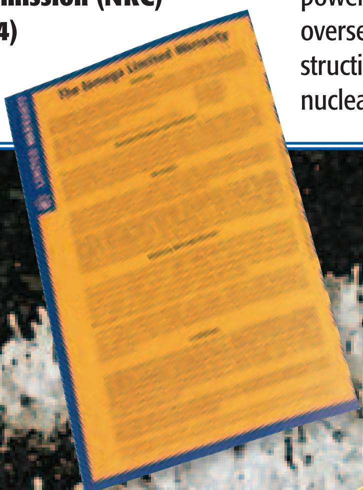
FIGURE 9.12

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 discrimination based on religion, gender, race, national origin, or age.
Occupational Safety and Health Administration (OSHA) (1970)	Regulates the 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.



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Deregulation 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.

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.

ECONOMICS Online

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

CLICK HERE

deregulation: *reduction of government regulation and control over business activity*

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 3 Assessment

Understanding Key Terms

1. **Define** interlocking directorate, antitrust legislation, merger, conglomerate, deregulation.

Reviewing Objectives

2. What is the difference between interlocking directorates and mergers?
3. **Graphic Organizer** Use a chart like the one below to describe the purpose of five federal regulatory agencies.

Agency	Purpose

4. How has some regulation hurt consumers?

Applying Economic Concepts

5. **Regulation** If the shampoo you just bought caused your hair to fall out, which regulatory agency should you contact to complain? Why? What agency should you contact if the new washing machine your family just bought breaks down, and the manufacturer refuses to honor the warranty?

Critical Thinking Activity

6. **Categorizing Information** Type *conglomerate* into a search engine. Research one of the conglomerates that you find, and list all the businesses or products owned by that conglomerate.

People & Perspectives

- Cofounder and chief executive officer of Microsoft
- Recipient of the 1993 Price Waterhouse Leadership Award for Lifetime Achievement
- "The richest man in the world" according to *Forbes Magazine*'s annual survey

William Gates

ENTREPRENEUR (1955–)

In the book *The Road Ahead* (1996), Bill Gates explains his vision of an interconnected world built around the Internet:

"Over the next decade, businesses worldwide will be transformed. Intranets will revolutionize the way companies share information internally, and the Internet will revolutionize how they communicate externally. Corporations will redesign their nervous systems to rely on the networks that reach every member of the organization and beyond into the world of suppliers, consultants, and customers. These changes will let companies be more effective and often smaller. In the longer run, as broadband networks make physical proximity to urban services less essential, many businesses will decentralize and disperse their activities, and cities may be downsized too.

Even the smallest of all businesses, the individual earning a living in a profession or as an artist, has been empowered by the PC. One person without any staff can produce reports, handle correspondence, bill customers, and maintain a credible business presence—all surprisingly easily. In field after field, the tools of the trade have been transformed by PCs and software.

All of these electronic innovations—e-mail, shared screens, videoconferencing, and video phone calls—are ways of overcoming physical separation. As they become commonplace, they'll change not just the way we work together but also the distinction we make between the workplace and everywhere else."

Checking for Understanding

1. In Gates's opinion, what will be the long-term impact of intranets and the Internet?
2. How does Gates characterize electronic innovations?

CHAPTER 9 Summary

ECONOMICS Online

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

CLICK HERE

SECTION 1 Perfect Competition

- There are four basic **market structures** in the United States: **monopoly, oligopoly, monopolistic competition,** and **perfect competition.**
- Perfect competition is characterized by numerous buyers and sellers, an identical product, easy entry into the market, easy access to information about prices, and no control over price.
- The market for agricultural products is often used as an example of perfect competition because individual farmers have almost no control over the market price of their goods.
- When perfect competition exists, society benefits from its efficient allocation of productive resources.

SECTION 2 Monopoly, Oligopoly, Monopolistic Competition

- In a monopoly, a single seller controls the supply of the good or service and thus determines the price.
- A monopoly is protected by **barriers to entry,** which could be government regulations, a large initial investment, or ownership of raw materials.
- Four types of monopolies exist: natural monopoly, geographic monopoly, technological monopoly, and government monopoly.
- Natural monopolies are often advantageous in that they give the company an **economy of scale**—which means because of its size, the company can produce the largest amount for the lowest cost.
- An oligopoly is an industry dominated by several suppliers who exercise some control over price.
- Oligopolies and monopolistic competitors use **product differentiation** to make their products more valuable in consumers' eyes.
- Advertising brand names is vital in the market structure known as monopolistic competition, in which a large number of sellers offer similar but slightly different products.

