Domain 3

MICROECONOMICS

ECONOMICS

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Georgia Standards of Excellence
MICRO CONCEPT CLUSTER

SSEMI1

Describe how households and businesses are interdependent and interact through flows of goods, services, resources, and money.

- Circular flow
- Money as a medium of exchange

Demonstration Activity

The student will describe how consumers and businesses interact in the U.S. economy.

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SS5E2 The student will describe the functions of four major sectors in the U.S.

a. Describe the **household function** in providing resources and consuming goods and services.

b. Describe the private **business function** in producing goods and services.

c. Describe the **bank function** in providing checking accounts, savings accounts, and loans.

d. Describe the **government function** in taxation and providing certain goods and services.

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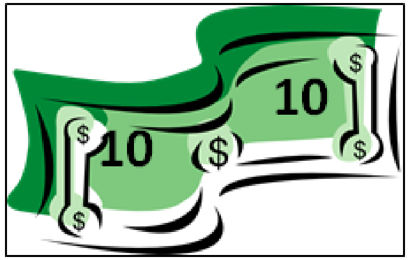
HOUSEHOLD

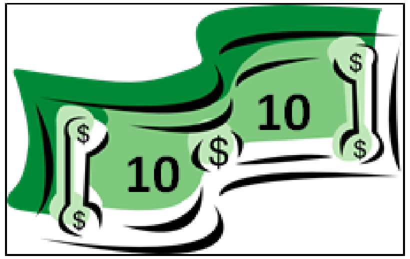
Provide Labor

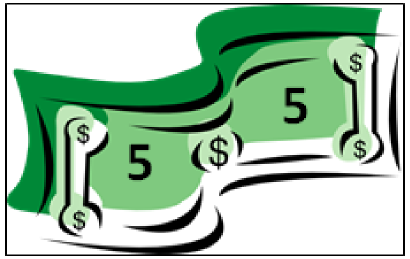
Consume Goods and Services

BUSINESS

Produce Goods and Services

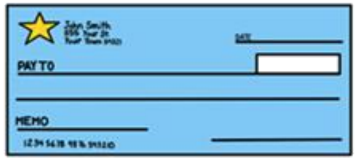






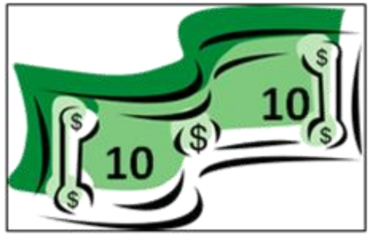
BANK

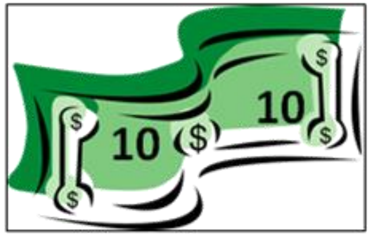
Provide Checking and Savings Account Services



Make Loans

(To Individuals and Businesses)





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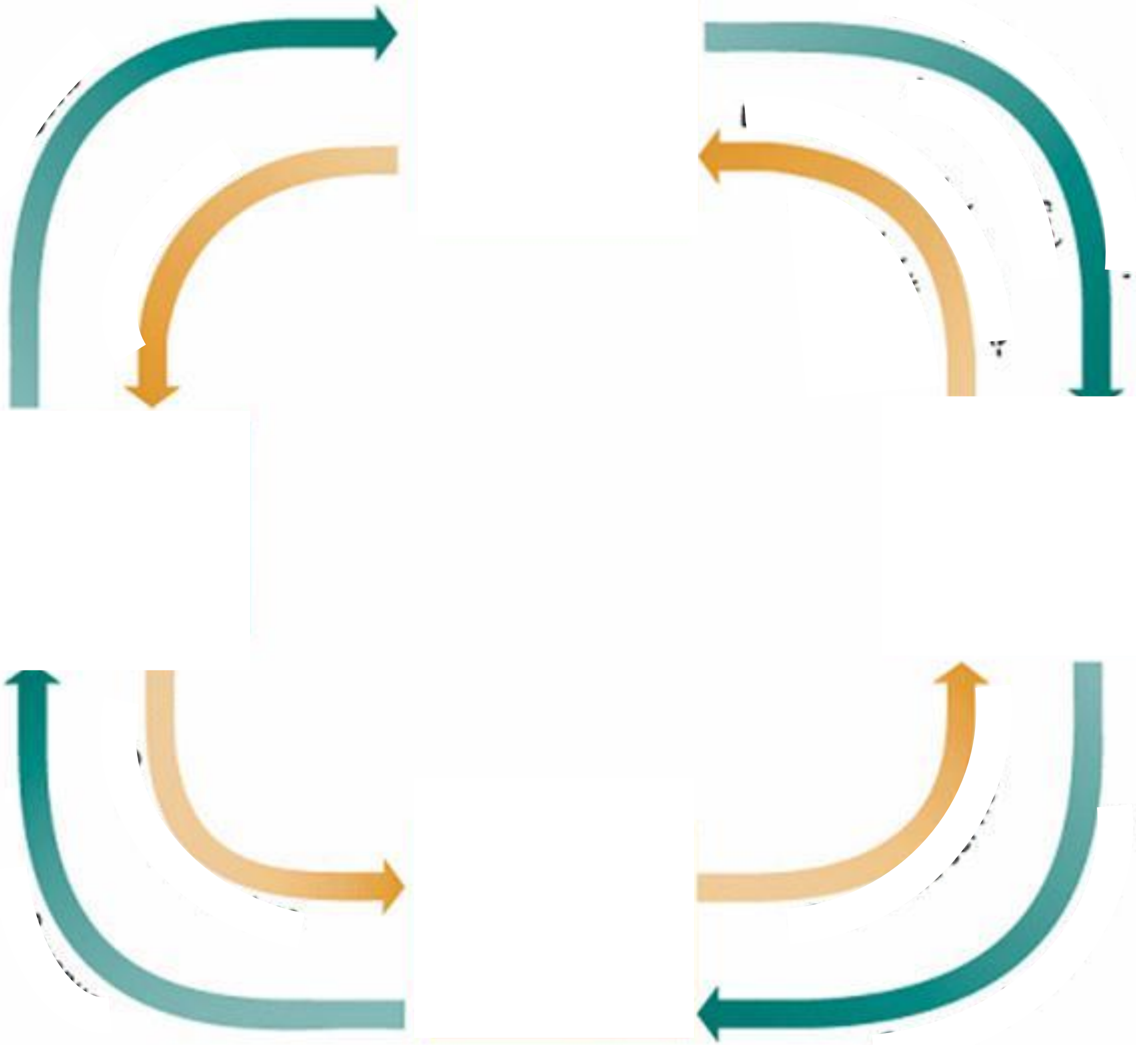
Circular Flow Model



GOVERNMENT

Set and Collect Taxes

INTERNAL REVENUE SERVICE

Provide Public Goods and Public Services

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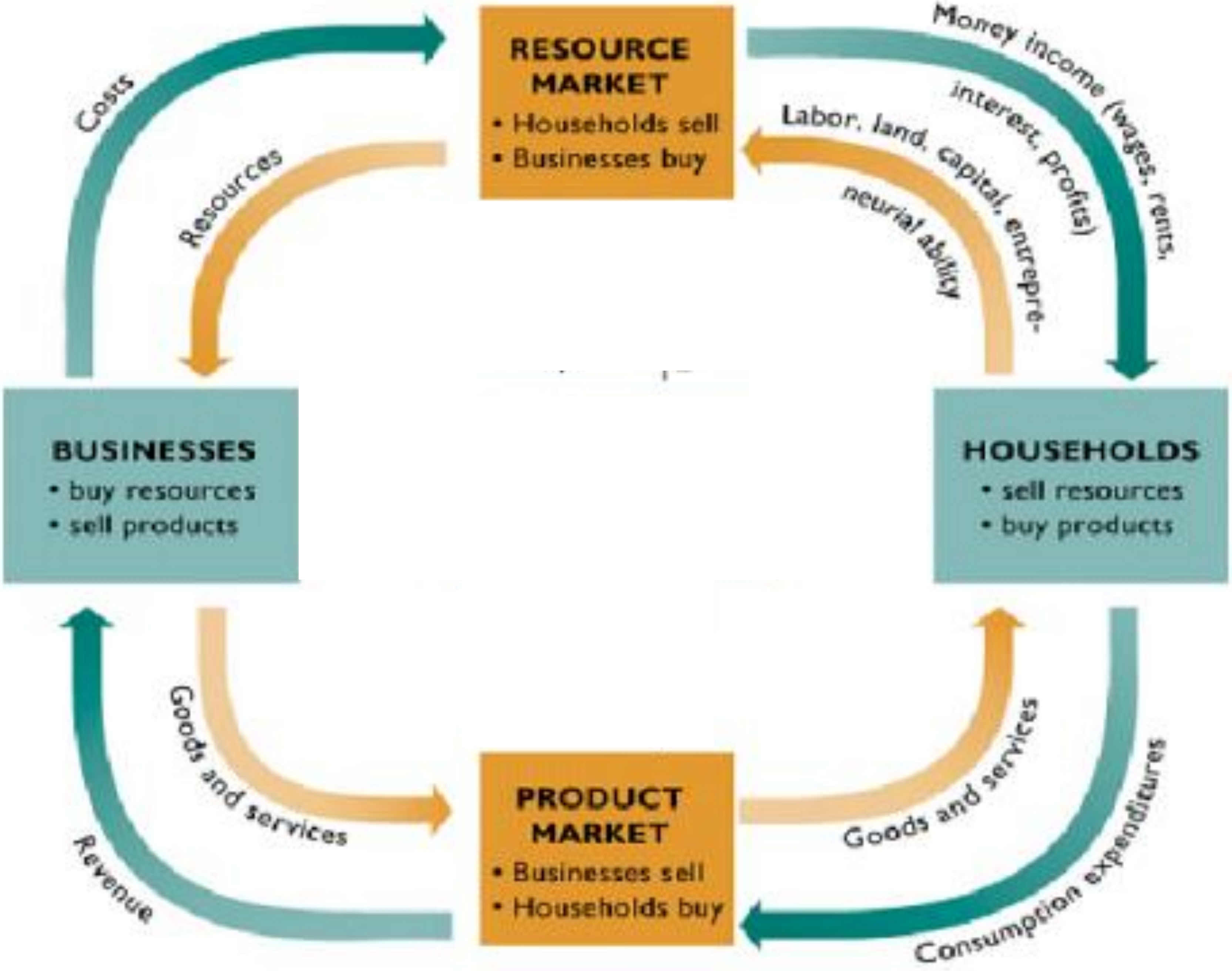
RESOURCE MARKET
• Households sell
• Businesses buy
Costs
Resources
Money income (wages, rents, interest, profits)
Labor, land, capital, entrepreneurial ability
BUSINESSES
• buy resources
• sell products
HOUSEHOLDS
• sell resources
• buy products
Goods and services
Revenue
PRODUCT MARKET
• Businesses sell
• Households buy
Goods and services
Consumption expenditures

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MICRO CONCEPT CLUSTER

SSEMI2

Explain how the law of demand, the law of supply and prices work to determine production and distribution in a market economy.

