

Chapter 3

MARKETS AND SOCIETY

Principles of Economics in Context (Goodwin, et al.), 2nd Edition

Chapter Overview

This chapter introduces you to the structure and workings of markets (leaving the more formal analysis of supply and demand to the next chapter.). Three different definition of markets are discussed, as well as the institutional requirements for smoothly-functioning markets. Markets are further classified according to what is sold and how prices are determined. The chapter ends with a brief discussion of the advantages and disadvantages of markets, a topic that will be discussed frequently throughout the book.

Objectives

After reading and reviewing this chapter, you should be able to:

1. Understand the three different meanings of “markets.”
2. Describe the institutional requirements for well-functioning markets.
3. Classify markets according to what is sold.
4. Classify markets according to how prices are determined.
5. Understand advantages and disadvantages of markets, as well as market outcomes

Key Terms

market (first meaning)
market (second meaning)
market (third meaning)
institution
private property
explicit contract
implicit contract
physical infrastructure
money
retail markets
wholesale markets
intermediate goods market
resale market

commodities market
labor market
financial market
underground market
posted prices
market price
auction market
bargaining
transaction costs
market power
static analysis
dynamic analysis

Active Review Questions

Fill in the blank

1. “The real estate market in Los Angeles” is an example of the definition of markets _____.
2. Markets for raw materials such as agricultural products and minerals are known as _____.
3. Markets for goods and service purchased from businesses, generally in small quantities, are known as _____.
4. A market in which a good is sold to the highest bidder is known as _____.
5. You decide to buy a used car. You discover that it is hard to get information on the quality of the used cars that are available. You have trouble communicating with the car dealer. It takes a considerable amount of time to get the information you need to successfully get the car you had in mind. In other words, buying a used car turns out to be an activity with high _____ costs.
6. A new factory begins discharging pollutants into a previously pristine river. Fish in the river begin to die, and people who make their living through fishing have trouble maintaining their catch. This factory is generating negative _____.

True or false

7. When we speak of a “laissez-faire economy” we are referring to a market based on product categories.
8. An implicit contract is an example of a social institution of trust.
9. Intermediate goods markets involve the sale of used products between households.
10. Markets with bargaining involve the interaction of a single buyer with a single seller.
11. Public goods, externalities, transactions costs, market power, the difficulty of getting information, and concern for human needs and equity are all examples of issues that lead to market failure.

Short answer

12. What are the three definitions of markets?

13. What are the four institutional requirements for smoothly functioning markets?

14. List five different markets classified according to what is sold.

Self Test

1. Which one of the following is an example of a market based on product categories?

- a. The stock market
- b. A grocery store
- c. A market-based capitalistic economy
- d. A used car dealership
- e. An on-line bookseller

2. Which one of the following is an example markets as an economic system?

- a. The stock market
- b. A grocery store
- c. A market-based capitalistic economy
- d. A used car dealership
- e. An on-line bookseller

3. Laws that define which goods can be owned are considered ...

- a. social institutions of trust.
- b. individualist institutions of property and decision making.
- c. infrastructure for the flow of information.
- d. unnecessary for market functioning.
- e. part of implicit contracts.

4. An implicit contract is an example of ...
 - a. an individualist institution of property and decision making.
 - b. an economic activity in the core sphere.
 - c. a social institution of trust.
 - d. infrastructure for the flow of information.
 - e. a market as an economic system.

5. Which one of the following is not a requirement for something to be considered money?
 - a. A durable store of value
 - b. A unit of account
 - c. Minimal handling costs
 - d. Backed by government-held assets
 - e. Acceptance as a medium of exchange

6. Markets for unfinished goods sold between businesses are referred to as ...
 - a. intermediate goods markets.
 - b. commodity markets.
 - c. resale markets.
 - d. wholesale markets.
 - e. retail markets.

7. Markets for goods and services sold by businesses to consumers, generally in small quantities are referred to as ...
 - a. intermediate goods markets.
 - b. commodity markets.
 - c. resale markets.
 - d. wholesale markets.
 - e. retail markets.

8. The prices of goods sold at a convenience store tend to be determined by ...
 - a. bargaining.
 - b. posted prices.
 - c. a Dutch auction.
 - d. a double auction.
 - e. social institutions.

9. Illegal drugs are sold primarily in which type of markets?
- Labor markets
 - Underground markets
 - Commodity markets
 - Intermediate goods markets
 - Wholesale markets
10. The sale of crude oil would most likely occur in which type of market?
- A resale market
 - A retail market
 - A labor market
 - A commodity market
 - An underground market
11. Bargaining involves the interactions of ...
- numerous buyers and sellers.
 - one buyer and one seller.
 - one seller and numerous buyers.
 - one buyer and numerous sellers.
 - buyers and sellers with equal market power.
12. Which one of the following is not a potential drawback of markets?
- A failure to account for environmental degradation.
 - A loss of certain community values.
 - The tendency to over-provide public goods.
 - An inability to correct for excessive market power.
 - A failure to address economic inequalities.
13. Which one of the following statements is false?
- Markets involve implicit and explicit contracts.
 - Markets require physical and communications infrastructure.
 - Markets provide feedback between buyers and sellers.
 - Markets encourage sellers to respond to buyer preferences.
 - Markets discourage economic actors from increasing efficiency.

14. Which of the following could lead to market failure?

- a. The existence of externalities.
- b. Transactions costs
- c. Market power on the part of large corporations.
- d. All of the above.
- e. (a) and (c) only.

Answers to Active Review Questions

1. based on product categories
2. commodity markets
3. retail markets
4. an auction market
5. transaction costs
6. externalities
7. False. We are referring to a market as an economic system.
8. True
9. False. Intermediate goods markets involve the sale of unfinished products between businesses.
10. True
11. True. These are all cases in which the market form of organization can lead to inefficient or harmful results.
12. Markets as place to buy and sell, markets defined by product categories, markets as economic systems.
13. Individualist institutions of property and decision making, social institutions of trust, infrastructure for the flow of goods and information, and money as a medium of exchange.
14. Retail markets, wholesale markets, intermediate goods markets, resale markets, commodities markets, labor market, financial markets, underground markets.

Answers to Self Test Questions

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|------|-------|
| 1. a | 8. b |
| 2. c | 9. b |
| 3. b | 10. d |
| 4. c | 11. b |
| 5. d | 12. c |
| 6. a | 13. e |
| 7. e | 14. d |