SECTION 3 Government Policies Toward Competition

- The government has passed **antitrust legislation** to prevent monopolies from forming or to break up those that already exist.
- Two famous pieces of antitrust legislation are the Sherman Antitrust Act and the Clayton Act.
- Three kinds of mergers exist: horizontal, vertical, and conglomerate.
- Federal regulatory agencies oversee various types of industries to ensure fair pricing and product quality.
- **Deregulating** some industries in the 1980s and 1990s resulted in more competition among businesses.

CHAPTER 9

Assessment and Activities

ECONOMICS Online

Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 9—Self-Check Quizzes*** to prepare for the Chapter Test.

CLICK HERE

Identifying Key Terms

Write the letter of the definition in Column B that correctly defines each term in Column A.

Column A

1. barriers to entry
2. deregulation
3. conglomerate
4. interlocking directorate
5. geographic monopoly
6. merger
7. monopolistic competition
8. oligopoly
9. government monopoly
10. antitrust legislation

Column B

a. large corporation made up of unrelated businesses
b. the joining of two corporations
c. characterized by many firms but differentiated products
d. obstacles that prevent new companies from being formed
e. removing government restrictions from industries
f. characterized by a few firms with differentiated products
g. a store located in an isolated area
h. passed to prevent monopolies
i. building and maintaining local roads and bridges
j. situation in which some of the board of directors for competing companies are the same people

Recalling Facts and Ideas

Section 1

1. In a perfectly competitive market structure, how much control does a single seller have over market price?
2. What is the relationship between the types of products that sellers sell in a perfectly competitive market?
3. What is one example of an almost perfectly competitive market?

Section 2

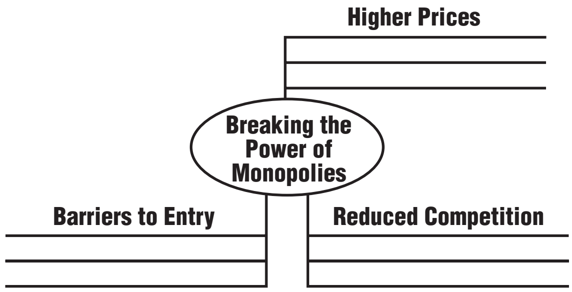
4. What are the three types of market structures with imperfect competition?
5. What is the difference between a geographic monopoly and a technological monopoly?
6. How much control does an oligopoly have over price?
7. In monopolistic competition, how many sellers are there?

Section 3

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

Thinking Critically

1. **Finding the Main Idea** Explain in a paragraph how supply and demand work in the agricultural market when government controls are not operating.
2. **Making Generalizations** Re-create the spider map below, then write two ways that the free enterprise system works to break the three powers of monopolies noted.



3. **Making Comparisons** What are the fundamental differences between the goals of antitrust legislation and the goals of federal government regulatory agencies?

Applying Economic Concepts

Competition and Market Structure Make a list of the four types of monopolies that exist. Under each type, list three real examples—whether at the federal, state, or local levels.

Cooperative Learning Project

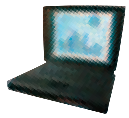
Organize into groups of three—with one group member representing monopolies; another, oligopolies; and the third, monopolistic competition. Each member of each group should clip business advertisements and articles that characterize his or her market structure. As a group, compare the ads (and businesses) that each person collected. Defend your reasoning behind placing a particular company in its particular grouping.

Reviewing Skills

Drawing Inferences and Conclusions Using **Figure 9.12** on page 252, infer which federal regulatory agency would be responsible for the following "ingredients" of making pizza.

1. Checks the freshness of milk that makes mozzarella cheese.
2. Determines that shipping rates are fair for the pepperoni arriving from out-of-state.
3. Makes sure the pizza advertisement on TV is truthful.
4. Enforces safe working conditions for employees in the pizza parlor.
5. Makes sure that the pizza parlor disposes of waste in a safe manner.

Technology Activity



Using the Internet Choose a regulatory agency mentioned in this chapter and use the Internet to find the agency's homepage. Use the information to analyze the main functions of the agency and explain how the agency's regulatory actions affect the circular flow model.