- Law of demand
- Law of supply
- Prices
- Profit
- Production
- Distribution
- Equilibrium
- Incentives

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Indiana Jones – Demand and Supply

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Understanding Demand

- What is the law of demand?
- How do the substitution effect and income effect influence decisions?
- What is a demand schedule?
- What is a demand curve?

What Is the Law of Demand?

The law of demand states that consumers buy more of a good when its price decreases and less when its price increases.

- The law of demand is the result of two separate behavior patterns that overlap, the substitution effect and the income effect.
- These two effects describe different ways that a consumer can change his or her spending patterns for other goods.

The Substitution Effect and Income Effect

The Substitution Effect

- The substitution effect occurs when consumers react to an increase in a good's price by consuming less of that good and more of other goods.

The Income Effect

- The income effect happens when a person changes his or her consumption of goods and services as a result of a change in real income.

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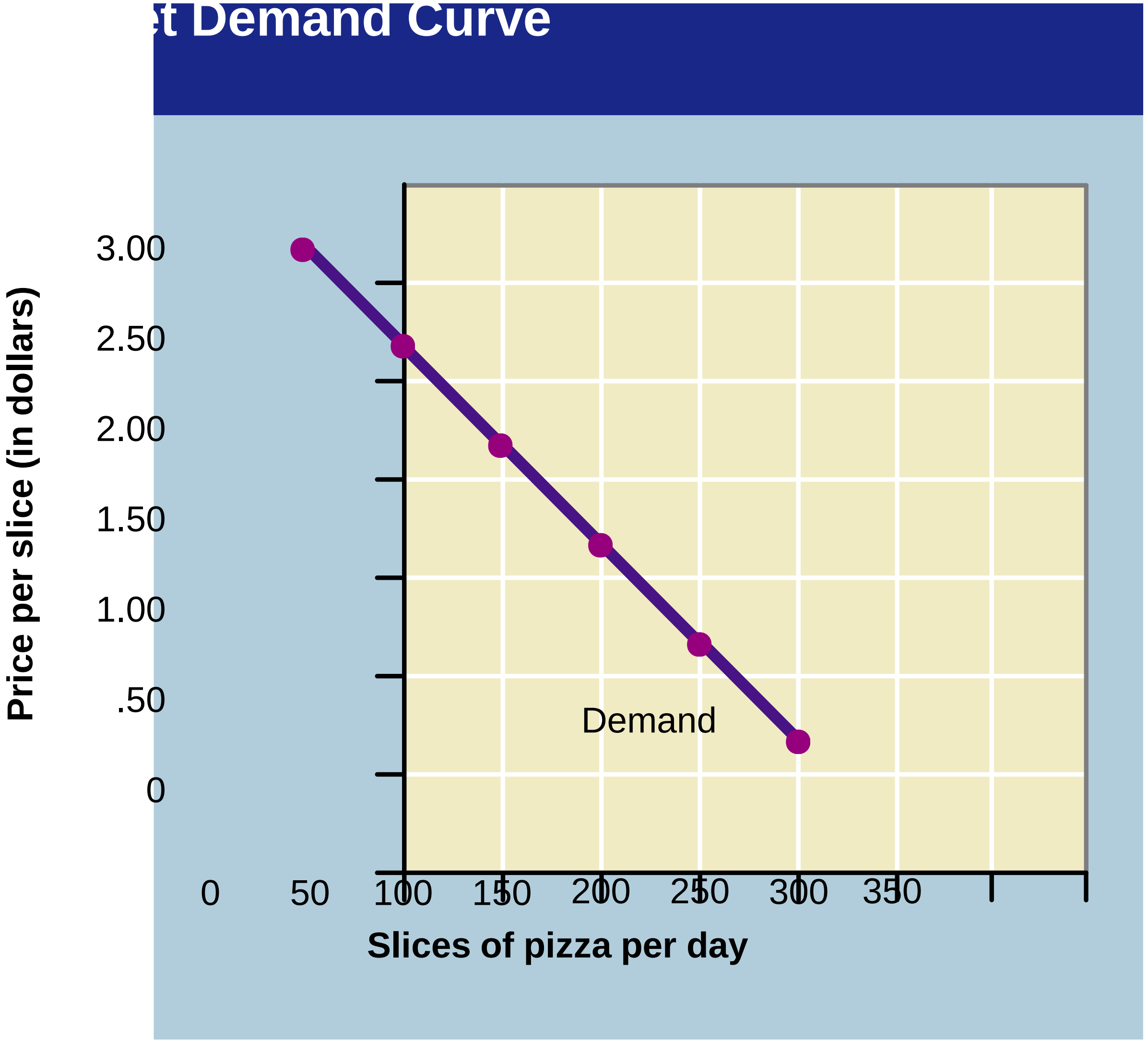
The Demand Schedule

- A demand schedule is a table that lists the quantity of a good a person will buy at each different price.
- A market demand schedule is a table that lists the quantity of a good all consumers in a market will buy at each different price.

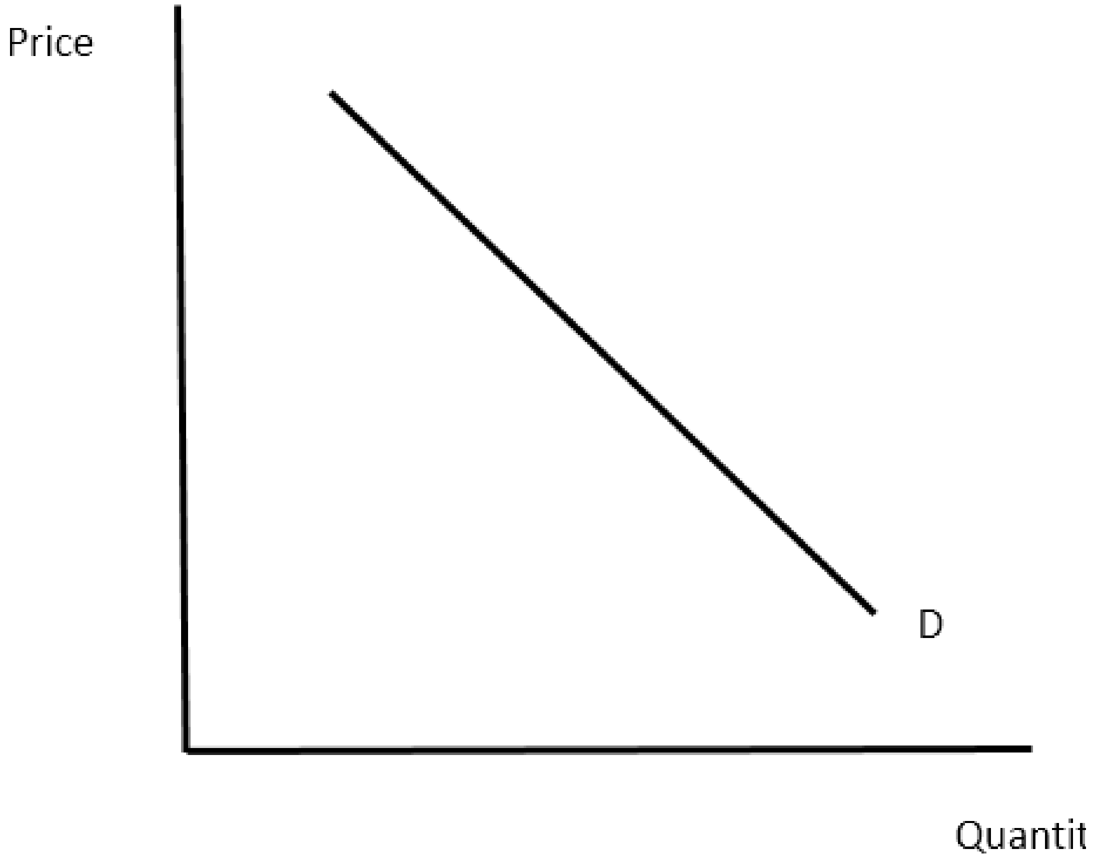
Demand Schedules			
Individual Demand Schedule		**Market Demand Schedule**	
Price of a slice of pizza	Quantity demanded per day	Price of a slice of pizza	Quantity demanded per day
$.50	5	$.50	300
$1.00	4	$1.00	250
$1.50	3	$1.50	200
$2.00	2	$2.00	150
$2.50	1	$2.50	100
$3.00	0	$3.00	50

The Demand Curve

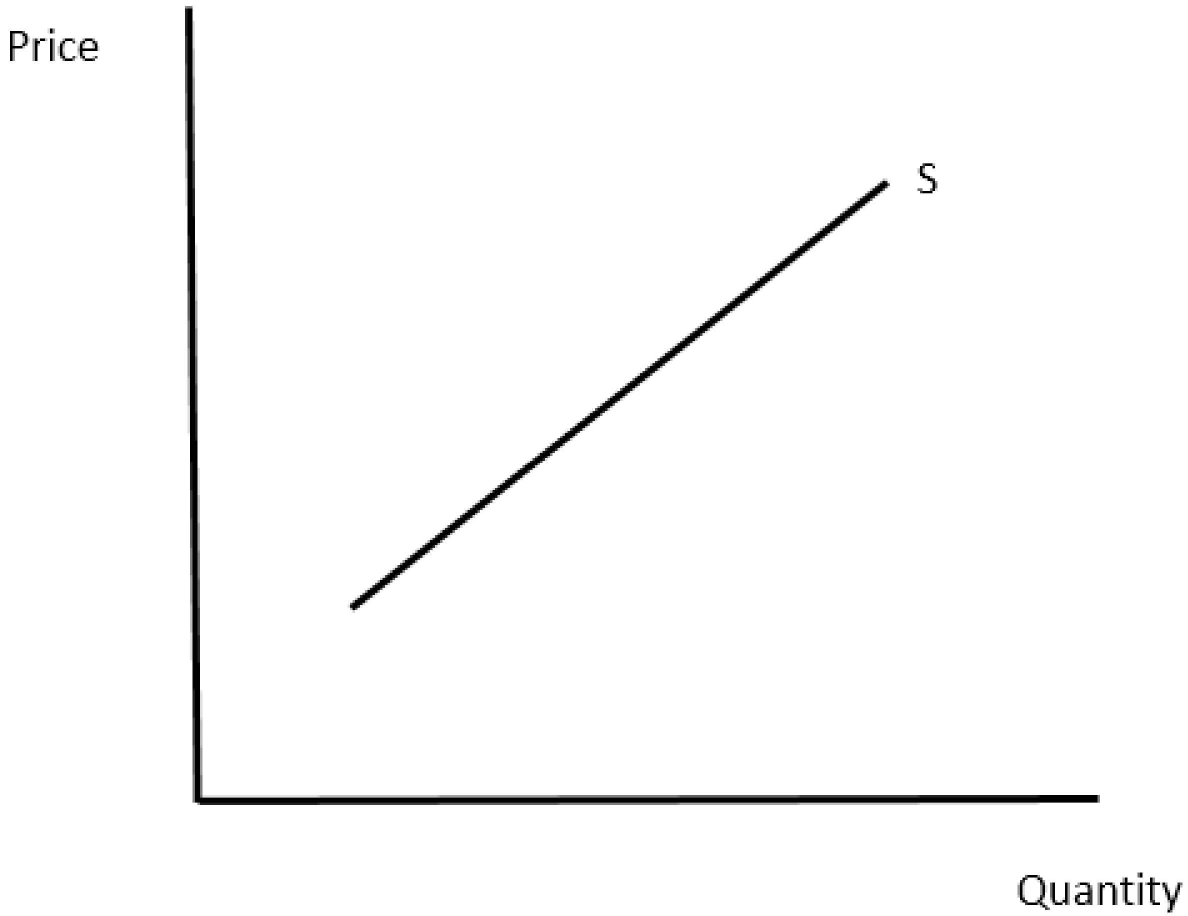
- A demand curve is a graphical representation of a demand schedule.
- When reading a demand curve, assume all outside factors, such as income, are held constant.



