Economics of Competition, Monopoly, and Market Power

Antitrust
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First, a review problem ...

Problem: Hal's House

Your friend Hal flips houses and trades stocks for a living. Right now, he's got some stock options, expiring next week, that allow him to purchase 2,000 shares of stock in GameBeyond at $100 each. That stock is trading currently at $200 a share. The problem is Hal doesn't have the cash to exercise the options because his money is tied up in a house he's trying to flip. He bought the house at 42 Pineberry Drive for $200,000 and put $100,000 into renovating it. He was hoping to sell it for $400,000, but now his best offer is $270,000. If he waits another six months, he's sure can sell it for $300,000. "I want to get rid of that house," he tells you. "But I can't afford to sell it at a loss!" *What do you advise him?*

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A good answer: "Hal, you can't afford to *not* sell it at a loss! That $300,000 is a sunk cost. Right now, if you can get $270,000 for it, then you can exercise your options for $200,000 and turn around and sell them for $400,000 for a gain of $200,000. That's $170,000 better than waiting six months for an extra $30,000 on the sale of your house."

Problem: Hal's House

Your fri ing. Right
now, at
allov d at
$100 The
prob ns
beca He
bou ut
$100
$400
anot ant
to g o
sell
A go s!
That
$270
$200, gain
of $20 ths
for an extra $30,000 on the sale of your house."

Here's the math:

SELL NOW:
receive $270K → total = $270K
spend $200K → total = $70K
get $400K → total = $470K

SELL LATER:
receive $300K → total = $300K

Comparing SELL NOW and SELL LATER:
$470K > $300K
∴ SELL NOW is better!
$470K - $300K = $170K
∴ SELL NOW is better by $170K!

(Other numbers are irrelevant! Sunk costs!)

Okay, now on to the new material ...

Thoughts on POE Ch. 8

- In Ch. 8, once again, we're way "overlearning" the economics ...
  - The math stuff in this chapter is skimmable material. It's unnecessary for our purposes, and there's even an arithmetic error on p. 196. ☹
- but this material will help us understand what's at stake with antitrust law.
- It's a necessary building block for monopoly economics.
- Combined with the concepts of monopoly economics, the Ch. 8 material will help us understand market power, dominant firms, oligopoly, etc.
- I think the most useful part of the chapter is the tables. Scrutinize them and think about how actors make decisions on the margins (a/k/a marginal analysis).
- Then let the tables help you make sense of the graphs to which they correspond.
- Remember—it's a warm up to going through stuff in class.

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For all the stuff in POE, here's how to gauge if you understood enough:

- **Can you understand the slides in class?**
- **Can you get the assigned review questions?**
- **Can you get the problems we do in class?**

If so, you're good to go.

Thoughts on POE Ch. 9

[which is assigned after Ch. 8 ...]

- With previous chapters in POE, I said we were "overlearning" the economics ...
- That's still true in large part with Ch .9, but Ch. 9 is also underlearning content at the same time.
- It's still true that we care more about conceptual understanding than math. But Ch. 9 is heavy on conceptual material, and when it comes to that, this chapter glosses over a lot that is important.
- I'm not going to go through the chapter and exhaustively point out perilous gloss and places needing caveats and nuance ...
- just remember that it's about giving us an introductory framework, and, in particular,
  - don't use this chapter as a source for any statement about the law!
- Again, I think the most useful part of the chapter is the tables. Scrutinize them and think about how actors make decisions on the margins (a/k/a marginal analysis).
- Then let the tables help you make sense of the graphs to which they correspond.
- Remember (again) — it's a warm up to going through stuff in class.

Thoughts on POE Ch. 9

[which is assigned after Ch. 8 …]

Again …

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- …
- …
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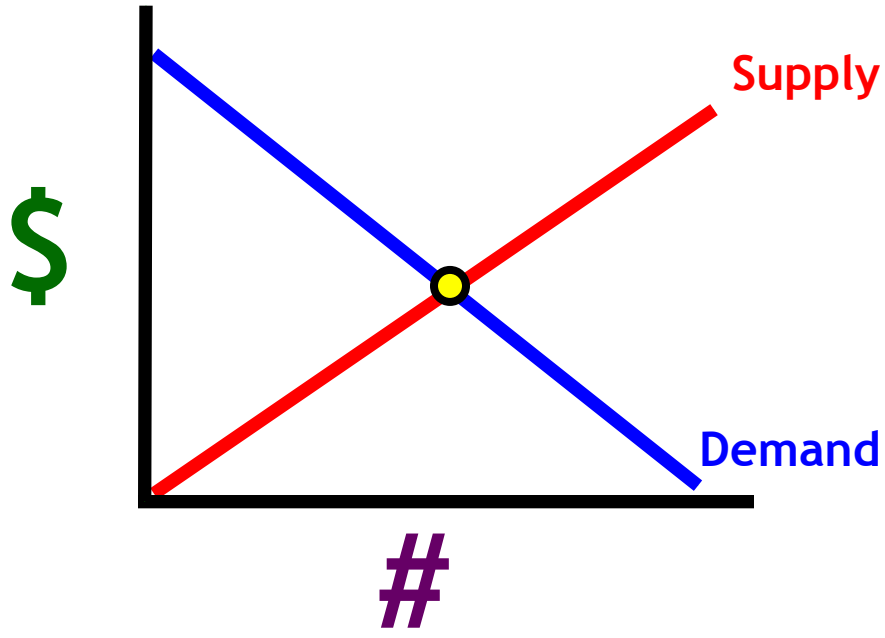