Analyzing the Global Economy

Procter & Gamble was mentioned in this chapter as an example of a multinational conglomerate. Use the Internet to find out (a) in how many countries P&G has manufacturing operations; (b) how many countries buy P&G products; (c) how many people are employed by P&G; and (d) what its annual worldwide sales are. Also note the names of products used in Africa, Asia, Europe, and Latin America. Write a report about your findings, and share your report with the class.

CASE STUDY

Focus on Free Enterprise

The Home Depot

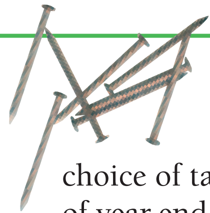
When Bernie Marcus and Arthur Blank lost their jobs at Handy Dan, a chain of home improvement stores in California, they knew what they were going to do. They would open their own home improvement store—and it would be the best in the United States. Just exactly how they were going to do this, they were not sure. It became clear to them, however, when they visited a store in Long Beach called Homeco.

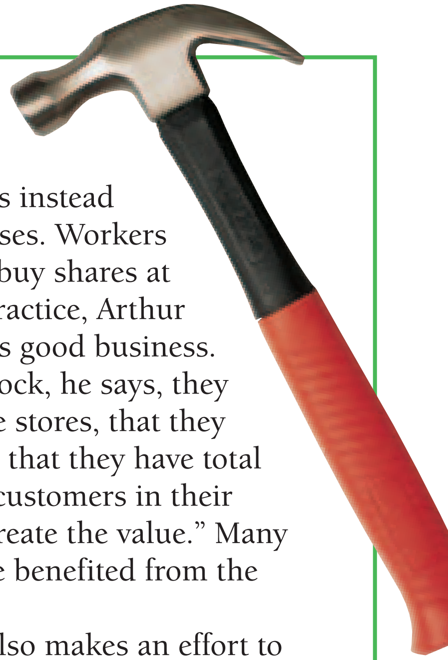
A Different Approach

Homeco did not look, or work, like any other home improvement store Marcus and Blank had seen. The huge barn-like space was stacked from floor to ceiling with a vast array of home supplies. Every item was offered at a rock-bottom price. And there were tradespeople—painters, carpenters, plumbers, electricians, and so on—throughout the store ready to give shoppers help and advice. Marcus and Blank recognized that this blend of warehouse retailing and superior customer service was the way to go. They quickly asked Homeco's owner, Pat Farrah, to join them in their business venture.

Shortly after, Marcus, Blank, and Farrah moved their operations to Atlanta, Georgia. They opened their first store—called The Home Depot—there in 1978. The store operated on four simple principles. First, stock a

Bernie Marcus (left) and Arthur Blank





large assortment of merchandise. Second, charge the lowest prices. Third, provide excellent customer service. Finally, cater to both the do-it-yourself amateur and the construction-industry professional.

The early days were a struggle. Sometimes, the partners did not have the cash to buy supplies. So Farrah stacked the store with empty paint cans and boxes to make it look as though it were well stocked. Over time, however, business began to pick up, and Marcus, Blank, and Farrah opened several more stores.

Building an Empire

In 1981 the partners took a major step, selling shares in the company. With the $4 million they made from the sale, they began an ambitious expansion program. First, The Home Depot began to establish a foothold in other states. Then the company went international, opening stores elsewhere in the Western Hemisphere. By 1999, it had outlets in 44 states, Puerto Rico, Canada, and Chile.

Sharing the Wealth

Since its earliest days, The Home Depot has offered employees the chance to share in its success. It gives many workers the choice of taking shares instead of year-end cash bonuses. Workers also have a chance to buy shares at discount rates. This practice, Arthur Blank thinks, simply is good business. When workers own stock, he says, they "feel that they own the stores, that they own the merchandise, that they have total responsibility for the customers in their aisles, and that they create the value." Many workers certainly have benefited from the practice.

The Home Depot also makes an effort to share its good fortune with the communities in which it operates. In 2002 alone, it invested $25 million to support local communities. It also encourages its workers to volunteer for local charitable organizations. Associates invested 6 million volunteer hours in local cities and towns.

Free Enterprise in Action

1. **What new approach did The Home Depot bring to the home improvement industry?**
2. **Why does Arthur Blank think that offering stock to employees is good business practice?**

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