Demand & Supply Curves



Inverse Relationship



Positive Relationship

Shifts of the Demand Curve

- What is the difference between a change in quantity demanded and a shift in the demand curve?
- What factors can cause shifts in the demand curve?
- How does the change in the price of one good affect the demand for a related good?

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Shifts in Demand

- Ceteris paribus is a Latin phrase economists use meaning "all other things held constant."
- A demand curve is accurate only as long as the ceteris paribus assumption is true.
- When the ceteris paribus assumption is dropped, movement no longer occurs along the demand curve. Rather, the entire demand curve shifts.

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What Causes a Shift in Demand?

- Several factors can lead to a change in demand:

1. Income

Changes in consumers incomes affect demand. A normal good is a good that consumers demand more of when their incomes increase. An inferior good is a good that consumers demand less of when their income increases.

2. Consumer Expectations

Whether or not we expect a good to increase or decrease in price in the future greatly affects our demand for that good today.

3. Population

Changes in the size of the population also affects the demand for most products.

4. Consumer Tastes and Advertising

Advertising plays an important role in many trends and therefore influences demand.

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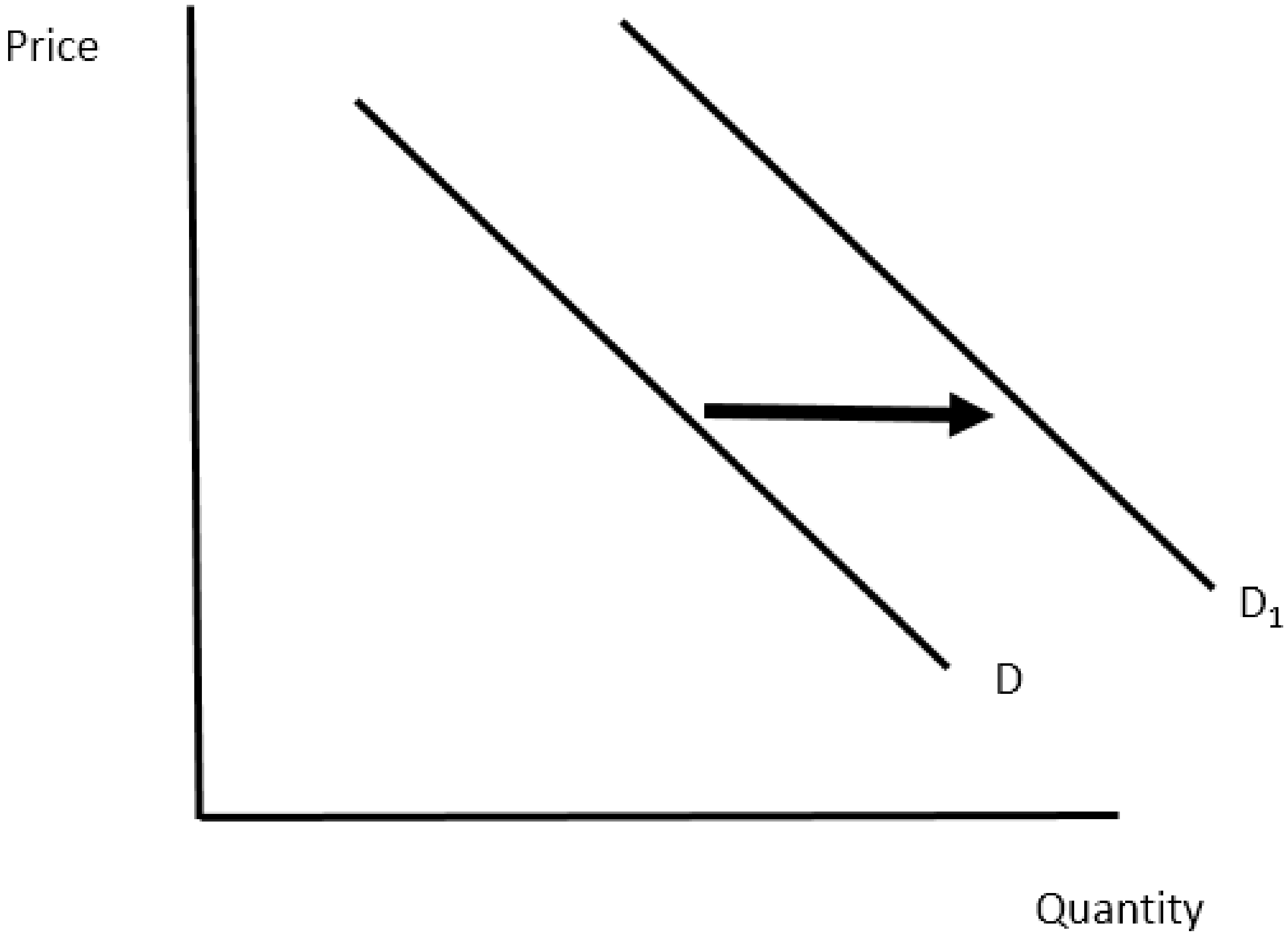
Shift in Demand

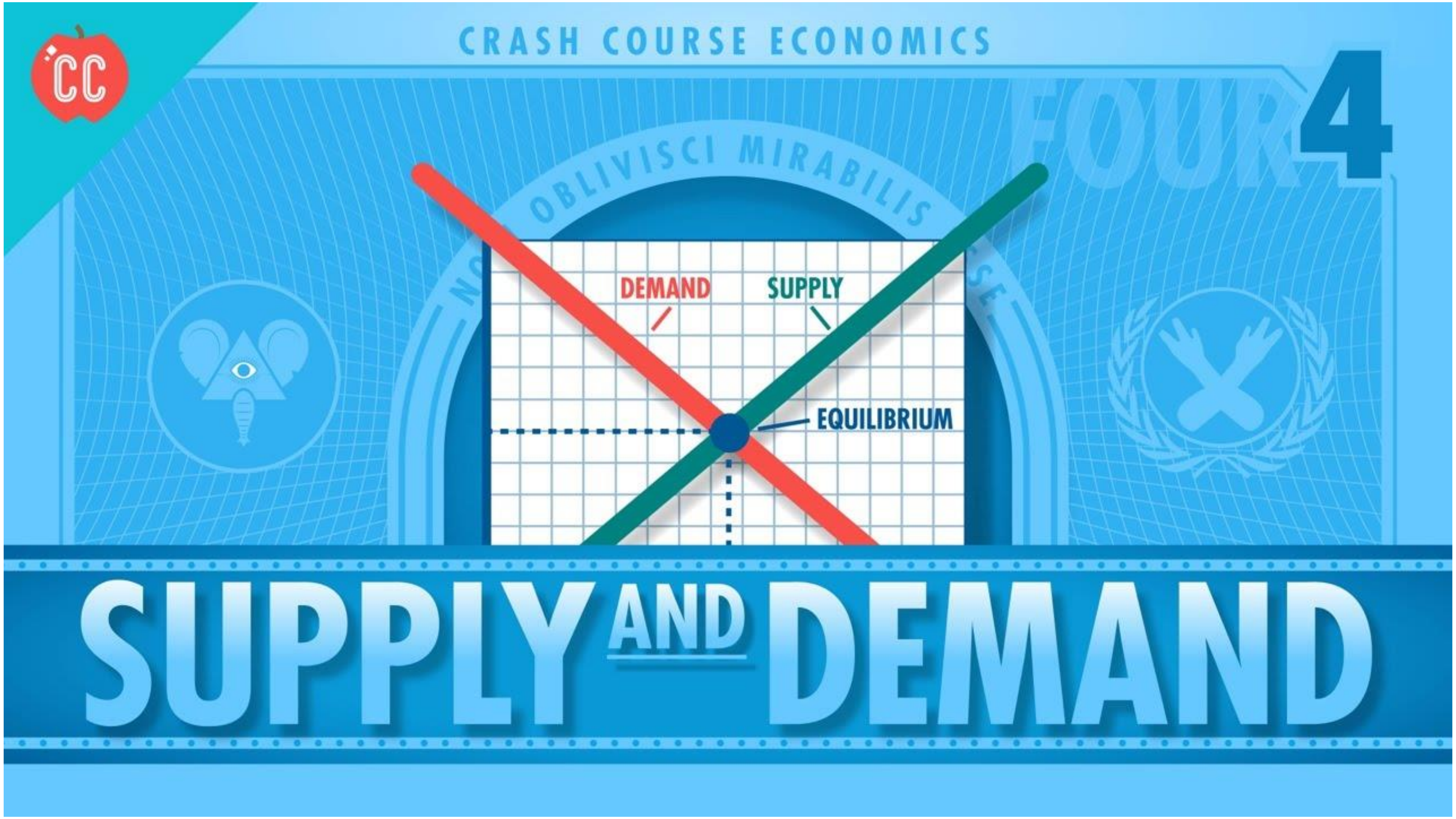


- Change in Demand due to one of the Determinants of Demand (absent of a price change)
- Demand is the whole curve. Quantity Demanded is one point on the curve at a particular Price.

Prices of Related Goods

The demand curve for one good can be affected by a change in the demand for another good.