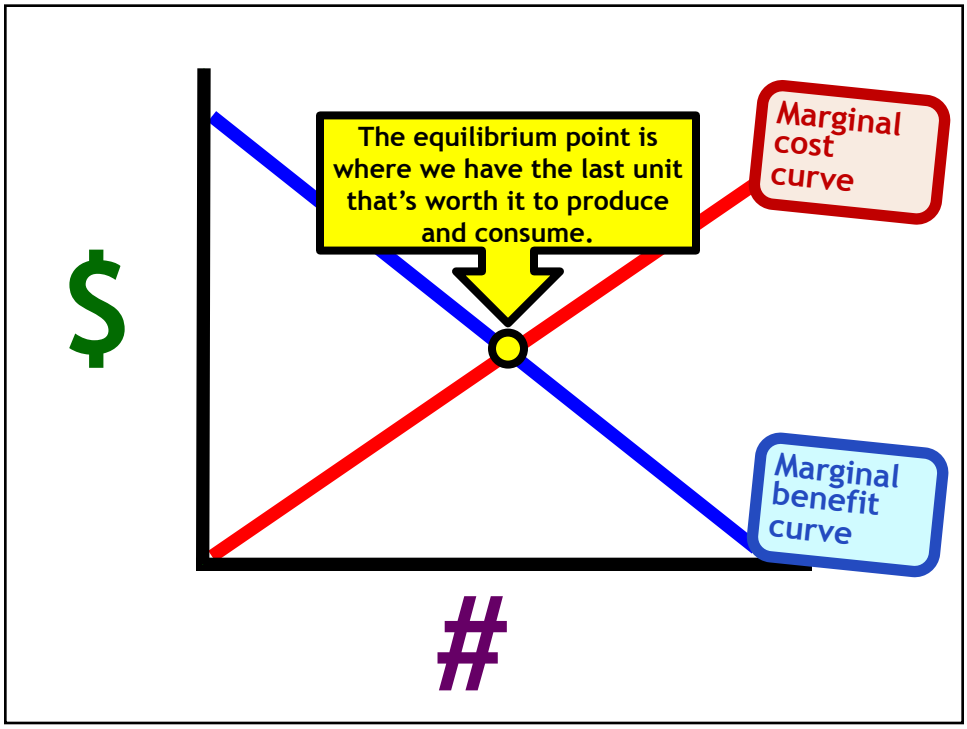

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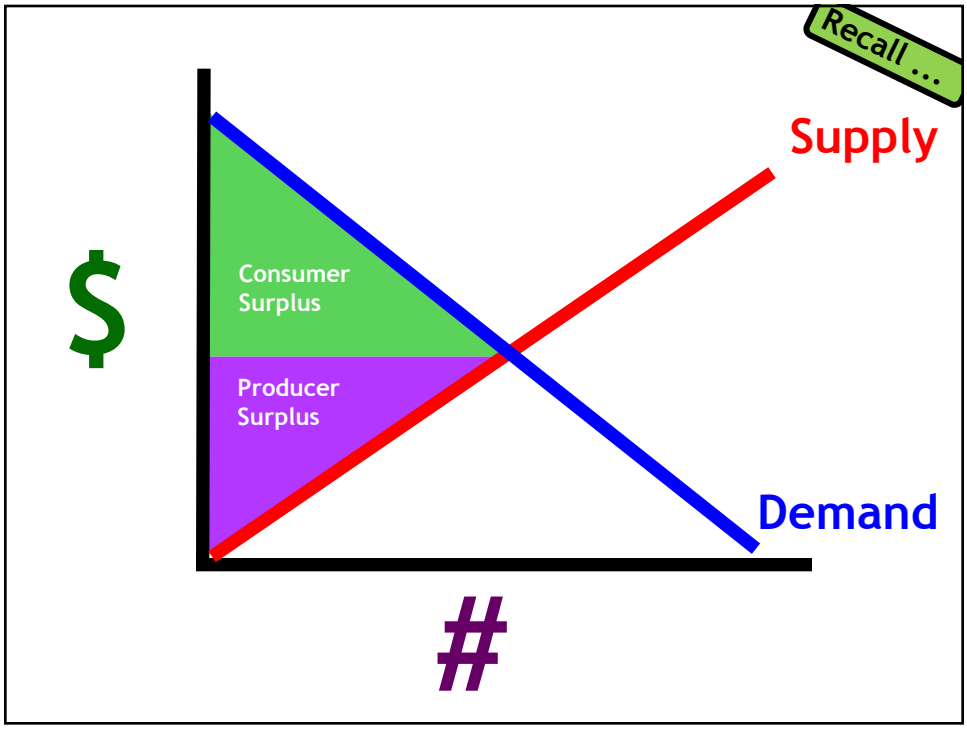
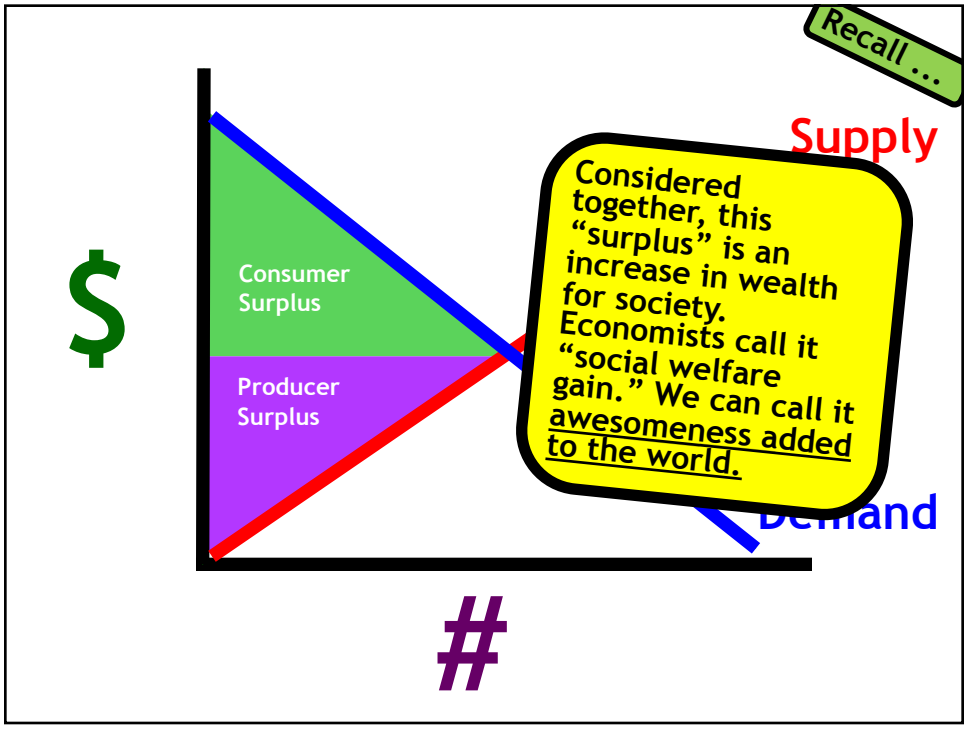
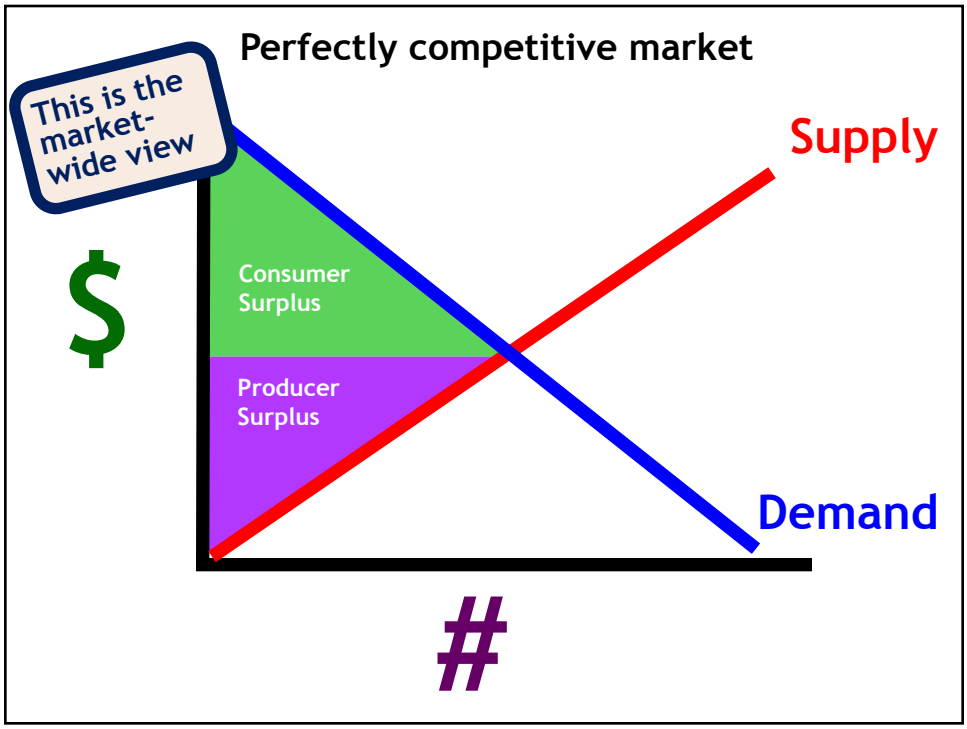
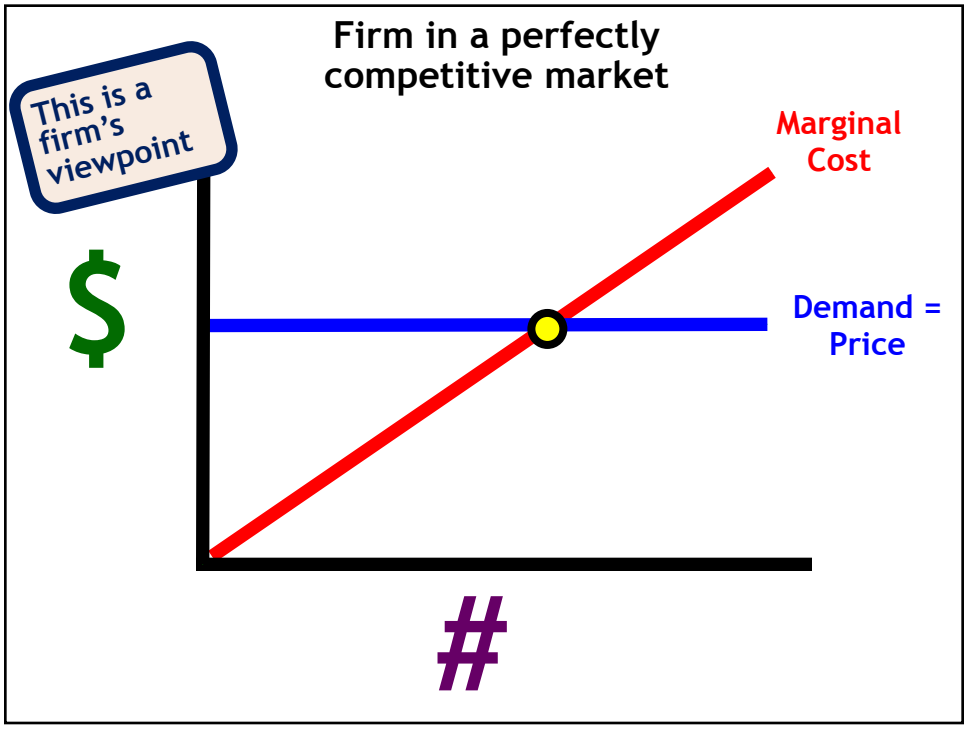
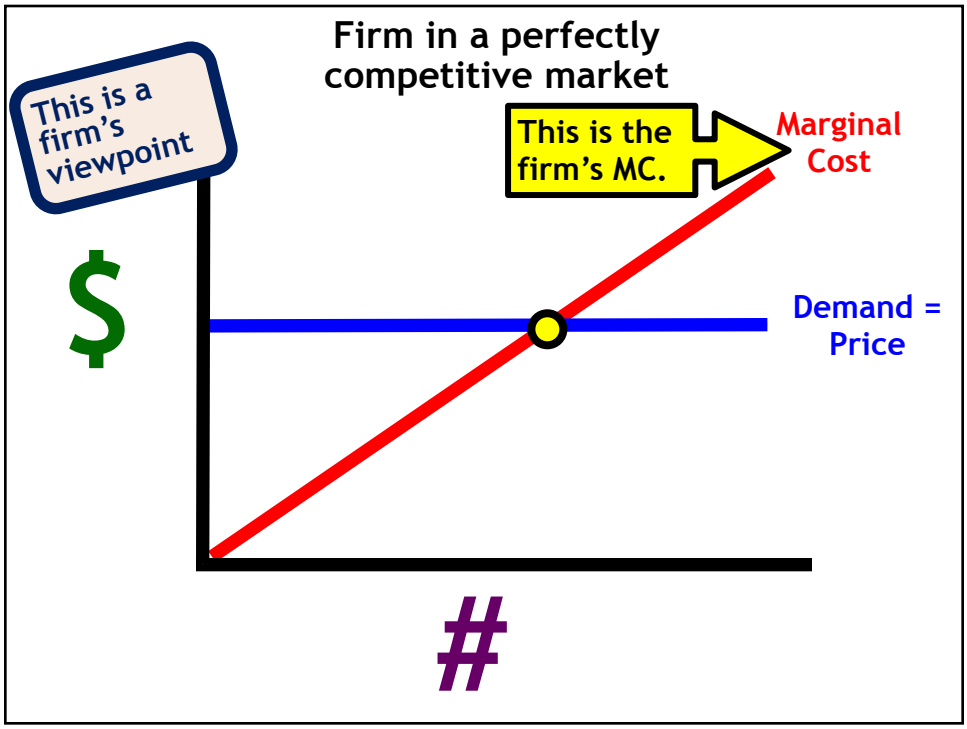
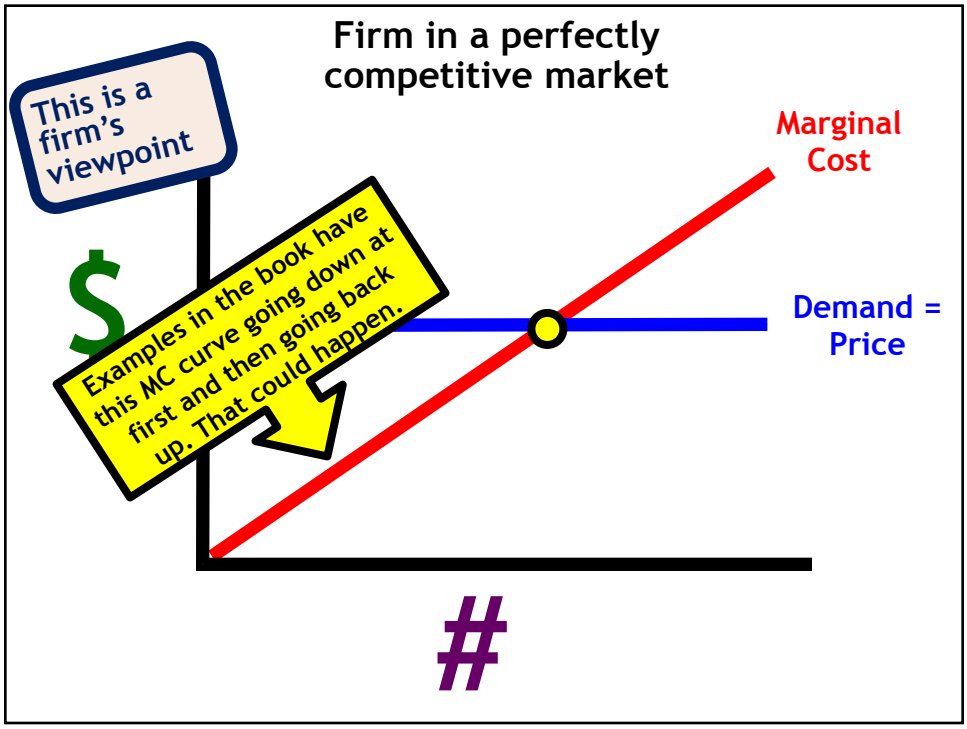

Recall ...
Supply
$
Consumer Surplus
Producer Surplus
Demand
#

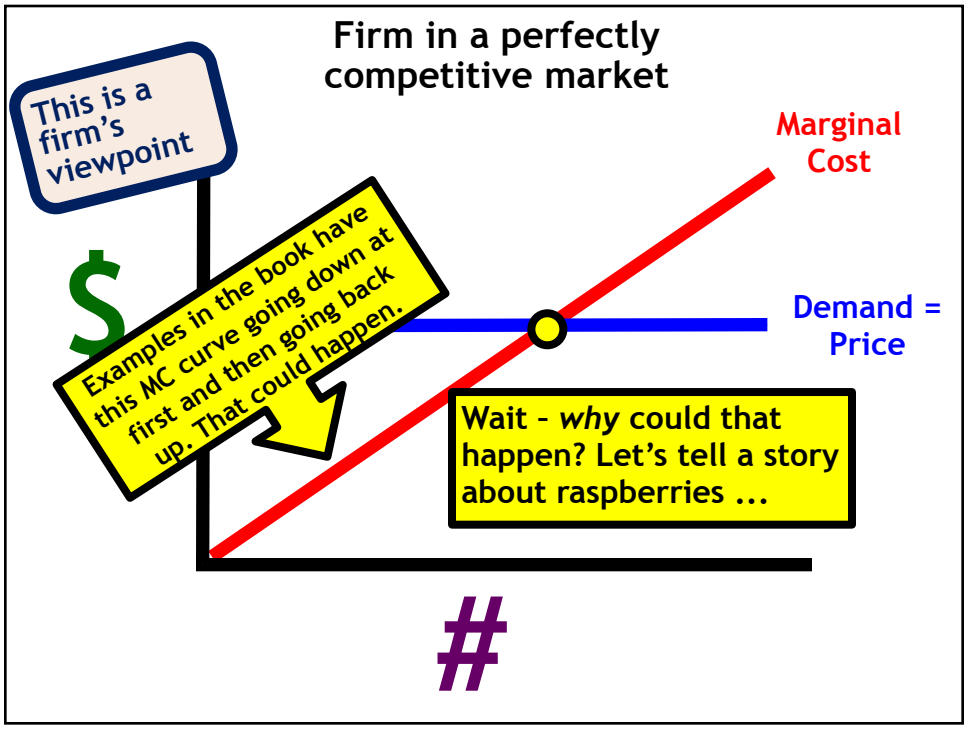

Recall ...
Supply
$
Consumer Surplus
Producer Surplus
Considered together, this "surplus" is an increase in wealth for society. Economists call it "social welfare gain." We can call it awesomeness added to the world.
Demand
#

