

Chapter 2

MARKETS AND SOCIETY

Microeconomics in Context (Goodwin, et al.), 5th Edition

Chapter Overview

This chapter points out that the economy may be understood as existing within “three spheres” of activity; not only businesses (estimated at 70% of the economy), but also the core sphere, comprising economic activity that occurs within households and communities (14%), as well as the public purpose sphere, of government and not-for-profit activity (16%). The chapter then discusses markets, first by defining markets in different ways and listing 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. Differentiate between the three spheres of economic activity.
2. Understand the three different meanings of “markets.”
3. Describe the institutional requirements for well-functioning markets.
4. Classify markets according to what is sold.
5. Classify markets according to how prices are determined.
6. Understand advantages and disadvantages of markets, as well as market outcomes

Key Terms

core sphere
public good
informal sphere
market (second meaning)
laissez-faire economy
private property
implicit contract
money
wholesale markets
resale market
labor market
underground market
auction market

public purpose sphere
business sphere
market (first meaning)
market (third meaning)
institutions
explicit contract
physical infrastructure
retail markets
intermediate goods market
bargaining
financial market
posted prices

Active Review Questions

Fill in the blank

1. A local grocery store is an example of an organization that would be classified into the _____ sphere.
2. Something that is freely available to everyone, and whose use by one person does not diminish the ability of others to use it, is known as _____.
3. About 14% of economic activity in the United States is classified as occurring in the _____ sphere.
4. “The real estate market in Los Angeles” is an example of the definition of markets _____.
5. Markets for car loans are an example of _____ markets.
6. Markets for goods and service purchased from businesses, generally in small quantities, are known as _____.
7. A market in which a good is sold to the highest bidder is known as _____.

True or false

8. Economic activity in the core sphere tends to be rewarded with wages and salaries.
9. Religious organizations would be classified into the public purpose sphere.
10. A public good is one which is available at low cost to everyone, and whose use by one person does not affect its availability to others.
11. One of the advantages of economic activity in the business sphere is that it tends to encourage innovation.
12. About 16% of economic activity in the United States occurs in the public purpose sphere.
13. When we speak of a “laissez-faire economy” we are referring to a market based on product categories.
14. An implicit contract is an example of a social institution of trust.
15. Intermediate goods markets involve the sale of used products between households.
16. Markets with bargaining involve the interaction of a single buyer with a single seller.

Short answer

17. What is a public good?

18. What are the three definitions of markets?

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

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

Self Test

1. What are the three spheres of economic activity?

- a. The core, business, and government spheres
- b. The monetary, core, and government spheres
- c. The public, private, and social spheres
- d. The core, business, and monetary spheres
- e. The core, business, and public purpose spheres

2. What sphere of economic activity is comprised of households, families, and communities?

- a. Public purpose sphere
- b. Core sphere
- c. Internal sphere
- d. Dependency sphere
- e. Institutional sphere

3. Which one of the following is an example of an organization in the public purpose sphere?
 - a. A family
 - b. A supermarket chain
 - c. A local grocery store
 - d. A state environmental protection agency
 - e. A child selling lemonade

4. Which one of the following is an example of a public good?
 - a. A clean house
 - b. A city park
 - c. A lawnmower shared by several neighbors
 - d. Cable television
 - e. A doctor's services

5. Which one of the following statements is false?
 - a. Public purpose sphere organizations tend to conduct economic activities at a larger scale than core sphere organizations.
 - b. Core sphere organizations can respond to needs as well as wants.
 - c. The primary place where good social relations are established is in the business sphere.
 - d. One critique of public purpose sphere organizations is that they can be inefficient.
 - e. Business sphere organizations may pursue motives other than making a profit.

6. About what percent of economic activity in the United States occurs in the core sphere?
 - a. 4%
 - b. 10%
 - c. 14%
 - d. 21%
 - e. 64%

7. About what percent of economic activity in the United States occurs in the business sphere?
- a. 15%
 - b. 21%
 - c. 32%
 - d. 61%
 - e. 70%
8. 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
9. 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
10. 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.
11. 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.

12. 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
13. 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.
14. 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.
15. The prices of goods sold at a convenience store tend to be determined by ...
- a. bargaining.
 - b. posted prices.
 - c. an auction.
 - d. the government.
 - e. social institutions.
16. Illegal drugs are sold primarily in which type of markets?
- a. Labor markets
 - b. Underground markets
 - c. Auction markets
 - d. Intermediate goods markets
 - e. Wholesale markets

17. The sale of used cars would most likely occur in which type of market?

- a. A gray market
- b. A retail market
- c. A labor market
- d. A resale market
- e. An underground market

18. 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.

19. 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.

20. 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.

Answers to Active Review Questions

1. business
2. a public good
3. core
4. based on product categories
5. financial markets
6. retail markets
7. an auction market
8. False. Activities in the core sphere tend to be rewarded by the direct outcome of the activity, such as vegetables grown in a garden.
9. True
10. False. The statement is true except that public goods are freely available to everyone.
11. True
12. True
13. False. We are referring to a market as an economic system.
14. True
15. False. Intermediate goods markets involve the sale of unfinished products between businesses.
16. True
17. A public good is freely available to anyone and its use by one person does not diminish its ability to be used by others.
18. Markets as place to buy and sell, markets defined by product categories, markets as economic systems.
19. 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.
20. Retail markets, wholesale markets, intermediate goods markets, resale markets, labor market, financial markets, underground markets.

Answers to Self Test Questions

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|-------|-------|
| 1. e | 11. c |
| 2. b | 12. d |
| 3. d | 13. a |
| 4. b | 14. e |
| 5. c | 15. b |
| 6. c | 16. b |
| 7. e | 17. d |
| 8. a | 18. b |
| 9. c | 19. c |
| 10. b | 20. e |