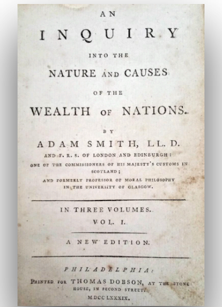
Four Levels of Market Competition



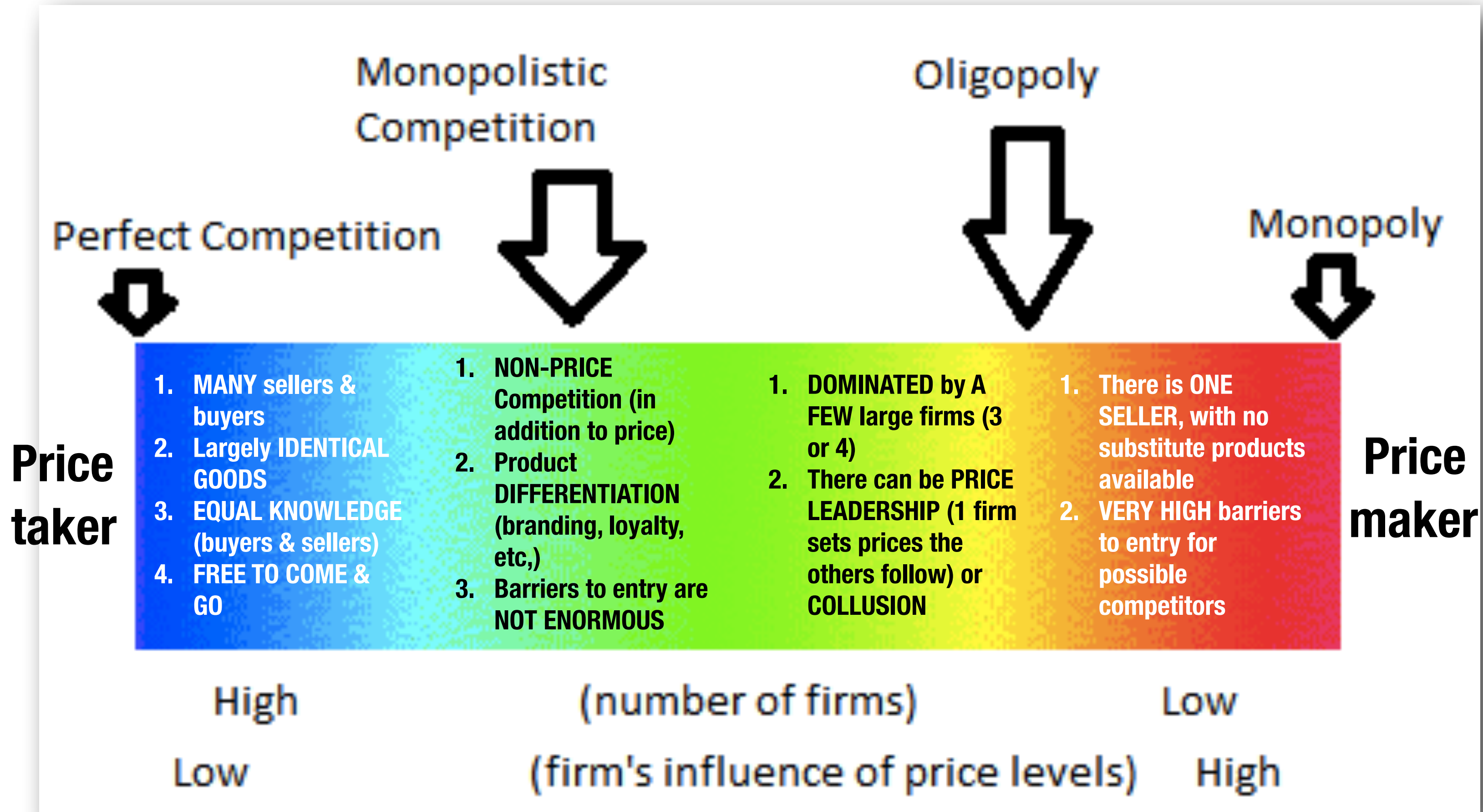
Adam Smith: The importance of ‘perfect competition’

Adam Smith is considered the “father of Economics” and is today widely seen as a major advocate of the benefits of markets. His famous work, *The Wealth of Nations* (1776), however, mostly praises markets that are assumed to be what economists call “perfectly competitive.” Similarly, most supply & demand curves that we have worked with so far assume perfect competition as well. It is in this market situation that the laws of demand and supply can most clearly be seen to operate (even though perfect competition is relatively rare in the modern world).

David A. Anderson, argues in his text, *Economics By Example* (2015, 2nd Edition) that if any of the four traits of perfect competition are not met, then a market has monopolistic competition (or is an oligopoly or monopoly) and there need to be regulations or adjustments of some kind (government intervention, basically) in order to maintain the market as a beneficial force (or to restore competition, in the case of a monopoly). With perfect competition, the sellers are each a “price taker” (they take the equilibrium price that is settled by the price adjustment process, thanks to the intense competition).

Adam Smith saw “market power” as dangerous. “Market power” grows as we move to the right on the market competition spectrum - especially when we get to Oligopoly and Monopoly, but even in Monopolistic Competition it comes into play (often because “knowledge” - of prices, of ingredients, of true costs, of safety testing. etc. is not fully known by consumers, or perhaps they cannot effectively compare prices.

NUMBER OF FIRMS (COMPANIES) AND DEGREE OF INFLUENCE FIRMS HAVE ON PRICE LEVELS



EXAMPLE:
Wheat, Oranges

EXAMPLE:
Fast Food, Hotels

EXAMPLE:
Smartphones

EXAMPLE:
DeBeers diamonds, EssilorLuxottica eyewear

As you move **from left** (perfect competition) **to right** (monopoly) on the competition spectrum, the **number of firms** in a market **will decrease** (from many to one) and the **market power** (influence of firms on market prices) will **increase.**