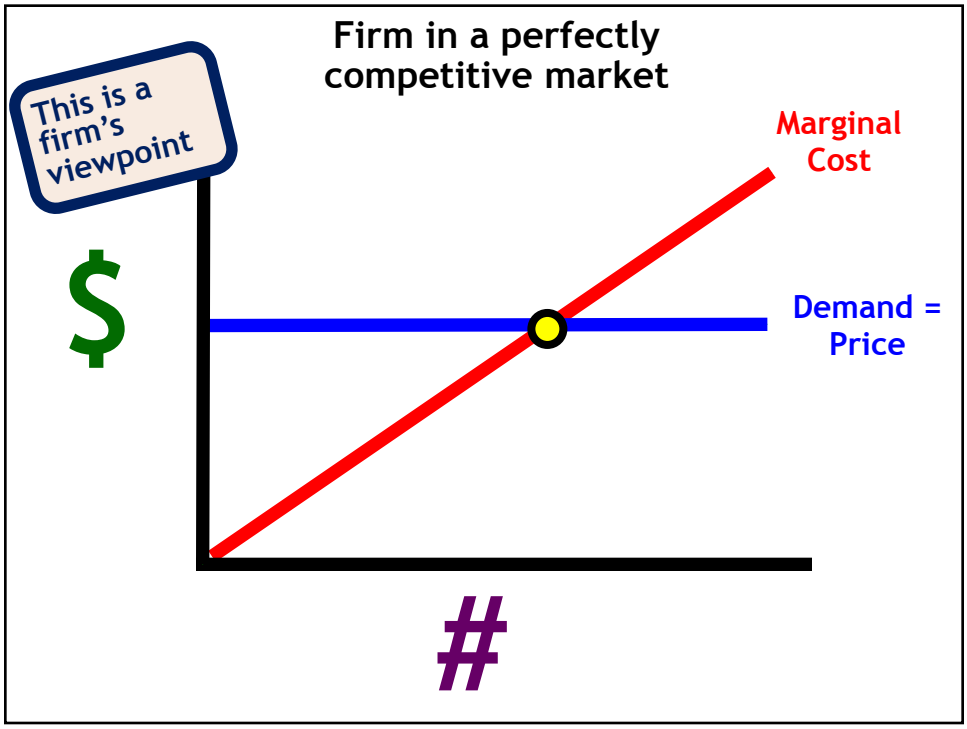

Perfectly competitive market
This is the market-wide view
Supply
$
Consumer Surplus
Producer Surplus
Demand
#

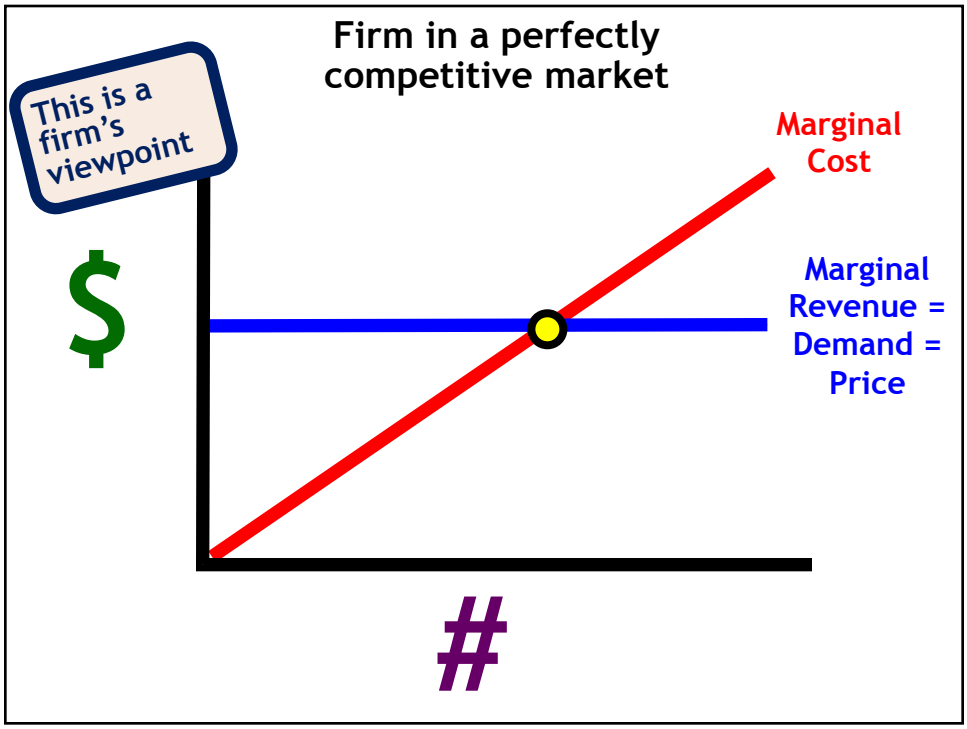

Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Demand = Price
$
#

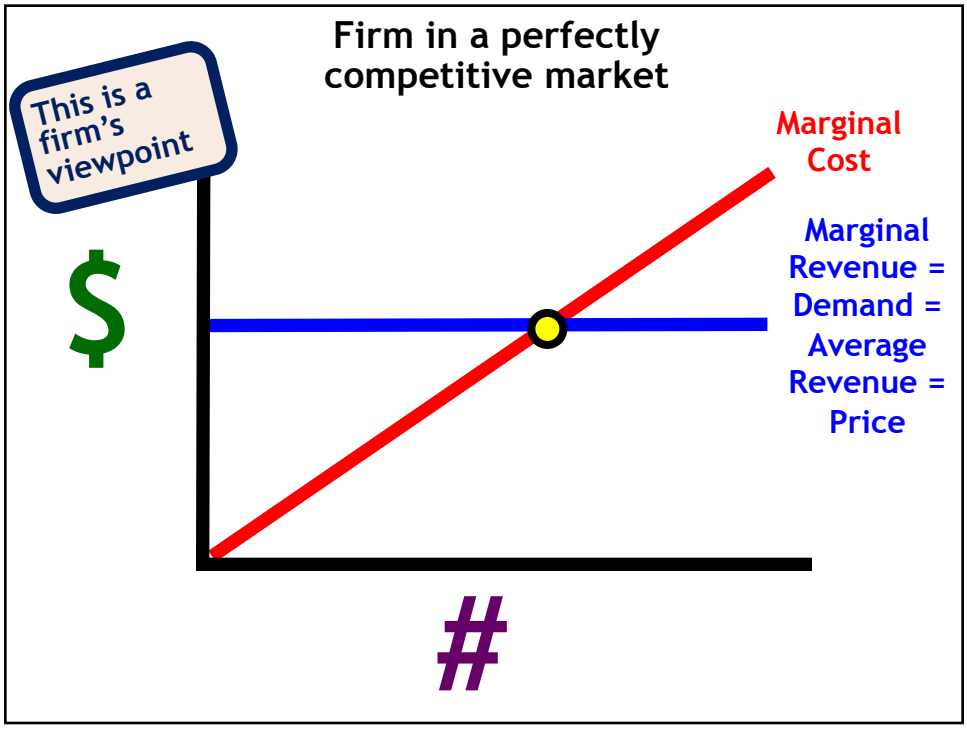

Firm in a perfectly competitive market
This is a firm's viewpoint
This is the firm's MC.
Marginal Cost
Demand = Price
$
#


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Demand = Price
$
Examples in the book have this MC curve going down at first and then going back up. That could happen.
#


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Demand = Price
$
Examples in the book have this MC curve going down at first and then going back up. That could happen.
Wait - *why* could that happen? Let's tell a story about raspberries ...
#


Firm in a perfectly competitive market
This is a firm's viewpoint
$
#
Marginal Cost
Demand = Price


Firm in a perfectly competitive market
This is a firm's viewpoint
$
#
Marginal Cost
Marginal Revenue = Demand = Price


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue = Demand = Average Revenue = Price
$
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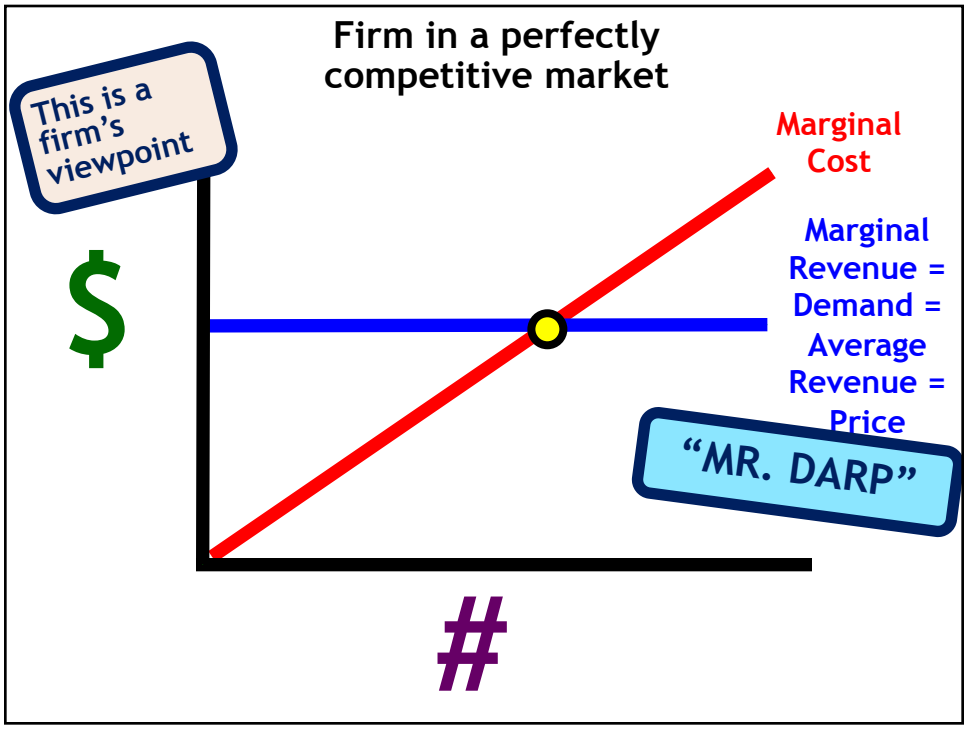
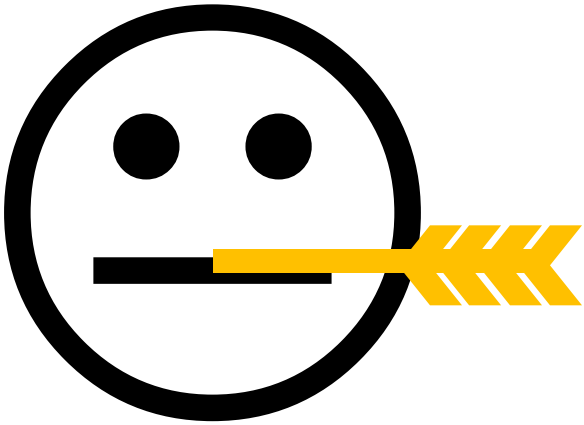
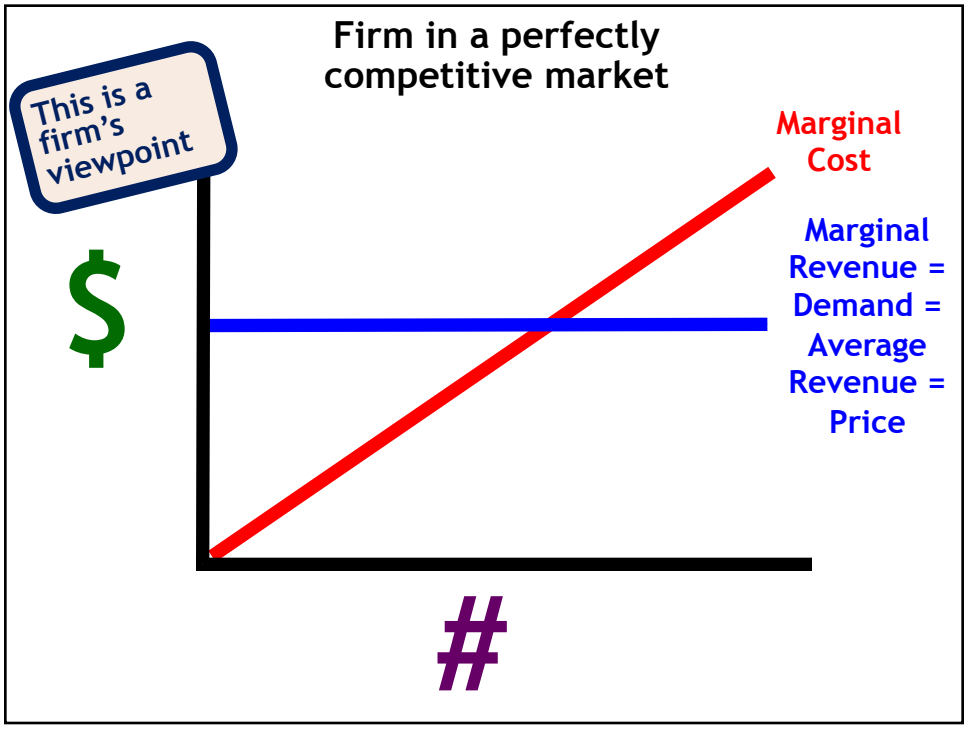

Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue = Demand = Average Revenue = Price
"MR. DARP"
$
#



MR. DARP

How firms in a perfectly competitive market make decisions ... in the short run.

