CHAPTER 3

MARKETS AND SOCIETY

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

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 discussion of the advantages and disadvantages of markets, a topic that will come up again 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. Discuss advantages and limitations of markets.

Key Terms

market (first meaning)
market (second meaning)
institutions
market (third meaning)
laissez-faire economy
private property
explicit contract
implicit contract
physical infrastructure
money
retail markets
wholesale markets
intermediate goods market
resale market
commodity market
labor market
financial market
underground market
posted prices
market value
auction market
open auction
Dutch auction
sealed-bid auction
double auction
bargaining
transaction costs
market power
static analysis
dynamic analysis
market failure

Active Review Questions

Fill in the blank

1. "The real estate market in Los Angeles" is an example of the definition of markets as ______________________.

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 the initial price is set high, and then lowered until a buyer is willing to pay that price is known as __________________________.

True or false

5. When we speak of a "laissez-faire economy" we are referring to a market as a social institution.

6. An implicit contract is an example of a social institution of trust.

7. Intermediate goods markets involve the sale of used products between households.

8. Markets with bargaining involve the interaction of a single buyer with a single seller.

9. 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

10. What are the three definitions of markets?

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

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

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Self Test

1. Which one of the following is an example of a market as a social institution?

    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. a legal institution of property and decision making.
    b. money as a medium of exchange.
    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. open auctions.
    d. closed auctions.
    e. social institutions.

9. An auction in which the initial price is set high, and lowered until someone is willing to pay that price, is known as …

    a. an open auction.
    b. a Dutch auction.
    c. a sealed-bid auction.
    d. a closed auction.
    e. a double auction.

10. An auction in which the initial price is set low, and bidders increase the bid until there is only one remaining buyer is known as …

    a. an open auction.
    b. a Dutch auction.
    c. a sealed-bid auction.
    d. a closed auction.
    e. a double auction.

11. Bargaining involves the interactions of …

    a. numerous buyers and sellers.
    b. one buyer and one seller.
    c. one seller and numerous buyers.
    d. one buyer and numerous sellers.
    e. buyers and sellers with equal market power.

12. Which one of the following is not a potential drawback of markets?

    a. A failure to account for environmental degradation.
    b. A loss of certain community values.
    c. The tendency to over-provide public goods.
    d. An inability to correct for excessive market power.
    e. A failure to address economic inequalities.

13. Which one of the following statements is false?

    a. Markets involve implicit and explicit contracts.
    b. Markets require physical and communications infrastructure.
    c. Markets provide feedback between buyers and sellers.
    d. Markets encourage sellers to respond to buyer preferences.
    e. 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. institutions that facilitate interaction among buyers and sellers
2. commodity markets
3. retail markets
4. A Dutch auction
5. False. We are referring to a market as an economic system.
6. True
7. False. Intermediate goods markets involve the sale of unfinished products between businesses.
8. True
9. True. These are all cases in which the market form of organization can lead to inefficient or harmful results.
10. Markets as place to buy and sell, markets as social institutions, markets as economic systems.
11. 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.
12. Retail markets, wholesale markets, intermediate goods markets, resale markets, commodities markets, labor market, financial markets, underground markets.

Answers to Self Test Questions

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