

Economic Competition & the Role of the Government

A. Market Structure

1. The forces of supply & demand work most effectively in markets with large numbers of sellers & buyers, reasonably accurate information about the market, & a relatively homogeneous (identical) product
 - a. Markets that do not possess those characteristics find the forces of supply & demand modified by different market structures
 - (1) Market structure
 - (2)
 - b. The level of competition in a market or industry among producers or buyers affects supply & demand & prices for different products
 - (1) Market
 - (2) Industry
2. The level of competition in a market is largely determined by the number of buyers & sellers in the market
 - a. The existence of competition in a market has an effect on prices & profits
 - (1)
 - (2)
 - b. The level of competition in an industry is in the long run determined largely by how difficult & expensive it is for new firms to enter the market
3. Sellers can engage in both price & nonprice competition
 - a. Price competition
 - b. Nonprice competition – involves competing with another firm based on nonprice related factors
 - (1)
 - (2)

4. Collusion among buyers or sellers reduces the level of competition in a market
 - a. Collusion – when independent consumers or producers agree to coordinate their decisions in a manner that restricts competition
 - (1)
 - (2)
 - b. Cartel – when collusion takes the form of an explicit (openly exposed) agreement to fix prices & share markets among a group of producers that furnishes a large share of a particular product
 - (1) 3 conditions necessary for successful cartels
 - (2) Ex)
5. There tend to be 4 main types of market structures
 - a. Perfect competition – exists when many independent sellers provide relatively homogeneous products for sale to many independent buyers
 - (1)
 - (2) Ex)
 - b. Monopolistic competition – exists when many sellers provide similar products that are differentiated to some extent by nonprice competition for sale to many buyers
 - (1)
 - (2) Ex)
 - c. Oligopoly/Oligopsony
 - (1) Oligopoly
 - (2) Oligopsony
 - d. Monopoly/Monopsony
 - (1) Monopoly
 - (2) Monopsony
6. In the U.S., laws & government regulations have been adopted to maintain competition known as antitrust laws

- a. Laws like the Sherman Antitrust Act of 1890 & the Clayton Antitrust Act of 1914 & government agencies like the Federal Trade Commission have ensured fair competition & destroyed unlawful monopolies

- (1) Sherman Antitrust Act of 1890

- (2) Clayton Antitrust Act of 1914

- (3) Federal Trade Commission

- b. Many laws & regulations have had the effect of reducing competition

B. Income Distribution

- 1. In a market economy, people's incomes depend largely on the value of goods or services they are able to sell in the marketplace

- a.

- b.

- 2. Functional distribution of income – classifies the income received by individuals & business firms according to the type of productive resources sold in resource markets

- a. The functional distribution of income divides the economy's total income into wages & salaries, rent, interest, profit, & transfer payments

- (1) Wages & salaries

- (2) Rent

- (3) Interest

- (4) Profit

- (5) Transfer payments

Sources and Distribution of Personal Income in the United States

Sources of Personal Income (Functional Distribution), 1993		
<i>Type of Income</i>	<i>Amount of Income (billions of \$)</i>	<i>Percent of Total Personal Income</i>
Wages, salaries, and other labor income less contributions for social insurance	\$3,166.8	58.8%
Personal rental income	13.0	0.2
Personal interest income	695.8	12.9
Personal dividend income	158.3	2.9
Net income of unincorporated business (including farms)	442.1	8.2
Transfer payments	<u>911.6</u>	<u>16.9</u>
Total	\$5,387.6	100.0%

- b. The functional distribution of income has overtime reflected changes in the occupational structure of the economy & changing economic conditions related to the business cycle
- 3. Personal distribution of income – classifies the population according to the amount of income they receive (including transfer payments) & has remained relatively stable in the U.S. over long periods of time

Distribution of Personal Income, 1992

Money Income Level	All families		Unrelated Individuals	
	Numbers in Millions	Percent of Total	Numbers in Millions	Percent of Total
Less than \$5,000	2.3	3.4%	2.1	7.4%
\$5,000–\$9,999	3.8	5.6	5.9	20.9
10,000–14,999	4.9	7.2	4.2	14.9
15,000–24,999	10.6	15.5	5.7	20.2
25,000–34,999	10.2	15.0	4.1	14.5
35,000–49,999	13.2	19.4	3.2	11.3
50,000–74,999	13.5	19.8	2.0	7.1
75,000 and up	<u>9.6</u>	<u>14.1</u>	<u>1.0</u>	<u>3.5</u>
Total	68.1	100.0%	28.2	100.0%

C. Market Failures

- 1. Market failures
- 2. The main forms of market failure include inadequate competition, inadequate information, externalities, public goods, & resource immobility
 - a. Without competition, there is no guarantee that scarce resources will be allocated to their most productive uses
 - (1) Natural monopoly
 - (2)
 - (3) Economies of scale

- b. The lack of reliable information can have very negative effects on markets
 - (1)
 - (2)
- c. Externalities – exists when some of the costs or benefits associated with the production or consumption of a good or service “spill over” to third parties other than the direct producers & consumers
 - (1) Positive externalities
 - (2) Negative externalities
- d. Public goods – goods or services the government supplies in situations involving shared consumption &/or nonexclusion
 - (1) Shared consumption product
 - (2) Nonexclusive product
 - (3) Ex)
- e. Lack of specialized skills or lack of money can limit the ability of workers to move from declining to expanding industries
- 3. Establishing & implementing government policies & programs can be used to correct for market failures
 - a.
 - b.
 - c. Goods or services with externalities can either be encouraged or discouraged through government actions
 - (1)
 - (2)
 - d. Resource immobility can be lessened with relocation allowances, favorable tax treatment, & retraining programs

4. Public policies aimed at correcting market failures are very costly activities in itself & are only economically justified when the expected benefits outweigh the costs, so economic analysis can help to determine where market failures are important enough to justify corrective actions by the government

D. Economic Roles of the Government

1. As previously mentioned, the government provides public goods, corrects for externalities, & works to maintain competition, but they also have additional functions
 - a.
 - b. The government redistributes income through transfer payments
 - (1) Social insurance programs
 - (2) Public-assistance programs
 - c. The government also promotes full employment, stable prices, & reasonable rates of economic growth
2. The goods & services provided by the government are paid for through borrowing & taxation
 - a. Different *taxes* (mandatory payments to the government) affect different income groups differently
 - (1) Progressive taxes
 - (2) Regressive taxes
 - (3) Proportional taxes
 - b. The largest sources of tax revenue include individual income taxes, corporate income taxes, Social Security taxes, property taxes, & sales taxes
3. Government policies often affect the well-being of people, businesses, & regions differently (as a result of different kinds of taxes, transfer payments, laws, regulations, & unequal use of goods & services), & public policies involve economic & political choices & are influenced by the actions of special interest groups
 - a.
 - b.