- We're assuming the firm is tiny compared to the market, and the market is perfectly competitive.
- The firm wants to maximize profit.
  - (Or minimize loss—same thing).
  - Obvious, of course! This is what firms always want to do. (At least in our regular microeconomic assumptions of rational behavior.)
- As a firm in a perfectly competitive market, it is a price taker. The market determines the price, and the firm can't do anything to change the price.
- And as the firm is a tiny participant in a huge market, the market will absorb as much quantity as the firm produces.
- So the firm's ONLY decision is how much to produce.
- And the firm decides this purely on the basis of its costs—*it's marginal costs*.
- The marginal cost curve goes up. (Remember?)
- So the firm will produce up to the point at which the marginal cost equals the market price (a/k/a demand a/k/a marginal revenue a/k/a average revenue).


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue = Demand = Average Revenue = Price
$
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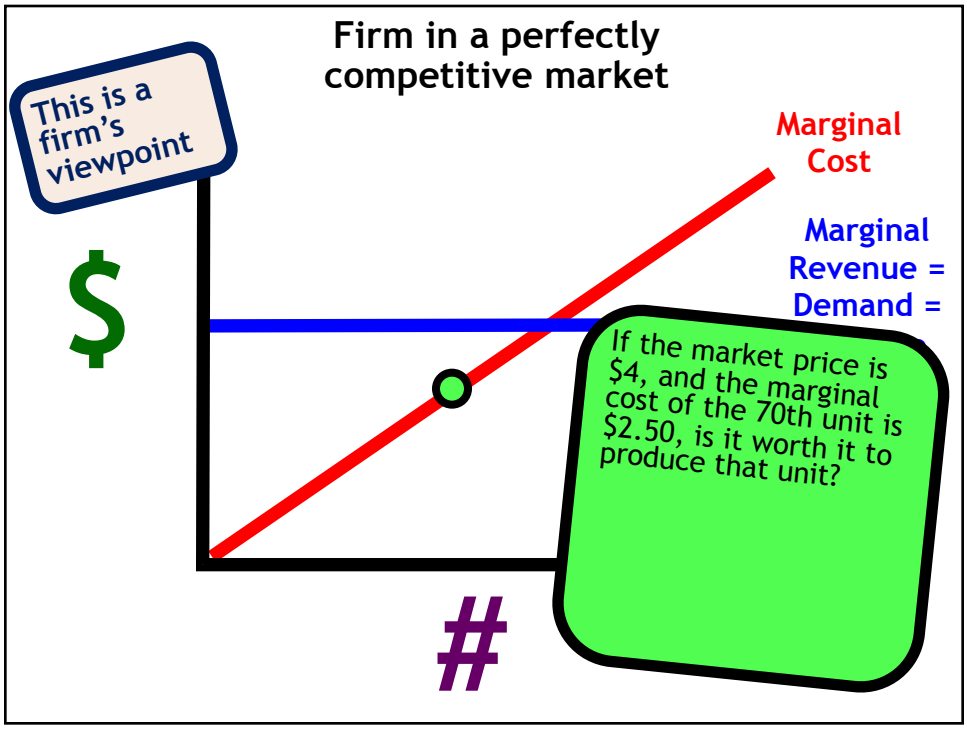
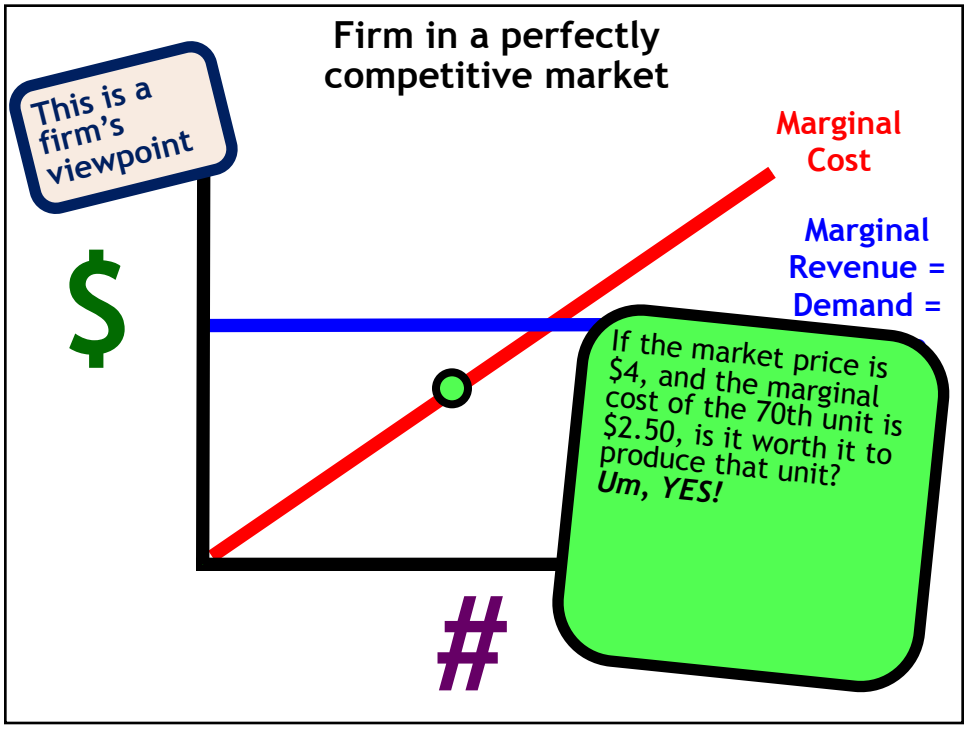

Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue = Demand =
If the market price is $4, and the marginal cost of the 70th unit is $2.50, is it worth it to produce that unit?
$
#


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue = Demand =
$
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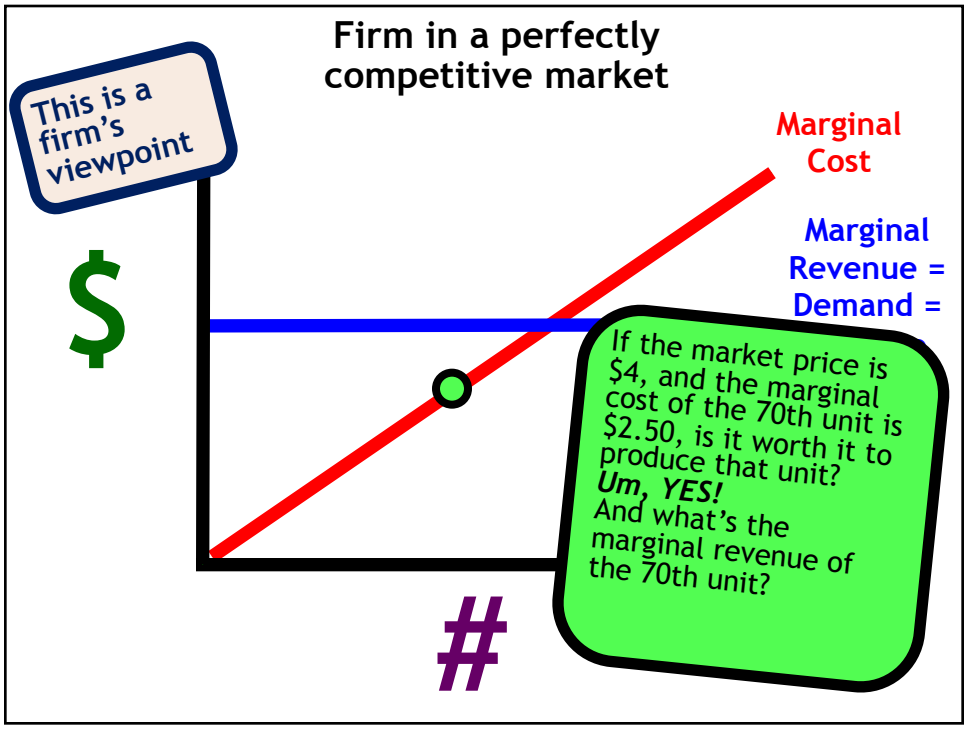
If the market price is $4, and the marginal cost of the 70th unit is $2.50, is it worth it to produce that unit?
Um, YES!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Marginal Cost
Marginal Revenue = Demand =
$
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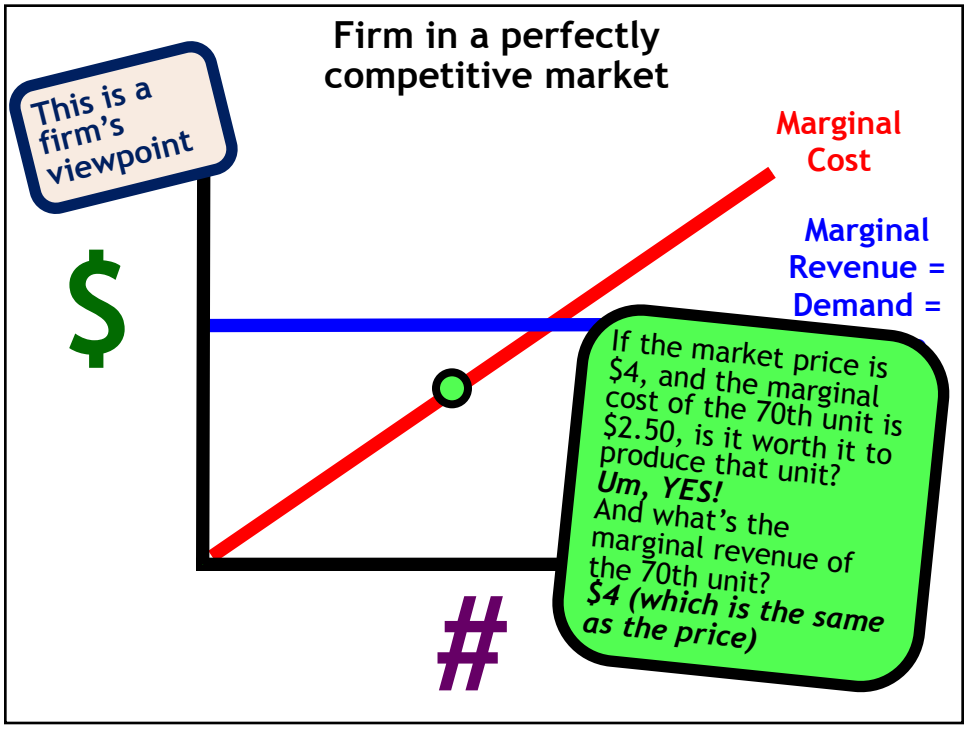
If the market price is $4, and the marginal cost of the 70th unit is $2.50, is it worth it to produce that unit?
Um, YES!
And what's the marginal revenue of the 70th unit?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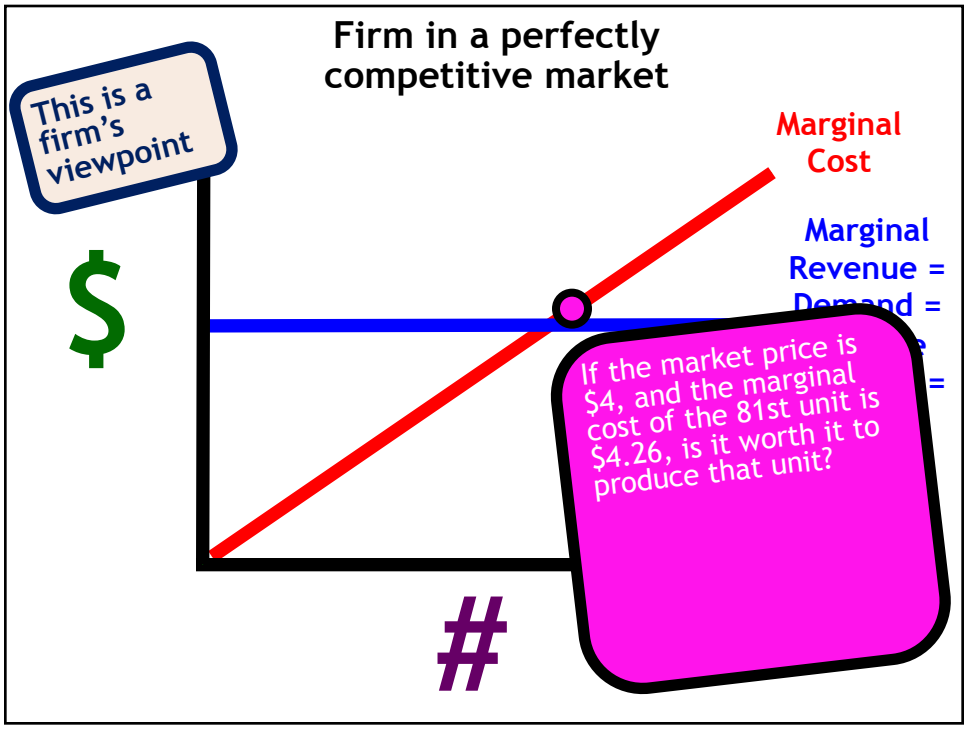
Marginal Cost
Marginal Revenue = Demand =
$
#
If the market price is $4, and the marginal cost of the 70th unit is $2.50, is it worth it to produce that unit?
Um, YES!
And what's the marginal revenue of the 70th unit?
$4 (which is the same as the price)