- **Complements** are two goods that are bought and used together. Example: skis and ski boots
- **Substitutes** are goods used in place of one another. Example: skis and snowboards



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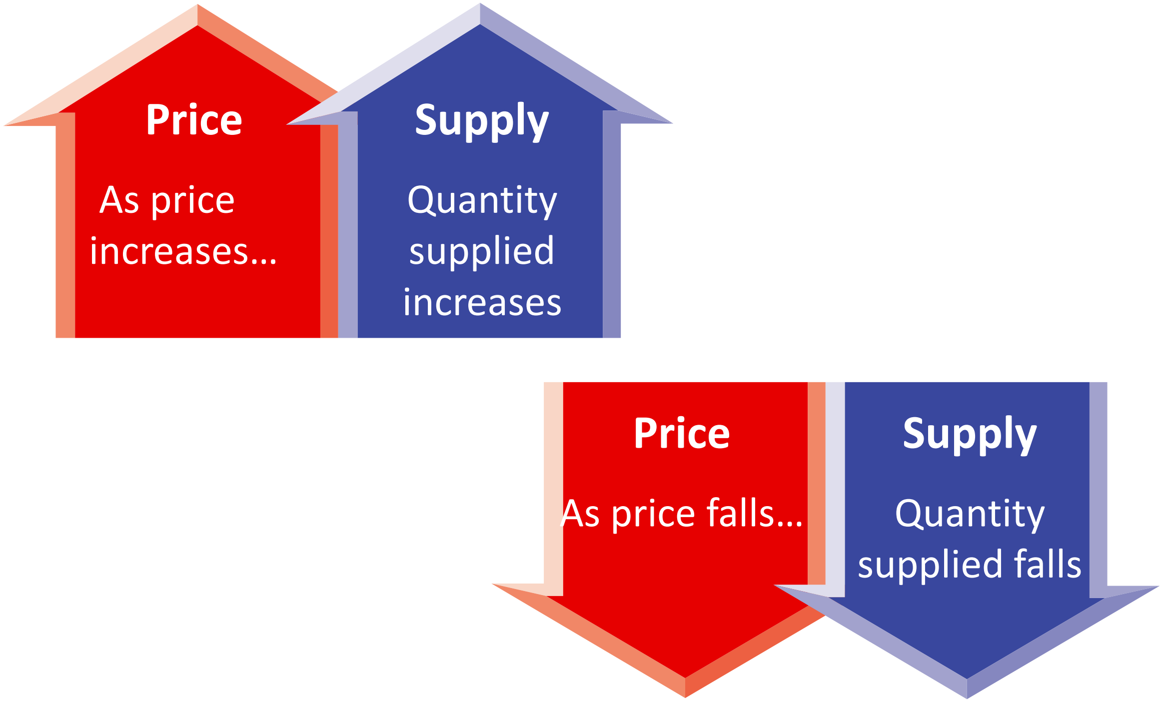
The Law of Supply

- According to the law of supply, suppliers will offer more of a good at a higher price.



How Does the Law of Supply Work?

- Economists use the term quantity supplied to describe how much of a good is offered for sale at a specific price.
- The promise of increased revenues when prices are high encourages firms to produce more.
- Rising prices draw new firms into a market and add to the quantity supplied of a good.

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Supply Schedules

- A market supply schedule is a chart that lists how much of a good all suppliers will offer at different prices.

Market Supply Schedule	
Price per slice of pizza	**Slices supplied per day**
$.50	1,000
$1.00	1,500
$1.50	2,000
$2.00	2,500
$2.50	3,000

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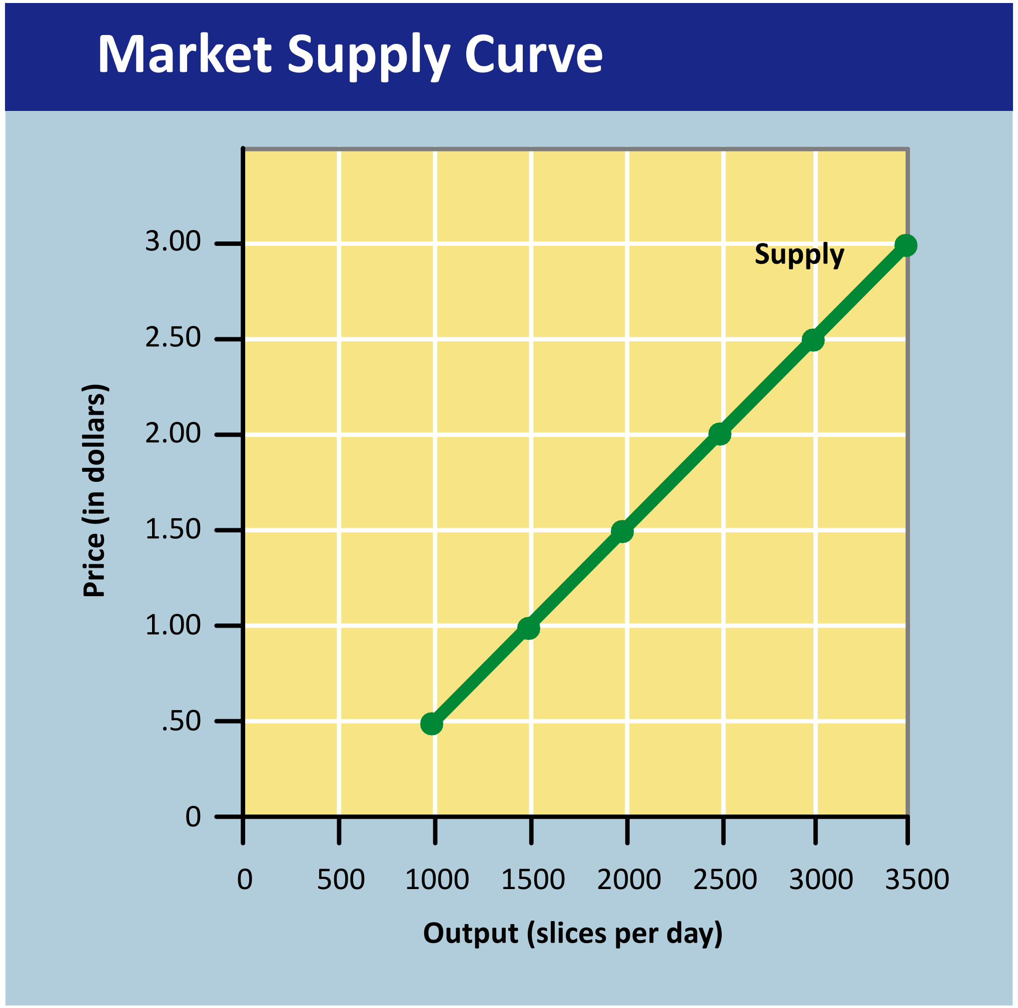
Supply Curves

- A market supply curve is a graph of the quantity supplied of a good by all suppliers at different prices.



Changes in Supply

- How do input costs affect supply?
- How can the government affect the supply of a good?
- What other factors can influence supply?

Input Costs and Supply

- Any change in the cost of an input such as the raw materials, machinery, or labor used to produce a good, will affect supply.
- As input costs increase, the firm's marginal costs also increase, decreasing profitability and supply.
- Input costs can also decrease. New technology can greatly decrease costs and increase supply.

Government Influences on Supply

- By raising or lowering the cost of producing goods, the government can encourage or discourage an entrepreneur or industry.

Subsidies

A subsidy is a government payment that supports a business or market. Subsidies cause the supply of a good to increase.

Taxes

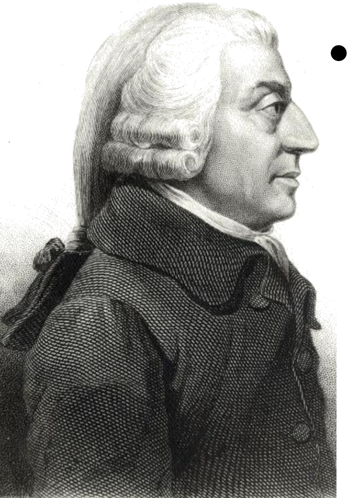
The government can reduce the supply of some goods by placing an excise tax on them. An excise tax is a tax on the production or sale of a good.

Regulation

Regulation occurs when the government steps into a market to affect the price, quantity, or quality of a good. Regulation usually raises costs.

Other Factors Influencing Supply

- **The Global Economy**
  - The supply of imported goods and services has an impact on the supply of the same goods and services here.
  - Government import restrictions will cause a decrease in the supply of restricted goods.
- **Future Expectations of Prices**
  - Expectations of higher prices will reduce supply now and increase supply later. Expectations of lower prices will have the opposite effect.
- **Number of Suppliers**
  - If more firms enter a market, the market supply of the good will rise. If firms leave the market, supply will decrease.



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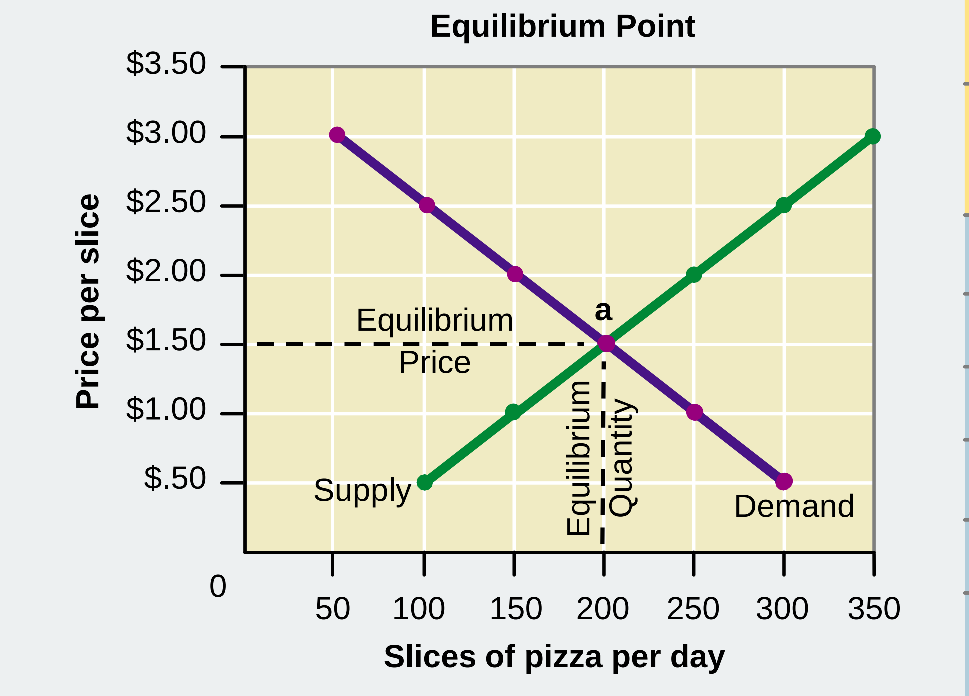
Combining Supply and Demand

- How do supply and demand create balance in the marketplace?
- What are differences between a market in equilibrium and a market in disequilibrium?
- What are the effects of price ceilings and price floors?