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue =
$
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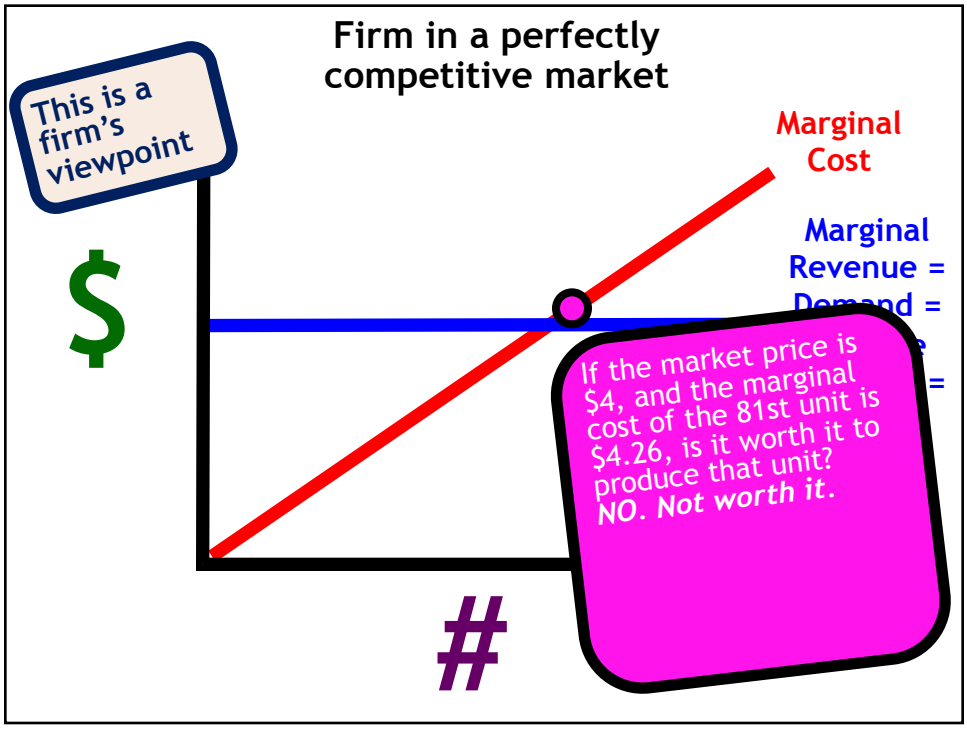
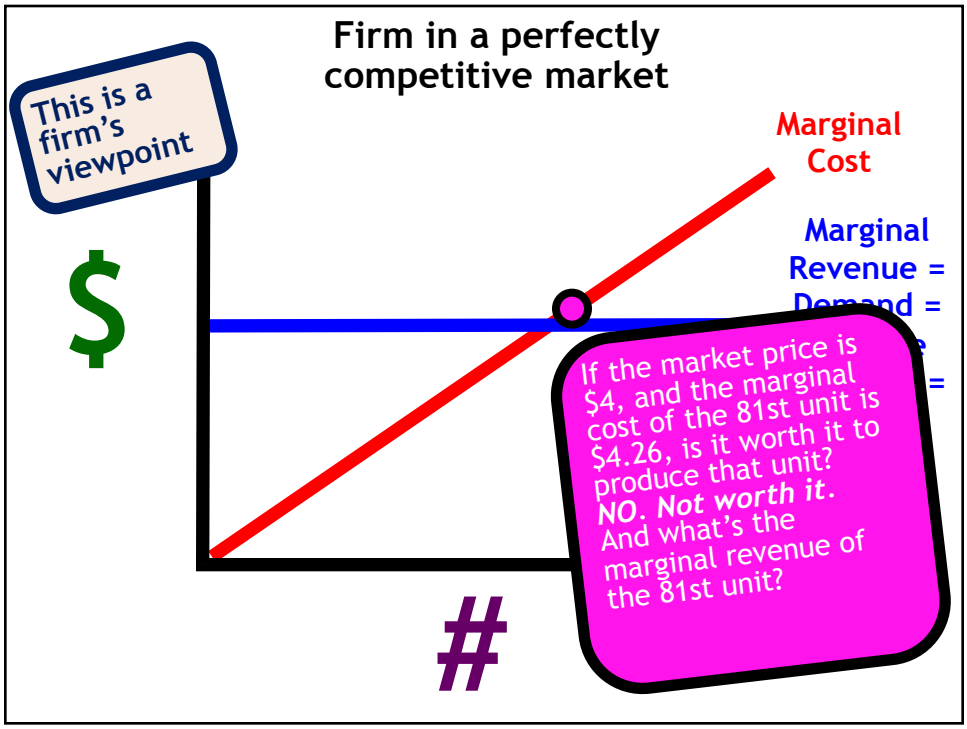
If the market price is $4, and the marginal cost of the 81st unit is $4.26, is it worth it to produce that unit?


Firm in a perfectly competitive market
This is a firm's viewpoint
Marginal Cost
Marginal Revenue =
$
#
If the market price is $4, and the marginal cost of the 81st unit is $4.26, is it worth it to produce that unit?
NO. Not worth it.


Firm in a perfectly competitive market
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Marginal Cost
Marginal Revenue =
$
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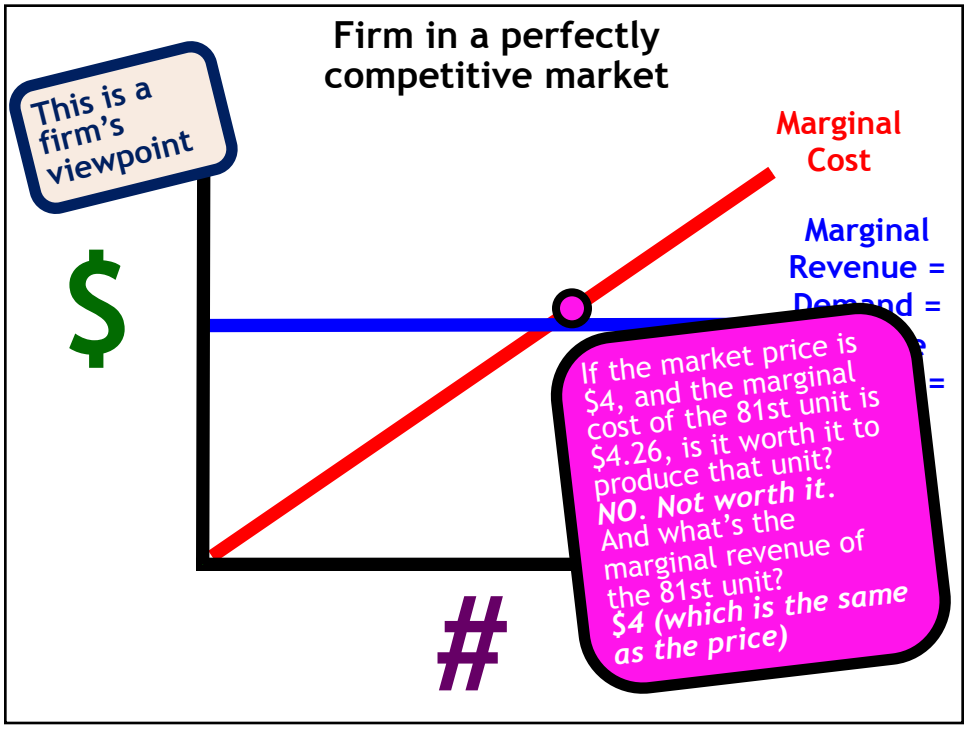
If the market price is $4, and the marginal cost of the 81st unit is $4.26, is it worth it to produce that unit?
NO. Not worth it.
And what's the marginal revenue of the 81st unit?


Firm in a perfectly competitive market
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$
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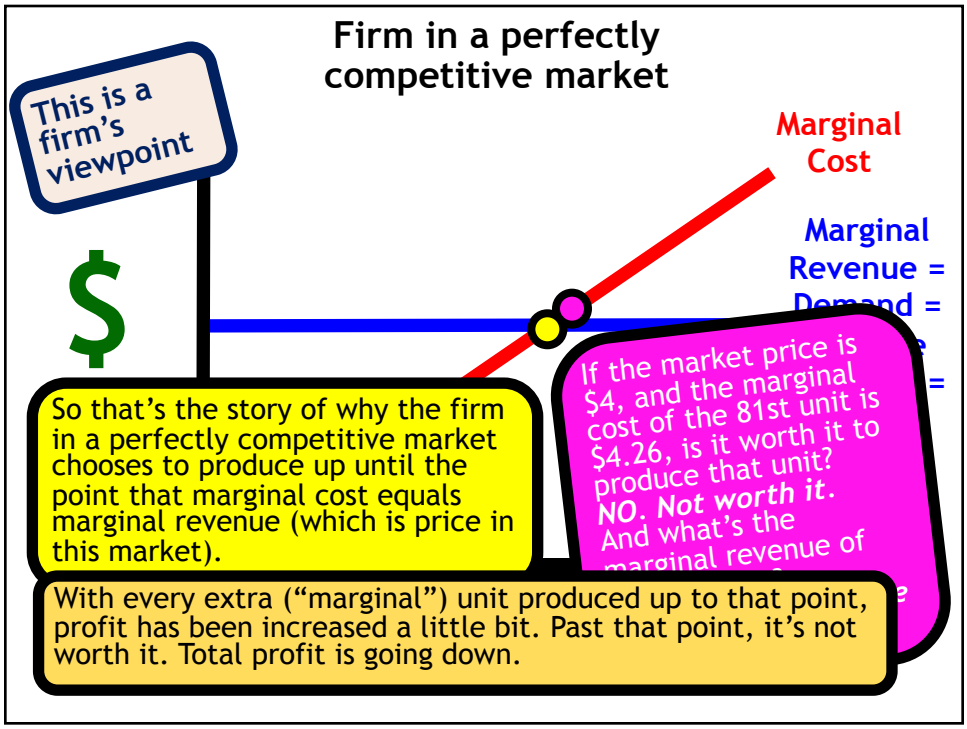
Marginal Cost
Marginal Revenue =
If the market price is $4, and the marginal cost of the 81st unit is $4.26, is it worth it to produce that unit? NO. Not worth it. And what's the marginal revenue of the 81st unit? $4 (which is the same as the price)


Firm in a perfectly competitive market
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$
Marginal Cost
Marginal Revenue =
If the market price is $4, and the marginal cost of the 81st unit is $4.26, is it worth it to produce that unit? NO. Not worth it. And what's the
So that's the story of why the firm in a perfectly competitive market chooses to produce up until the point that marginal cost equals marginal revenue (which is price in this market).
With every extra ("marginal") unit produced up to that point, profit has been increased a little bit. Past that point, it's not worth it. Total profit is going down.

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4.5 MILLION PATIENTS across the United States and Puerto Rico

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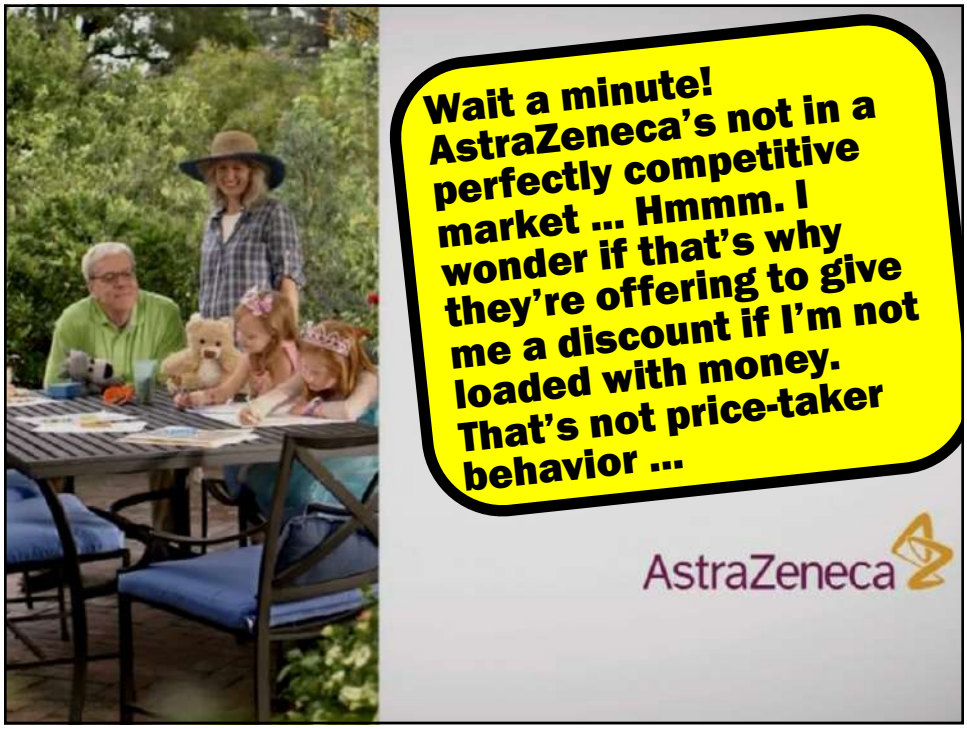

Wait a minute! AstraZeneca's not in a perfectly competitive market ... Hmmm. I wonder if that's why they're offering to give me a discount if I'm not loaded with money. That's not price-taker behavior ...
AstraZeneca

Wait a minute! AstraZeneca's not in a perfectly competitive market ... Hmmm. I wonder if that's why they're offering to give me a discount if I'm not
with money.
taker
We will meet Big Pharma again when we discuss ... MONOPOLY ECONOMICS!
AstraZeneca

Review Questions for Ch. 8

Similar to self-check questions ...

Review Problems

1. If you sell products in a perfectly competitive market, would you lower your price below the market price in order to sell more units?

Similar to self-check questions ...

Review Problems

1. If you sell products in a perfectly competitive market, would you lower your price below the market price in order to sell more units?

No, because then you would still sell the same number of units, because from the perspective of a firm in a perfectly competitive market, demand is perfectly elastic. The market will take as much as you provide as long as it's not above the market price. Selling below market won't increase your sales volume, it will just leave money on the table.

Similar to self-check questions ...

Review Problems

2. Would sales of concrete sand to the construction industry fit the characteristics of a perfectly competitive market?

Similar to self-check questions ...

Review Problems

2. Would sales of concrete sand to the construction industry fit the characteristics of a perfectly competitive market?

It would probably be pretty close. Why pay over the market price for sand that's going to be mixed into concrete?

Similar to self-check questions ...

Review Problems

3. What about the retail market for gasoline - does that fit the characteristics of a perfectly competitive market?

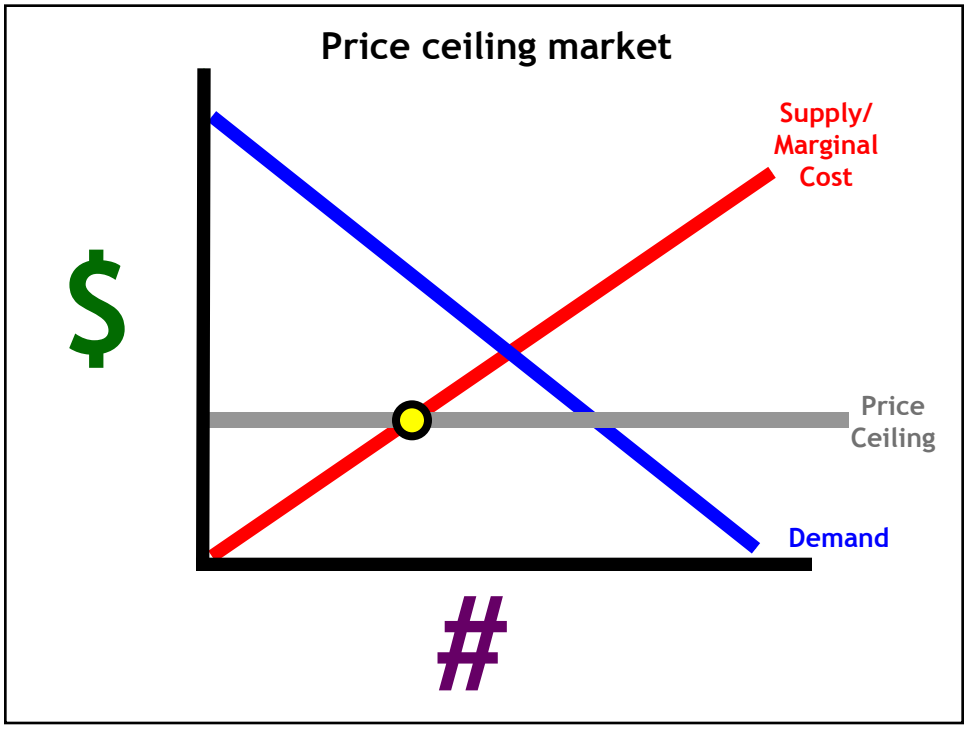
Similar to self-check questions …

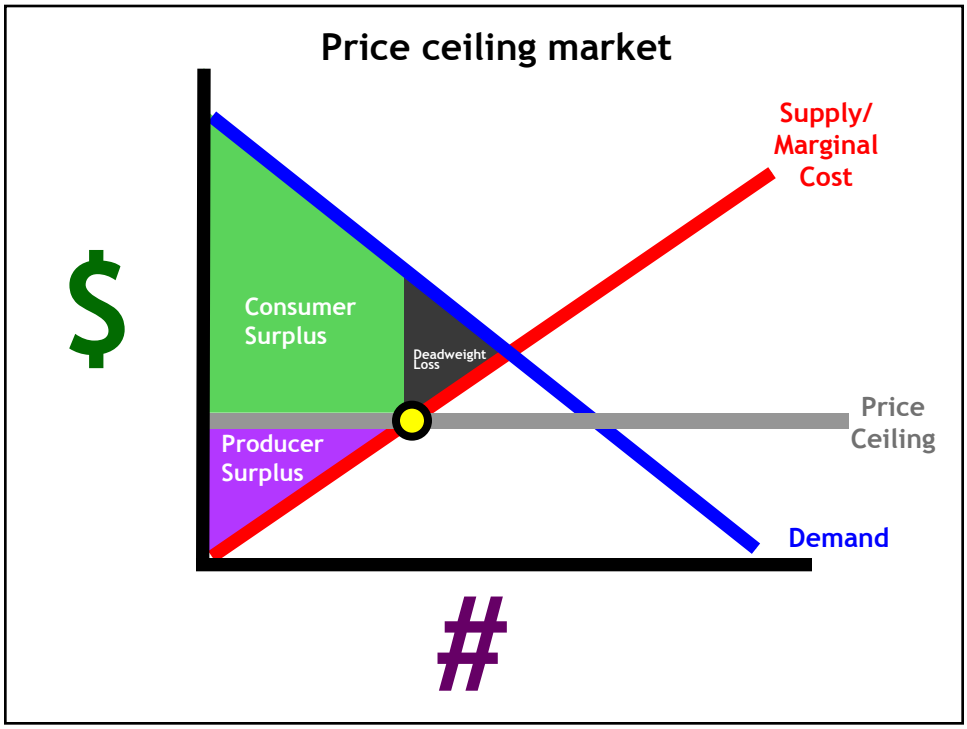
Review Problems

3. What about the retail market for gasoline – does that fit the characteristics of a perfectly competitive market?

On the one hand, I want to say yes, because gas is pretty much the same. But in reality, I guess not not so much, because if I drive around town, I see that gas prices vary. That must have to do with the convenience of the location mostly, but perhaps other things as well, such as the cleanliness of restrooms, credit terms, or loyalty programs.

Let's go over the assigned review problems out of the book for Ch. 8.