Balancing the Market

The point at which quantity demanded and quantity supplied come together is known as equilibrium.

Finding Equilibrium



Combined Supply and Demand Schedule

Price of a slice of pizza	Quantity demanded	Quantity supplied	Result
$ .50	300	100	Shortage from excess demand
$1.00	250	150	
$1.50	200	200	Equilibrium
$2.00	150	250	Surplus from excess supply
$2.50	100	300	
$3.00	50	350	

Market Disequilibrium

If the market price or quantity supplied is anywhere but at the equilibrium price, the market is in a state called disequilibrium. There are two causes for disequilibrium:

Excess Demand

- Excess demand occurs when quantity demanded is more than quantity supplied.

Excess Supply

- Excess supply occurs when quantity supplied exceeds quantity demanded.

Interactions between buyers and sellers will always push the market back towards equilibrium.

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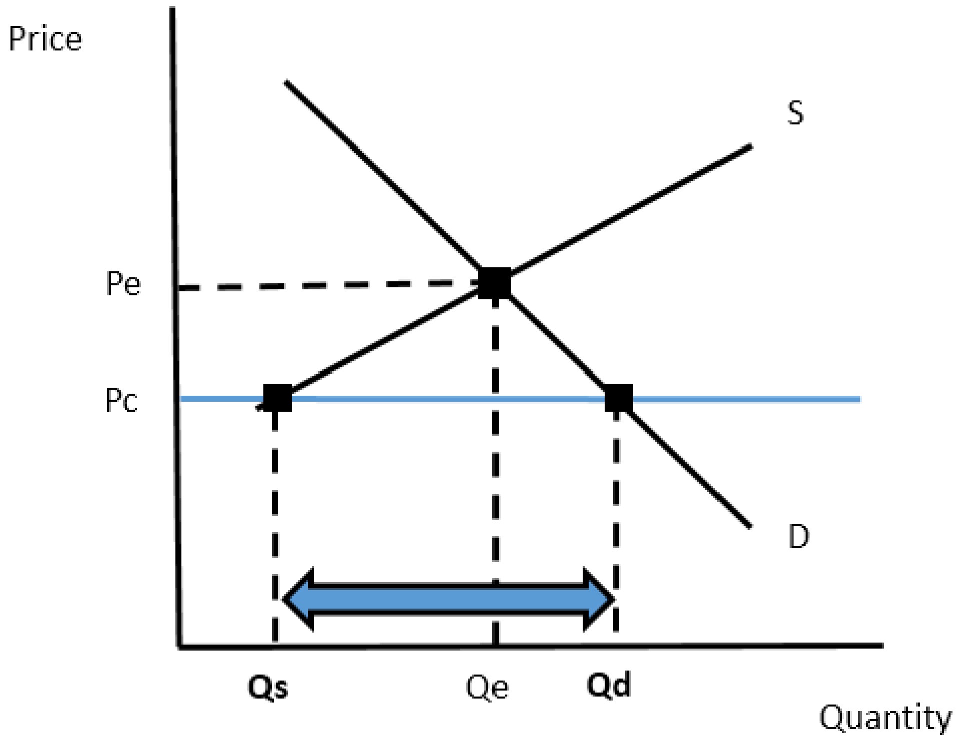
Price Ceilings

In some cases the government steps in to control prices. These interventions appear as price ceilings and price floors.

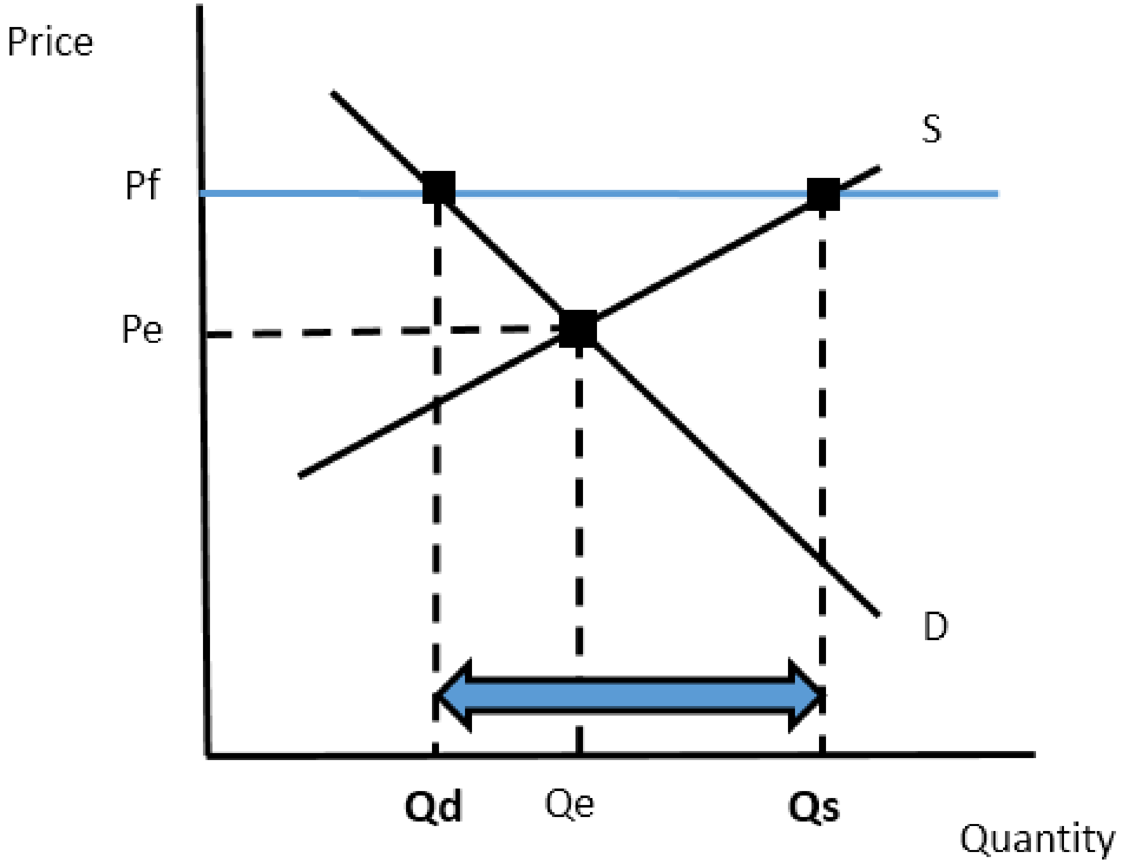
- A price ceiling is a maximum price that can be legally charged for a good.
- An example of a price ceiling is rent control, a situation where a government sets a maximum amount that can be charged for rent in an area.
- Price Ceilings result in a <u>SHORTAGE</u>.



Price Floors

- A price floor is a minimum price, set by the government, that must be paid for a good or service.

- One well-known price floor is the minimum wage, which sets a minimum price that an employer can pay a worker for an hour of labor.
- Price Floors result in a SURPLUS



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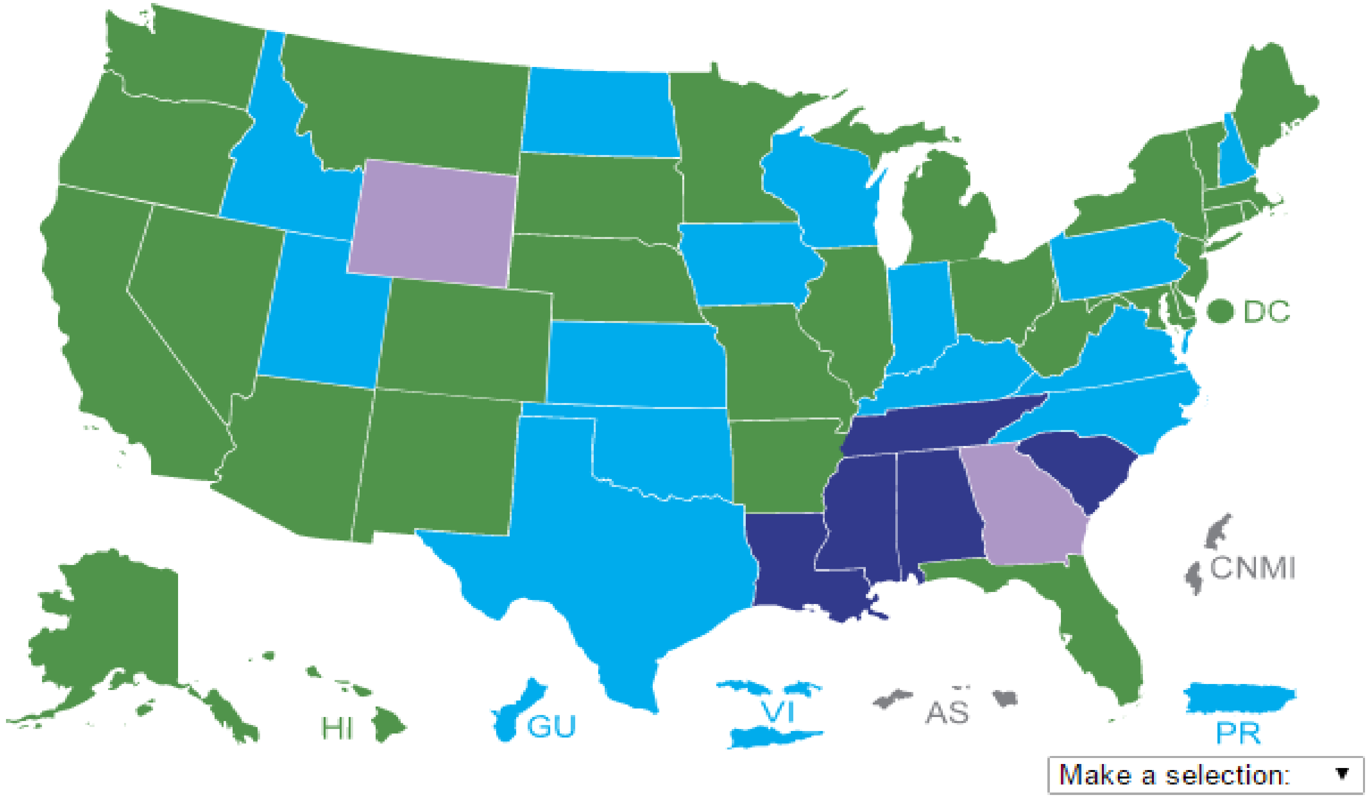
Minimum Wage Laws in the States



States with minimum wage rates higher than the federal

States with minimum wage rates the same as the federal

American Samoa and the Commonwealth of the Northern Mariana Islands have special minimum wage rates.