Price ceiling market
Supply/
Marginal
Cost
$
Price
Ceiling
Demand
#


Price ceiling market
Supply/
Marginal
Cost
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Consumer
Surplus
Deadweight
Loss
Price
Ceiling
Producer
Surplus
Demand
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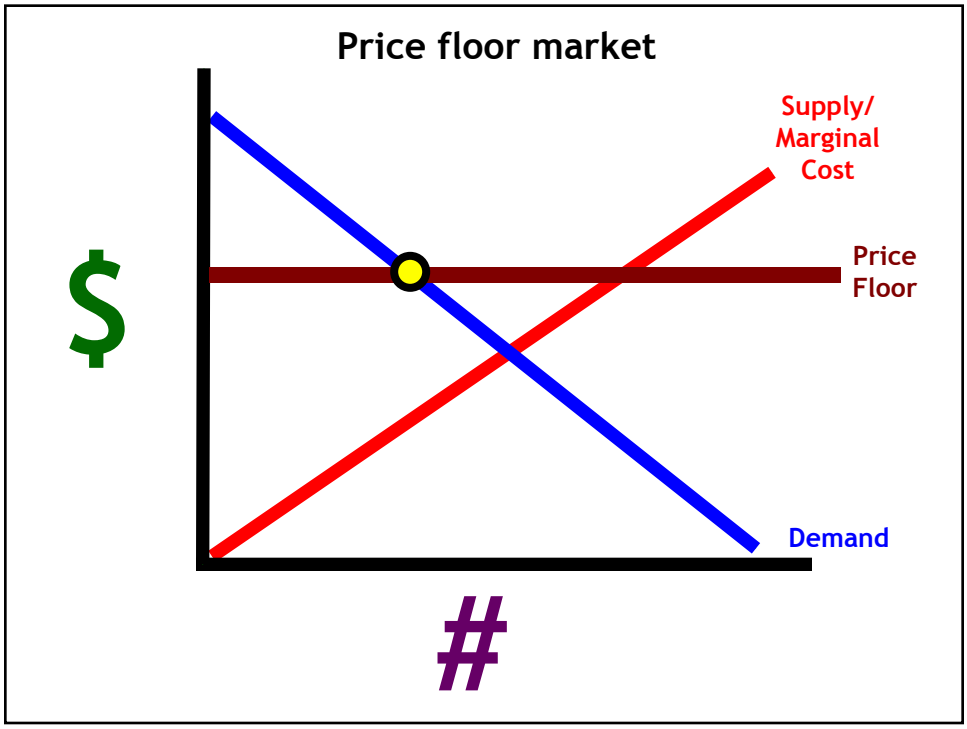
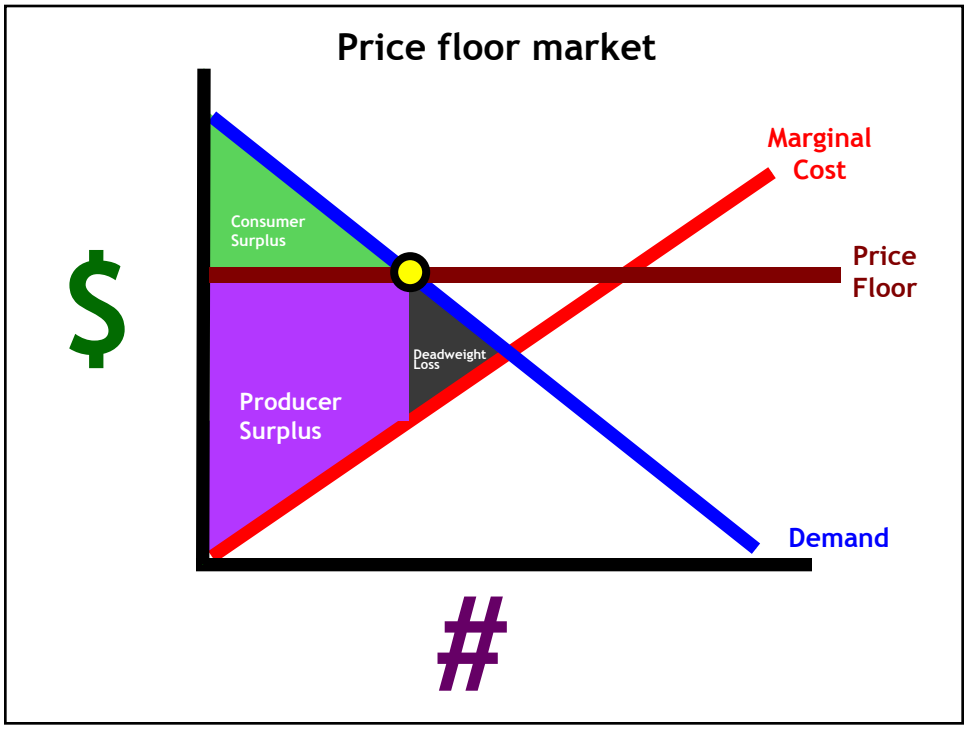
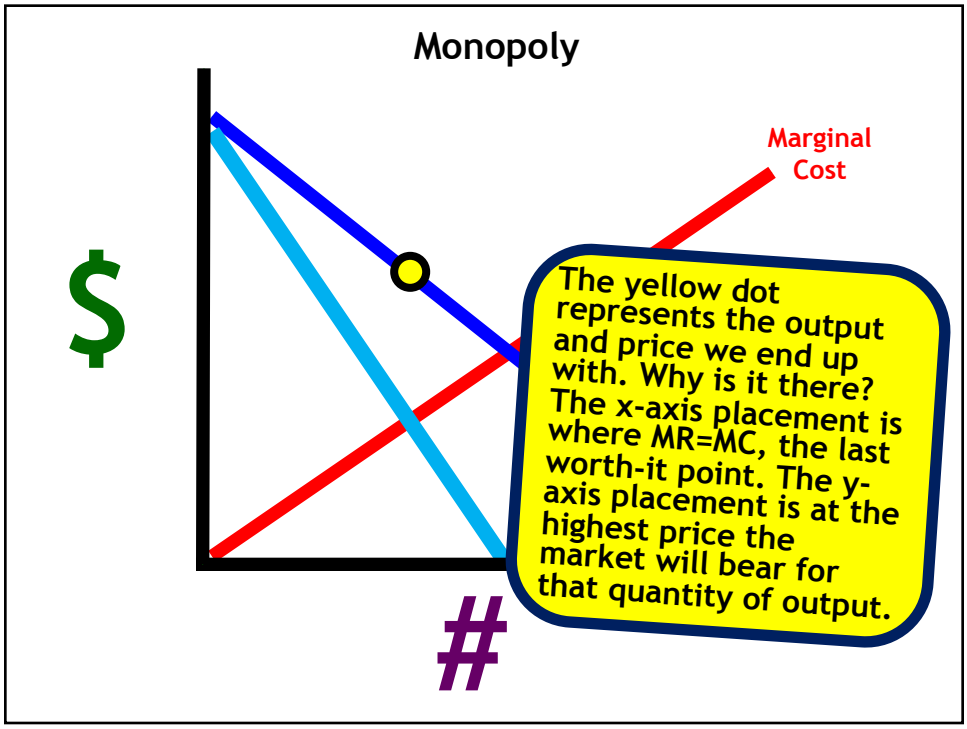
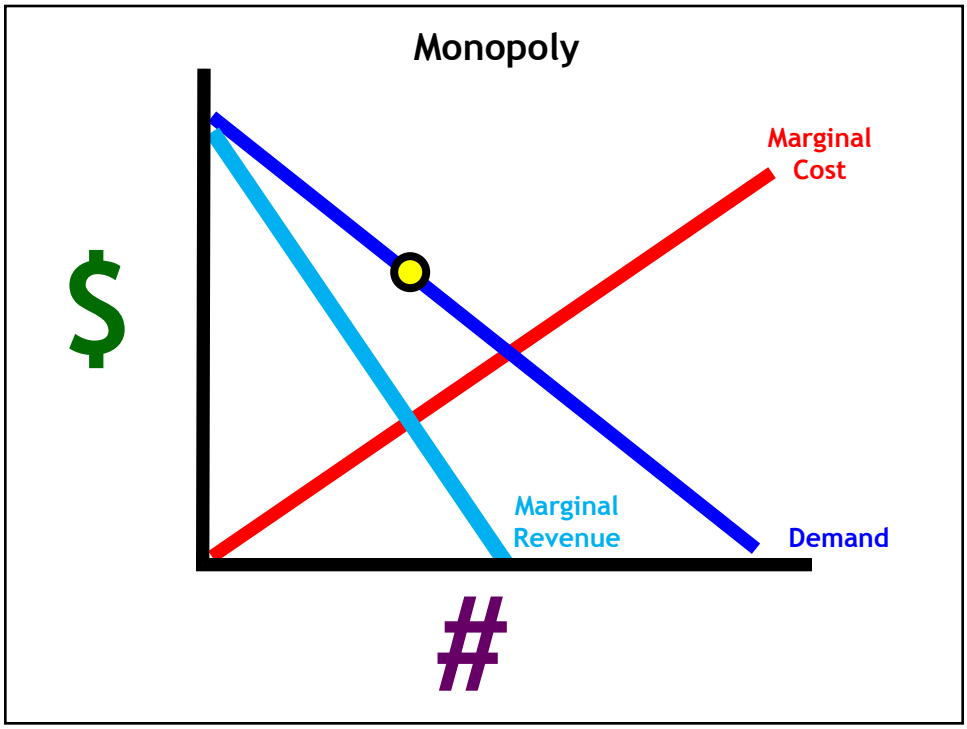
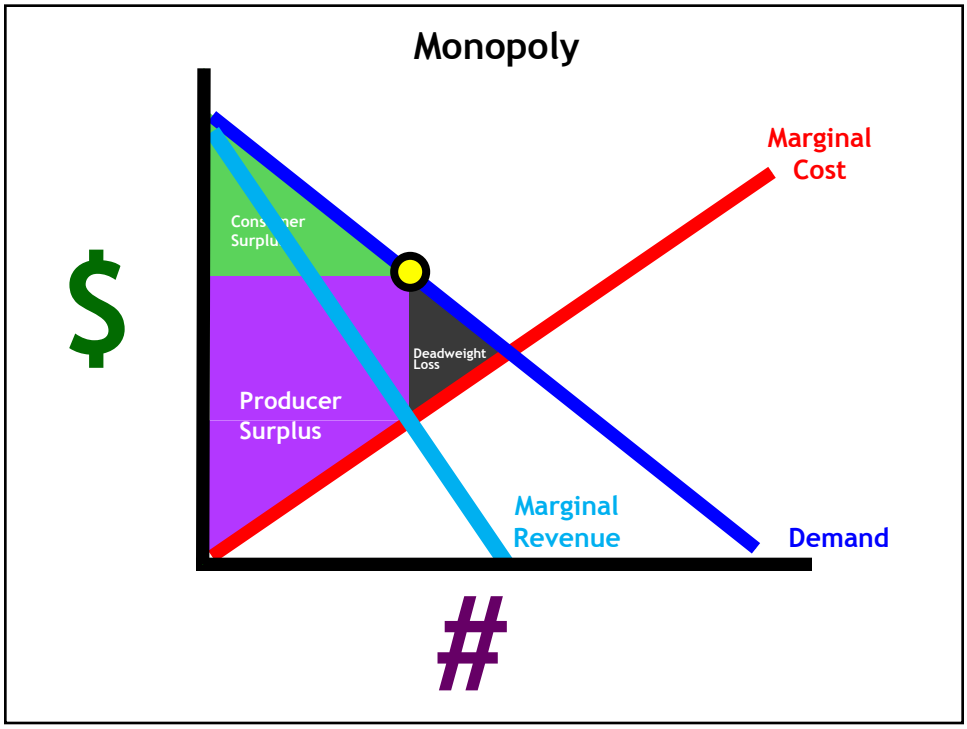
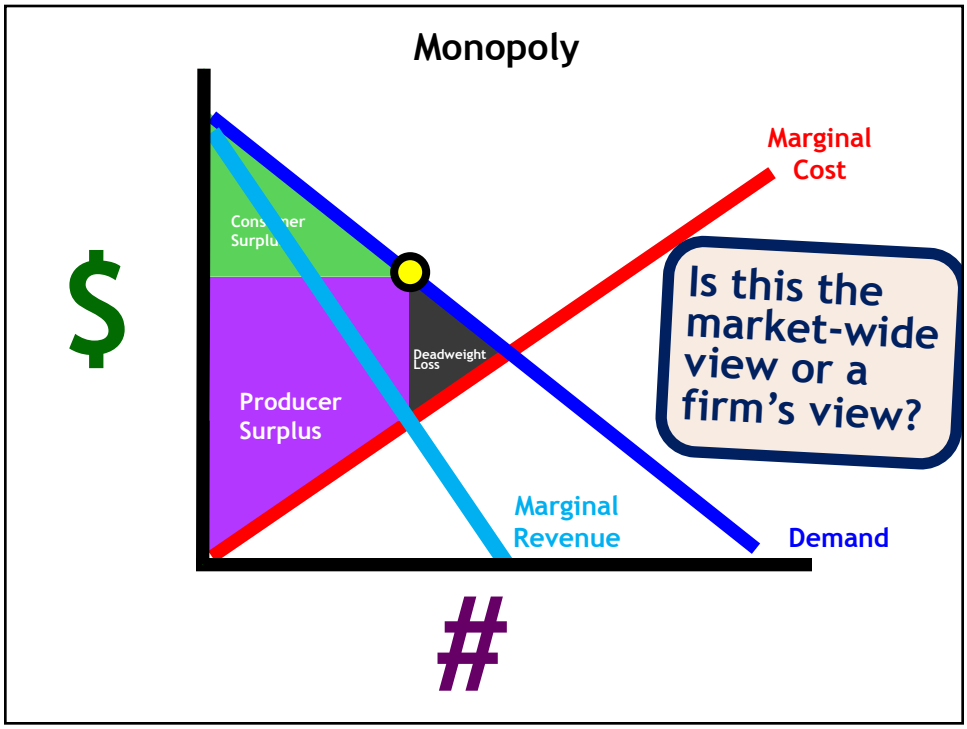