States with no minimum wage law (federal minimum wage rate applies)

States with minimum wage rates lower than the federal (federal minimum wage rate applies)

https://www.dol.gov/whd/minwage/america.htm

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Changes in Market Equilibrium

- How do shifts in supply affect market equilibrium?
- How do shifts in demand affect market equilibrium?
- How can we use supply and demand curves to analyze changes in market equilibrium?

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Shifts in Supply

- Understanding a Shift
  - Since markets tend toward equilibrium, a change in supply will set market forces in motion that lead the market to a new equilibrium price and quantity sold.
- Excess Supply
  - A surplus is a situation in which quantity supplied is greater than quantity demanded. If a surplus occurs, producers reduce prices to sell their products. This creates a new market equilibrium.
- A Fall in Supply
  - The exact opposite will occur when supply is decreased. As supply decreases, producers will raise prices and demand will decrease.

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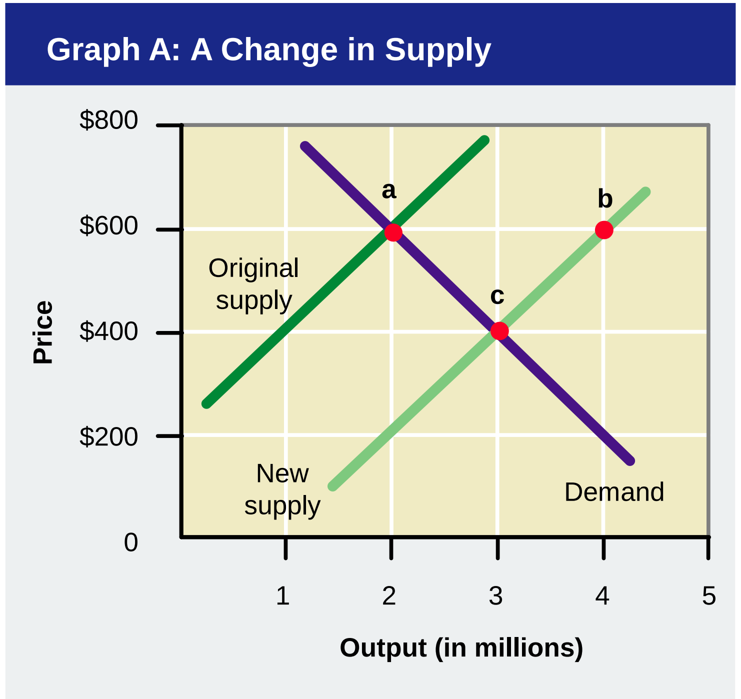
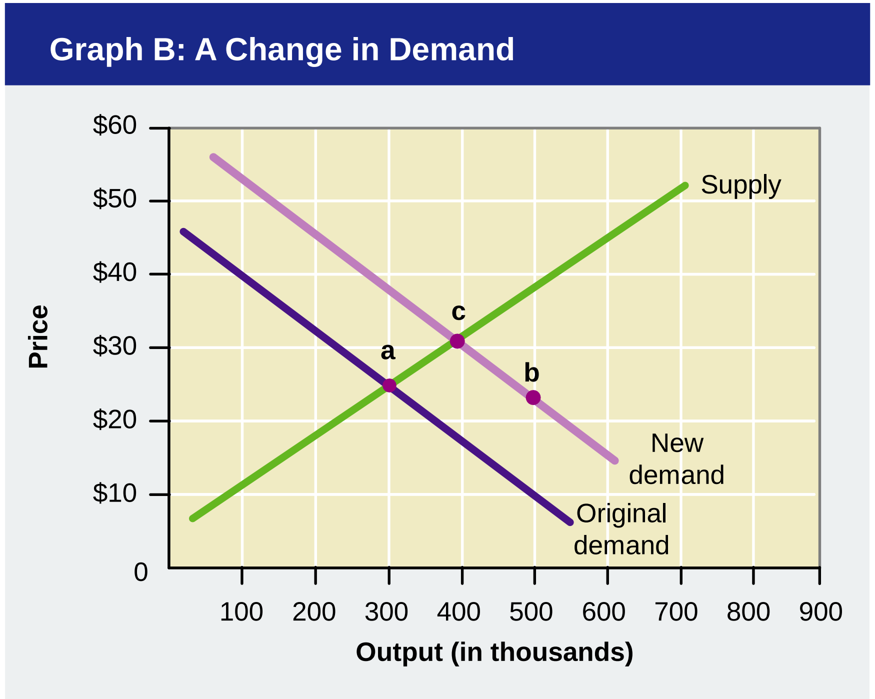
Shifts in Demand

- Excess Demand
  - A shortage is a situation in which quantity demanded is greater than quantity supplied.
- Search Costs
  - Search costs are the financial and opportunity costs consumers pay when searching for a good or service.
- A Fall in Demand
  - When demand falls, suppliers respond by cutting prices, and a new market equilibrium is found.

Analyzing Shifts in Supply and Demand





Graph A shows how the market finds a new equilibrium when there is an increase in supply.

Graph B shows how the market finds a new equilibrium when there is an increase in demand.

The Role of Prices

- What role do prices play in a free market system?
- What advantages do prices offer?
- How do prices allow for efficient resource allocation?

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The Role of Prices in a Free Market

- Prices serve a vital role in a free market economy.
- Prices help move land, labor, and capital into the hands of producers, and finished goods in to the hands of buyers.
- Prices create efficient resource allocation for producers and a language that both consumers and producers can use.

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Advantages of Prices

Prices provide a language for buyers and sellers.

1. Prices as an Incentive

   Prices communicate to both buyers and sellers whether goods or services are scarce or easily available. Prices can encourage or discourage production.

2. Signals

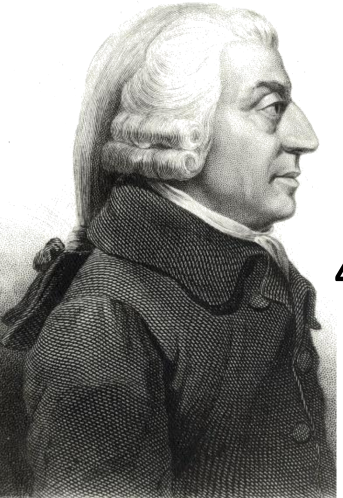
   Think of prices as a traffic light. A relatively high price is a green light telling producers to make more. A relatively low price is a red light telling producers to make less.

3. Flexibility

   In many markets, prices are much more flexible than production levels. They can be easily increased or decreased to solve problems of excess supply or excess demand.

4. Price System is "Free"

   Unlike central planning, a distribution system based on prices costs nothing to administer.



Efficient Resource Allocation

- Resource Allocation
  - A market system, with its fully changing prices, ensures that resources go to the uses that consumers value most highly.
- Market Problems
  - Imperfect competition between firms in a market can affect prices and consumer decisions.
  - Spillover costs, or externalities, are costs of production, such as air and water pollution, that "spill over" onto people who have no control over how much of a good is produced.
  - If buyers and sellers have imperfect information on a product, they may not make the best purchasing or selling decision.

Costs of Production

- How do firms decide how much labor to hire?
- What are production costs?
- How do firms decide how much to produce?

A Firm's Labor Decisions

- Business owners have to consider how the number of workers they hire will affect their total production.
- The marginal product of labor is the change in output from hiring one additional unit of labor, or worker.

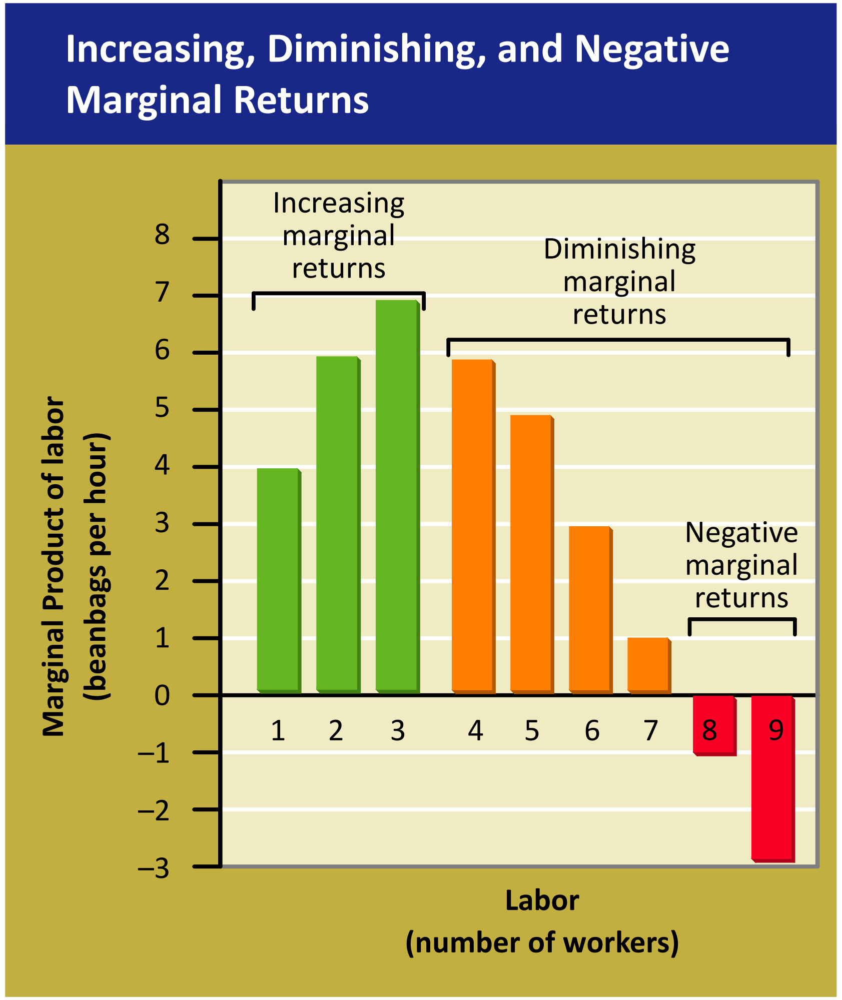
Marginal Product of Labor		
Labor (number of workers)	Output (beanbags per hour)	Marginal product of labor
0	0	—
1	4	4
2	10	6
3	17	7
4	23	6
5	28	5
6	31	3
7	32	1
8	31	–1

Marginal Returns

Increasing marginal returns occur when marginal production levels increase with new investment.

Diminishing marginal returns occur when marginal production levels decrease with new investment.

Negative marginal returns occur when the marginal product of labor becomes negative.



Production Costs

- A fixed cost is a cost that does not change, regardless of how much of a good is produced. Examples: rent and salaries
- Variable costs are costs that rise or fall depending on how much is produced. Examples: costs of raw materials, some labor costs.
- The total cost equals fixed costs plus variable costs.
- The marginal cost is the cost of producing one more unit of a good.

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Setting Output

- Marginal revenue is the additional income from selling one more unit of a good. It is usually equal to price.
- To determine the best level of output, firms determine the output level at which marginal revenue is equal to marginal cost.

Production Costs

Beanbags (per hour)	Fixed cost	Variable cost	Total cost (fixed cost + variable cost)	Marginal cost	Marginal revenue (market price)	Total revenue	Profit (total revenue – total cost)
0	$36	$0	$36	—	$24	$0	$ –36
1	36	8	44	$8	24	24	–20
2	36	12	48	4	24	48	0
3	36	15	51	3	24	72	21
4	36	20	56	5	24	96	40
5	36	27	63	7	24	120	57
6	36	36	72	9	24	144	72
7	36	48	84	12	24	168	84
8	36	63	99	15	24	192	93
9	36	82	118	19	24	216	98
10	36	106	142	24	24	240	98
11	36	136	172	30	24	264	92
12	36	173	209	37	24	288	79

https://youtu.be/01lKDkYSFDg

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SSEMI3

Explain the organization and role of business and analyze the four types of market structure in the US economy.

- Organization of Business
  - ✓ *Sole proprietorship*
  - ✓ *Partnership*
  - ✓ *Corporation*
- Market Structures
  - ✓ *Monopoly*
  - ✓ *Oligopoly*
  - ✓ *Monopolistic competition*
  - ✓ *Pure competition*

Sole Proprietorships

- What role do sole proprietorships play in our economy?
- What are the advantages of a sole proprietorship?
- What are the disadvantages of a sole proprietorship?

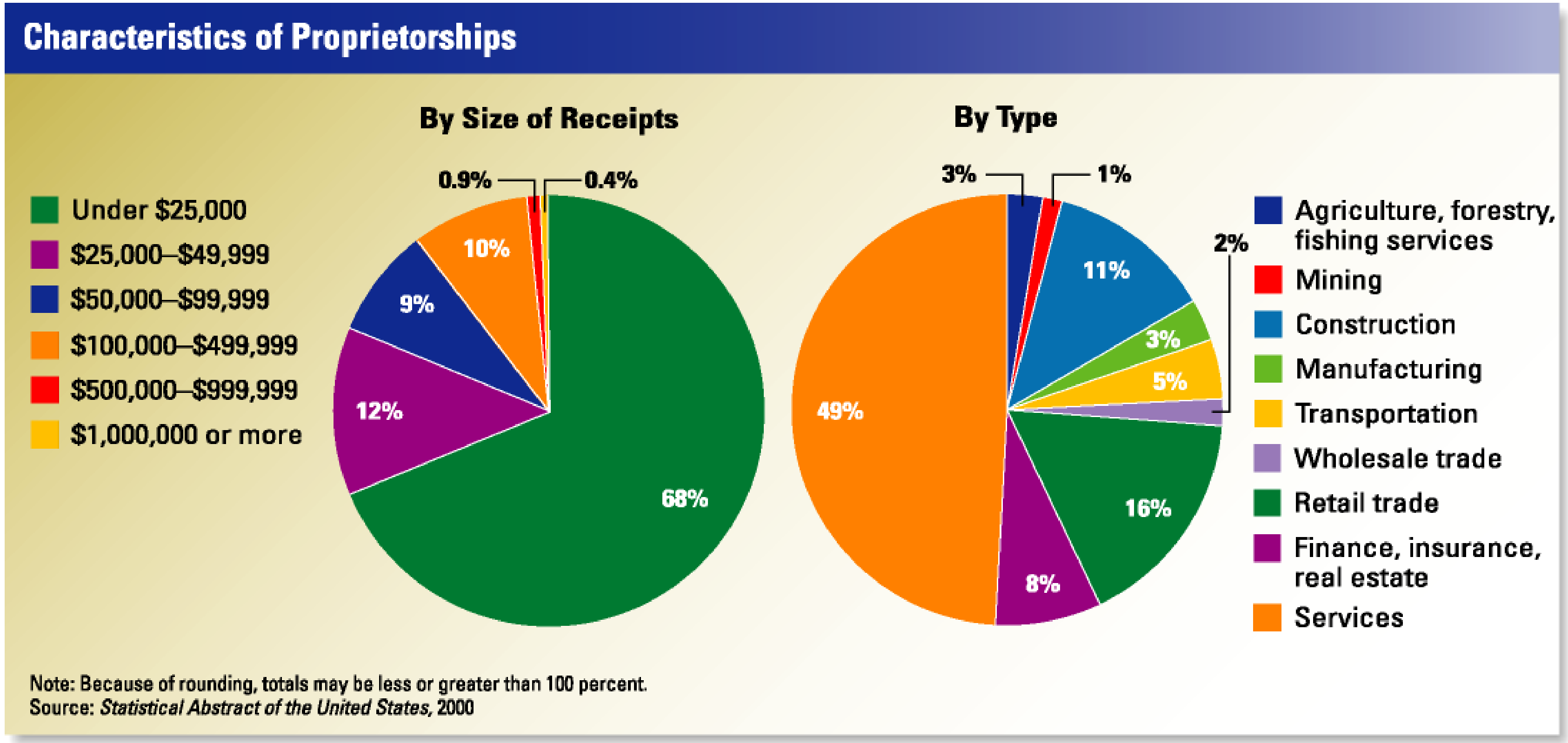
The Role of Sole Proprietorships

- A business organization is an establishment formed to carry on commercial enterprise. Sole proprietorships are the most common form of business organization.
- Most sole proprietorships are small. All together, sole proprietorships generate only about 6 percent of all United States sales.

A sole proprietorship is a business owned and managed by a single individual.

Characteristics of Proprietorships

- Most sole proprietorships earn modest incomes.
- Many proprietors run their businesses part-time.



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Advantages of Sole Proprietorships

Sole proprietorships offer their owners many advantages:

Ease of Start-Up

- With a small amount of paperwork and legal expenses, just about anyone can start a sole proprietorship.

Relatively Few Regulations

- A proprietorship is the least-regulated form of business organization.

Sole Receiver of Profit

- After paying taxes, the owner of sole proprietorship keeps all the profits.

Full Control

- Owners of sole proprietorships can run their businesses as they wish.

Easy to Discontinue

- Besides paying off legal obligations, such as taxes and debt, no other legal obligations need to be met to stop doing business.

Disadvantages of Sole Proprietorships

- Sole proprietorships have limited access to resources, such as physical capital. Human capital can also be limited, because no one knows everything.
- Sole proprietorships also lack permanence. Whenever an owner closes shop due to illness, retirement, or any other reason, the business ceases to exist.

The biggest disadvantage of sole proprietorships is unlimited personal liability. Liability is the legally bound obligation to pay debts.

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Partnerships

- What types of partnerships exist?
- What are the advantages of partnerships?
- What are the disadvantages of partnerships?

Types of Partnerships

Partnerships fall into three categories:

- General Partnership
  - In a general partnership, partners share equally in both responsibility and liability.
- Limited Partnership
  - In a limited partnership, only one partner is required to be a general partner, or to have unlimited personal liability for the firm.
- Limited Liability Partnership
  - A newer type of partnership is the limited liability partnership. In this form, all partners are limited partners.

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Advantages of Partnerships

- Partnerships offer entrepreneurs many benefits.

1. Ease of Start-Up

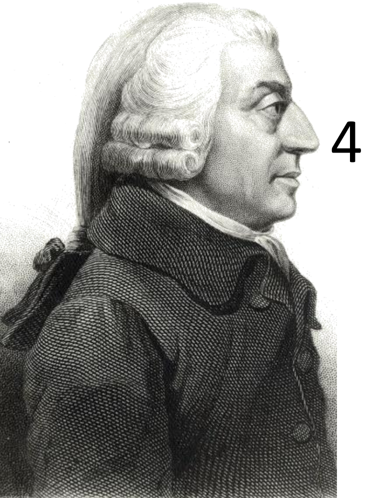
   Partnerships are easy to establish. There is no required partnership agreement, but it is recommended that partners develop articles of partnership.

2. Shared Decision Making and Specialization

   In a successful partnership, each partner brings different strengths and skills to the business.

3. Larger Pool of Capital

   Each partner's assets, or money and other valuables, improve the firm's ability to borrow funds for operations or expansion.



4. Taxation

   Individual partners are subject to taxes, but the business itself does not have to pay taxes.

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Disadvantages of Partnerships

- Unless the partnership is a limited liability partnership, at least one partner has unlimited liability.
- General partners are bound by each other's actions.
- Partnerships also have the potential for conflict. Partners need to ensure that they agree about work habits, goals, management styles, ethics, and general business philosophies.

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Corporations, Mergers, and Multinationals

- What types of corporations exist?
- What are the advantages of incorporation?
- What are the disadvantages of incorporation?
- How can corporations combine?
- What role do multinational corporations play?

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Types of Corporations

- A corporation is a legal entity, or being, owned by individual stockholders.
- Stocks, or shares, represent a stockholder's portion of ownership of a corporation.
- A corporation which issues stock to a limited a number of people is known as a closely held corporation.
- A publicly held corporation, buys and sells its stock on the open market.

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Advantages of Incorporation

Advantages for the Stockholders

- Individual investors do not carry responsibility for the corporation’s actions.
- Shares of stock are transferable, which means that stockholders can sell their stock to others for money.

Advantages for the Corporation

- Corporations have potential for more growth than other business forms.
- Corporations can borrow money by selling bonds.
- Corporations can hire the best available labor to create and market the best services or goods possible.
- Corporations have long lives.

Disadvantages of Incorporation

- Corporations are not without their disadvantages, including:

Difficulty and Expense of Start-Up

Corporate charters can be expensive and time consuming to establish. A state license, known as a certificate of incorporation, must be obtained.

Double Taxation

Corporations must pay taxes on their income. Owners also pay taxes on dividends, or the portion of the corporate profits paid to them.

Loss of Control

Managers and boards of directors, not owners, manage corporations.

More Regulation

Corporations face more regulations than other kinds of business organizations.

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Multinationals

Advantages of MNCs

- Multinationals benefit consumers by offering products worldwide. They also spread new technologies and production methods across the globe.

Disadvantages of MNCs

- Some people feel that MNCs unduly influence culture and politics where they operate. Critics of multinationals are concerned about wages and working conditions provided by MNCs in foreign countries.

Multinational corporations (MNCs) are large corporations headquartered in one country that have subsidiaries throughout the world.

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Perfect Competition

- What conditions must exist for perfect competition?
- What are barriers to entry and how do they affect the marketplace?
- What are prices and output like in a perfectly competitive market?

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The Four Conditions for Perfect Competition

Perfect competition is a market structure in which a large number of firms all produce the same product.

1. **Many Buyers and Sellers**
   There are many participants on both the buying and selling sides.
2. **Identical Products**
   There are no differences between the products sold by different suppliers.
3. **Informed Buyers and Sellers**
   The market provides the buyer with full information about the product and its price.
4. **Free Market Entry and Exit**
   Firms can enter the market when they can make money and leave it when they can't.

Barriers to Entry

Factors that make it difficult for new firms to enter a market are called barriers to entry.

Start-up Costs

- The expenses that a new business must pay before the first product reaches the customer are called start-up costs.

Technology

- Some markets require a high degree of technological know-how. As a result, new entrepreneurs cannot easily enter these markets.

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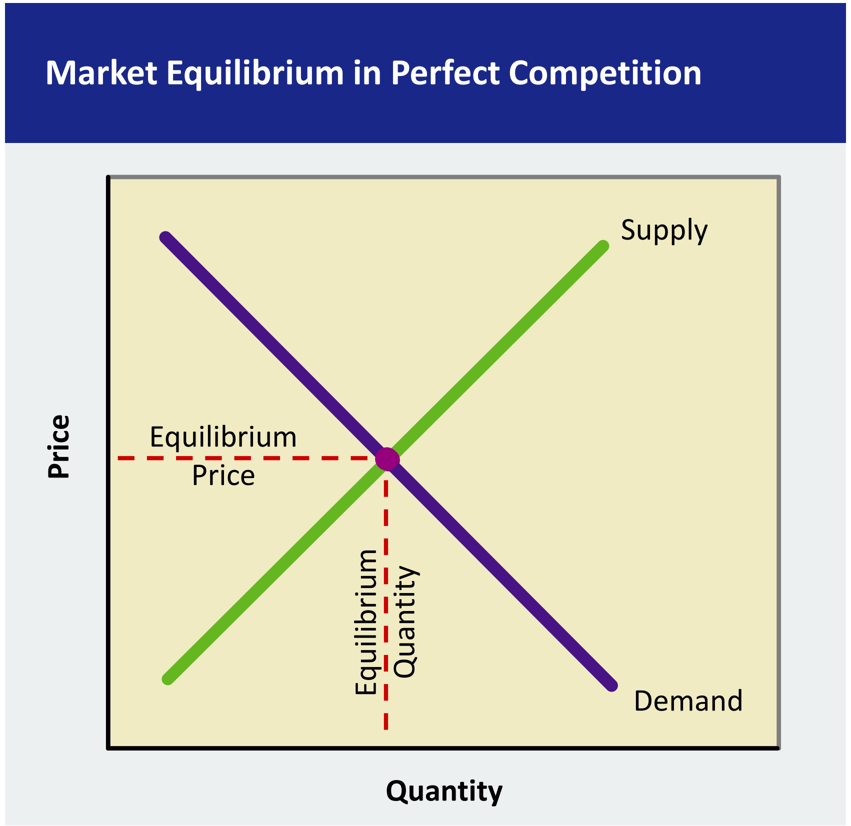
Price and Output

One of the primary characteristics of perfectly competitive markets is that they are efficient. In a perfectly competitive market, price and output reach their equilibrium levels.



Monopoly

- How do economists define the word monopoly?
- How are monopolies formed?
- What is price discrimination?
- How do firms with monopoly set output?

Defining Monopoly

- A monopoly is a market dominated by a single seller.
- Monopolies form when barriers prevent firms from entering a market that has a single supplier.
- Monopolies can take advantage of their monopoly power and charge high prices.

Forming a Monopoly

Different market conditions can create different types of monopolies.

1. **Economies of Scale**
   If a firm's start-up costs are high, and its average costs fall for each additional unit it produces, then it enjoys what economists call economies of scale. An industry that enjoys economies of scale can easily become a natural monopoly.

2. **Natural Monopolies**
   A natural monopoly is a market that runs most efficiently when one large firm provides all of the output.

3. **Technology and Change**
   Sometimes the development of a new technology can destroy a natural monopoly.

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Government Monopolies

A government monopoly is a monopoly created by the government.

- Technological Monopolies
  - The government grants patents, licenses that give the inventor of a new product the exclusive right to sell it for a certain period of time.
- Franchises and Licenses
  - A franchise is a contract that gives a single firm the right to sell its goods within an exclusive market. A license is a government-issued right to operate a business.
- Industrial Organizations
  - In rare cases, such as sports leagues, the government allows companies in an industry to restrict the number of firms in the market.

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Price Discrimination

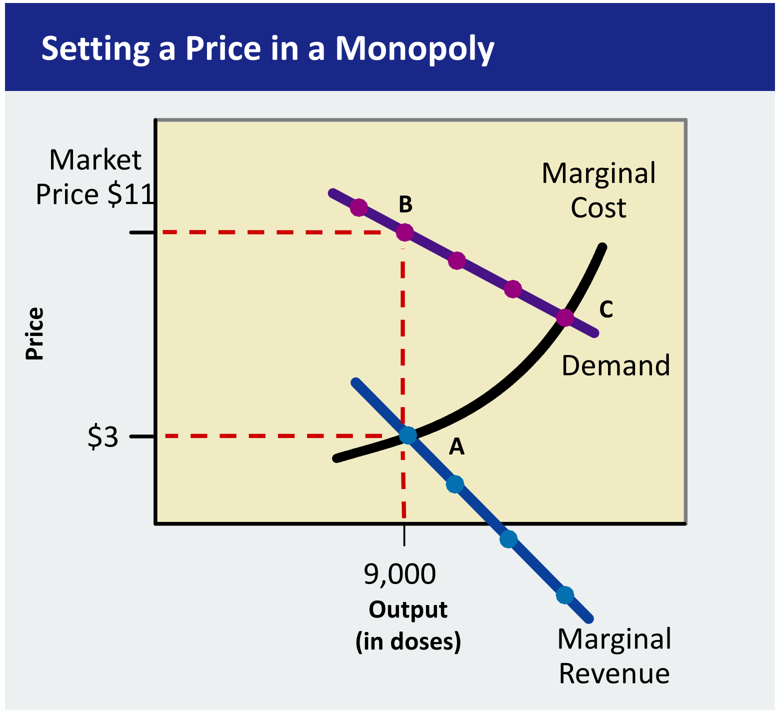
Price discrimination is the division of customers into groups based on how much they will pay for a good.

- Although price discrimination is a feature of monopoly, it can be practiced by any company with market power. Market power is the ability to control prices and total market output.
- Targeted discounts, like student discounts and manufacturers' rebate offers, are one form of price discrimination.
- Price discrimination requires some market power, distinct customer groups, and difficult resale.

Output Decisions

- Even a monopolist faces a limited choice – it can choose to set either output or price, but not both.
- Monopolists will try to maximize profits; therefore, compared with a perfectly competitive market, the monopolist produces fewer goods at a higher price.

A monopolist sets output at a point where marginal revenue is equal to marginal cost.



Monopolistic Competition and Oligopoly

- How does monopolistic competition compare to a monopoly and to perfect competition?
- How can firms compete without lowering prices?
- How do firms in a monopolistically competitive market set output?
- What is an oligopoly?

Four Conditions of Monopolistic Competition

In monopolistic competition, many companies compete in an open market to sell products which are similar, but not identical.

1. **Many Firms**
   As a rule, monopolistically competitive markets are not marked by economies of scale or high start-up costs, allowing more firms.
2. **Few Artificial Barriers to Entry**
   Firms in a monopolistically competitive market do not face high barriers to entry.
3. **Slight Control over Price**
   Firms in a monopolistically competitive market have some freedom to raise prices because each firm's goods are a little different from everyone else's.
4. **Differentiated Products**
   Firms have some control over their selling price because they can differentiate, or distinguish, their goods from other products in the market.

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Nonprice Competition

Nonprice competition is a way to attract customers through style, service, or location, but not a lower price.

1. Characteristics of Goods

The simplest way for a firm to distinguish its products is to offer a new size, color, shape, texture, or taste.

2. Location of Sale

A convenience store in the middle of the desert differentiates its product simply by selling it hundreds of miles away from the nearest competitor.

3. Service Level

Some sellers can charge higher prices because they offer customers a higher level of service.

4. Advertising Image

Firms also use advertising to create apparent differences between their own offerings and other products in the marketplace.

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Prices, Profits, and Output

- Prices
  - Prices will be higher than they would be in perfect competition, because firms have a small amount of power to raise prices.
- Profits
  - While monopolistically competitive firms can earn profits in the short run, they have to work hard to keep their product distinct enough to stay ahead of their rivals.
- Costs and Variety
  - Monopolistically competitive firms cannot produce at the lowest average price due to the number of firms in the market. They do, however, offer a wide array of goods and services to consumers.

Oligopoly

Oligopoly describes a market dominated by a few large, profitable firms.

Collusion

- Collusion is an agreement among members of an oligopoly to set prices and production levels. Price- fixing is an agreement among firms to sell at the same or similar prices.

Cartels

- A cartel is an association by producers established to coordinate prices and production.

Comparison of Market Structures

- Markets can be grouped into four basic structures: perfect competition, monopolistic competition, oligopoly, and monopoly

Comparison of Market Structures

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Number of firms	Many	Many	Two to four dominate	One
Variety of goods	None	Some	Some	None
Control over prices	None	Little	Some	Complete
Barriers to entry and exit	None	Low	High	Complete
Examples	Wheat, shares of stock	Jeans, books	Cars, movie studios	Public water

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Regulation and Deregulation

- How do firms use market power?
- What market practices does the government regulate or ban to protect competition?
- What is deregulation?

Market Power

Market power is the ability of a company to control prices and output.

- Markets dominated by a few large firms tend to have higher prices and lower output than markets with many sellers.
- To control prices and output like a monopoly, firms sometimes use predatory pricing. Predatory pricing sets the market price below cost levels for the short term to drive out competitors.

Government and Competition

Government policies keep firms from controlling the prices and supply of important goods. Antitrust laws are laws that encourage competition in the marketplace.

1. Regulating Business Practices
The government has the power to regulate business practices if these practices give too much power to a company that already has few competitors.

2. Breaking Up Monopolies
The government has used anti-trust legislation to break up existing monopolies, such as the Standard Oil Trust and AT&T.

3. Blocking Mergers
A merger is a combination of two or more companies into a single firm. The government can block mergers that would decrease competition.

4. Preserving Incentives
In 1997, new guidelines were introduced for proposed mergers, giving companies an opportunity to show that their merging benefits consumers.

Deregulation

Deregulation is the removal of some government controls over a market.

- Deregulation is used to promote competition.
- Many new competitors enter a market that has been deregulated. This is followed by an economically healthy weeding out of some firms from that market, which can be hard on workers in the short term.

What are your questions?

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