Price floor market
Supply/
Marginal
Cost
Price
Floor
$
Demand
#

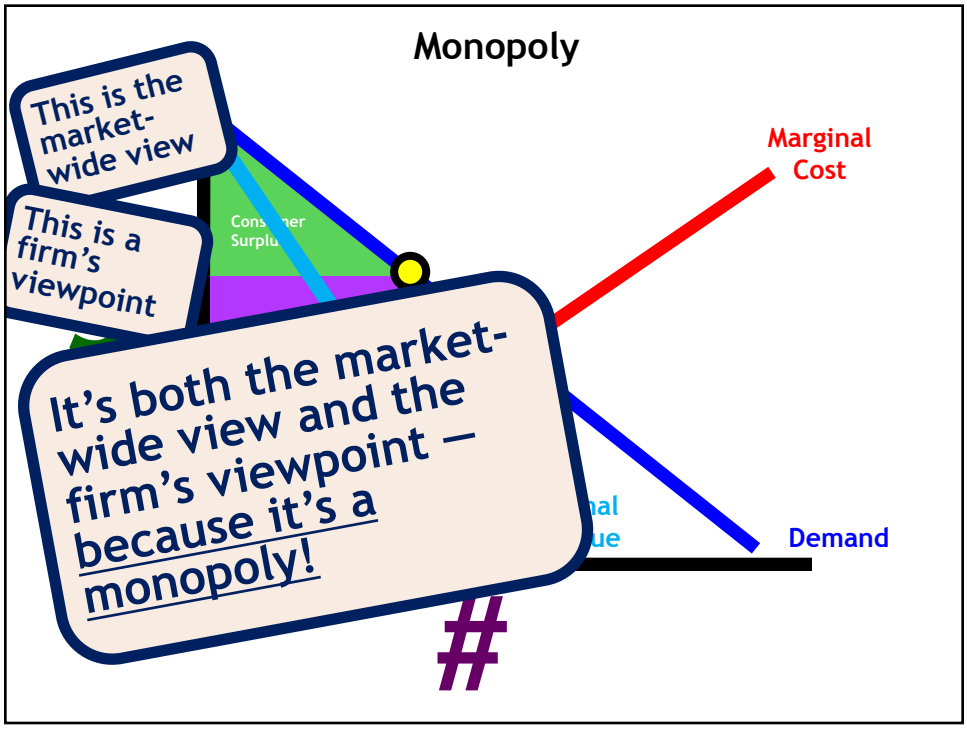

Price floor market
Marginal
Cost
Consumer
Surplus
Price
Floor
$
Deadweight
Loss
Producer
Surplus
Demand
#

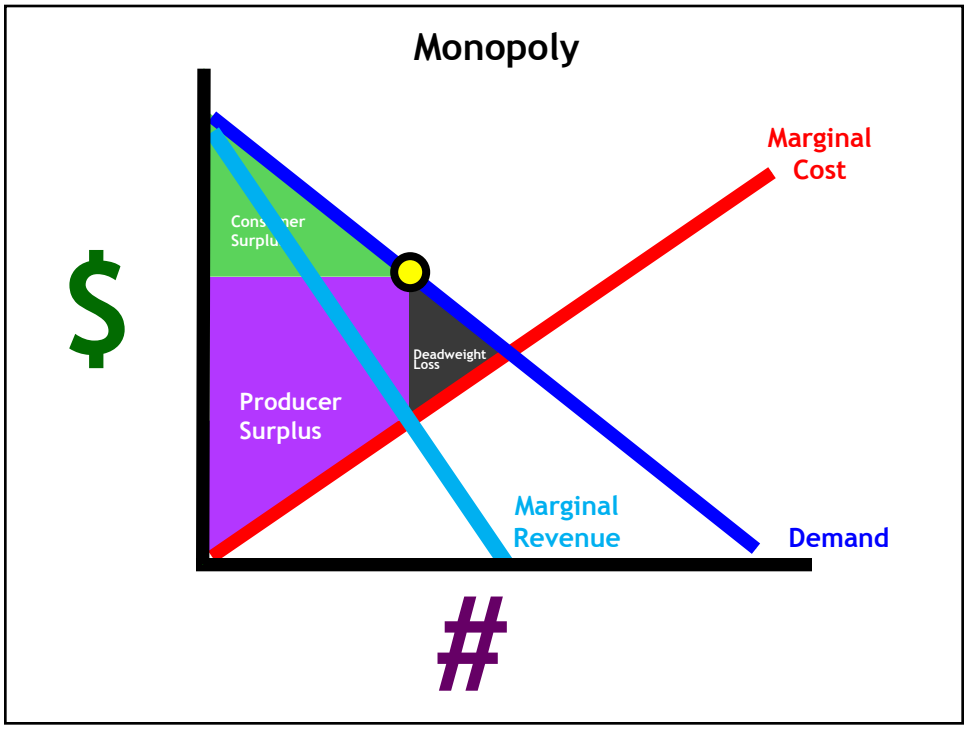

Monopoly
Marginal Cost
$
The yellow dot represents the output and price we end up with. Why is it there? The x-axis placement is where MR=MC, the last worth-it point. The y-axis placement is at the highest price the market will bear for that quantity of output.
#

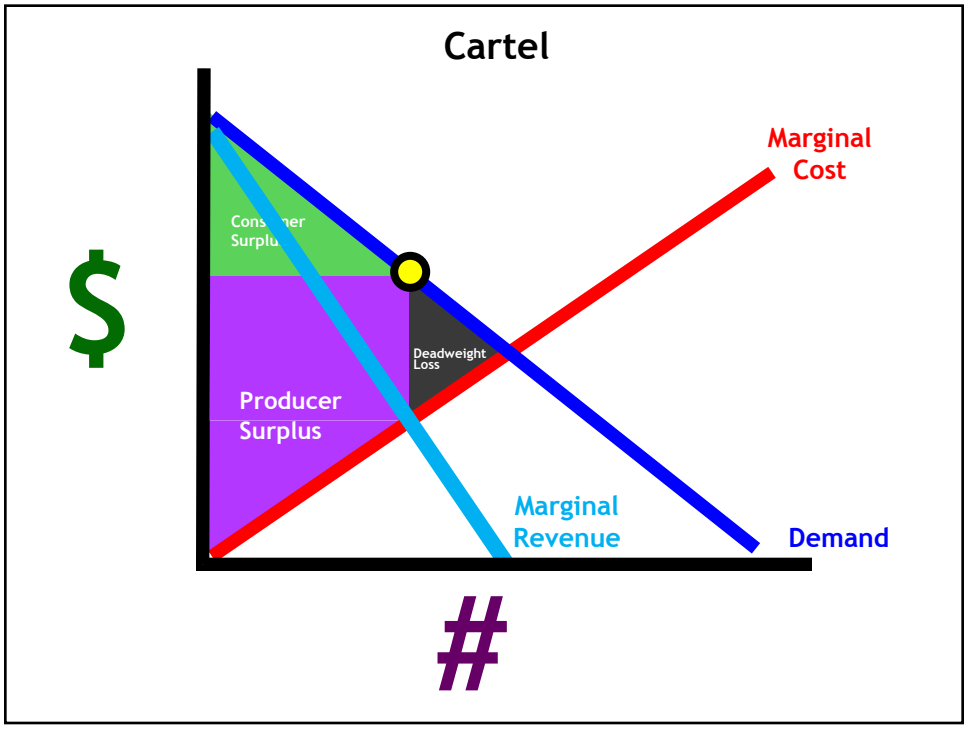

Monopoly
Marginal Cost
$
Marginal Revenue
Demand
#

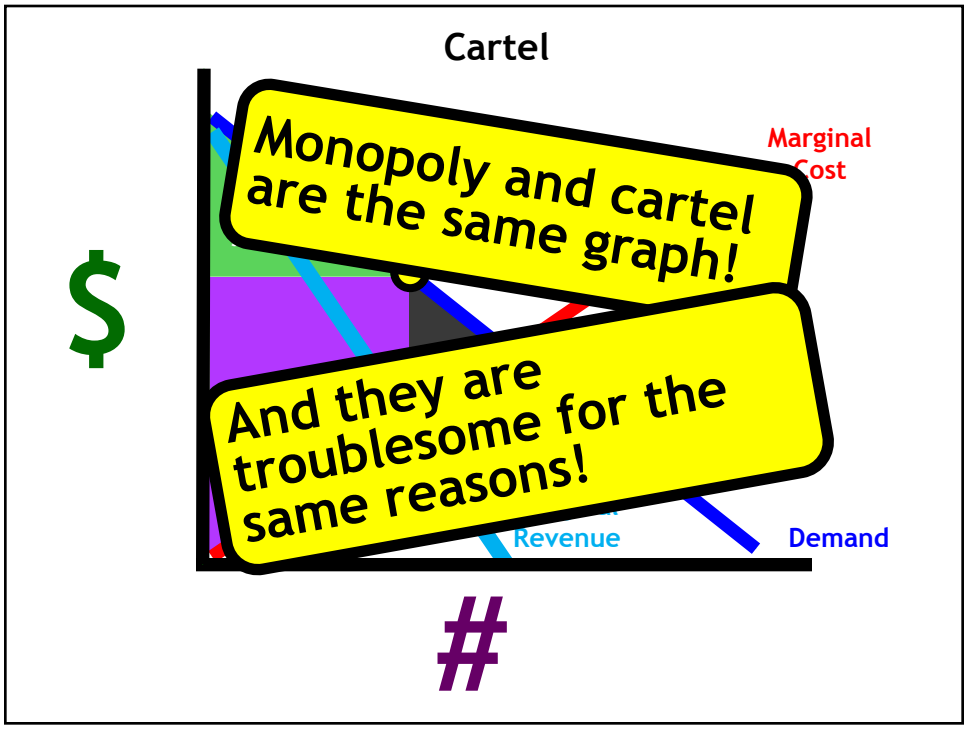

Monopoly
Marginal Cost
$
Consumer Surplus
Deadweight Loss
Producer Surplus
Marginal Revenue
Demand
#

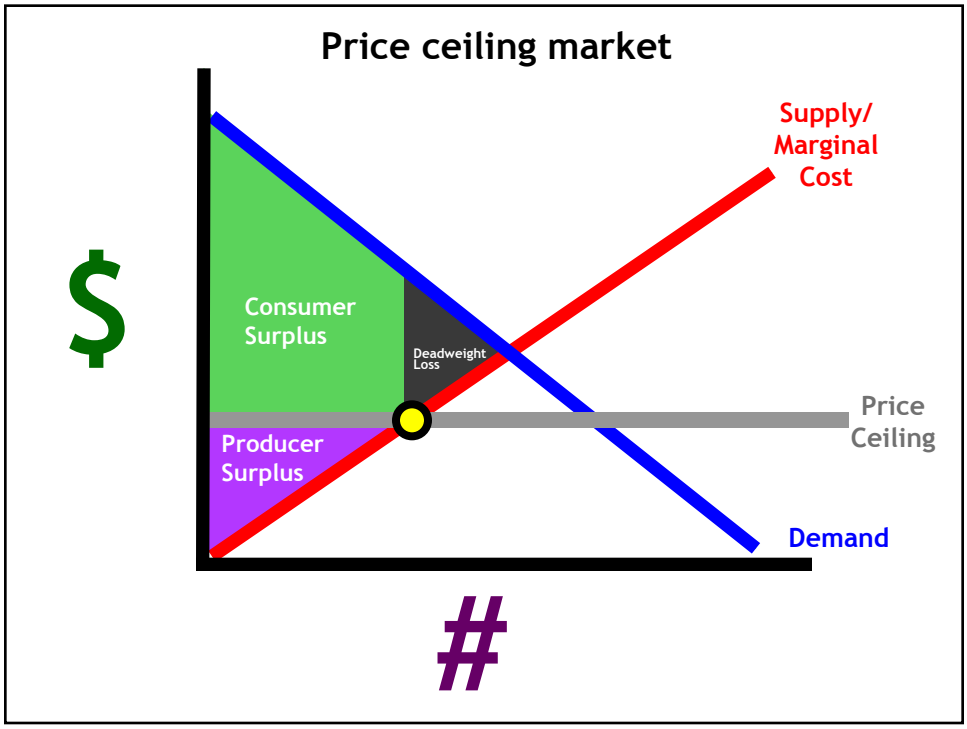

Monopoly
Marginal Cost
$
Consumer Surplus
Deadweight Loss
Producer Surplus
Is this the market-wide view or a firm's view?
Marginal Revenue
Demand
#

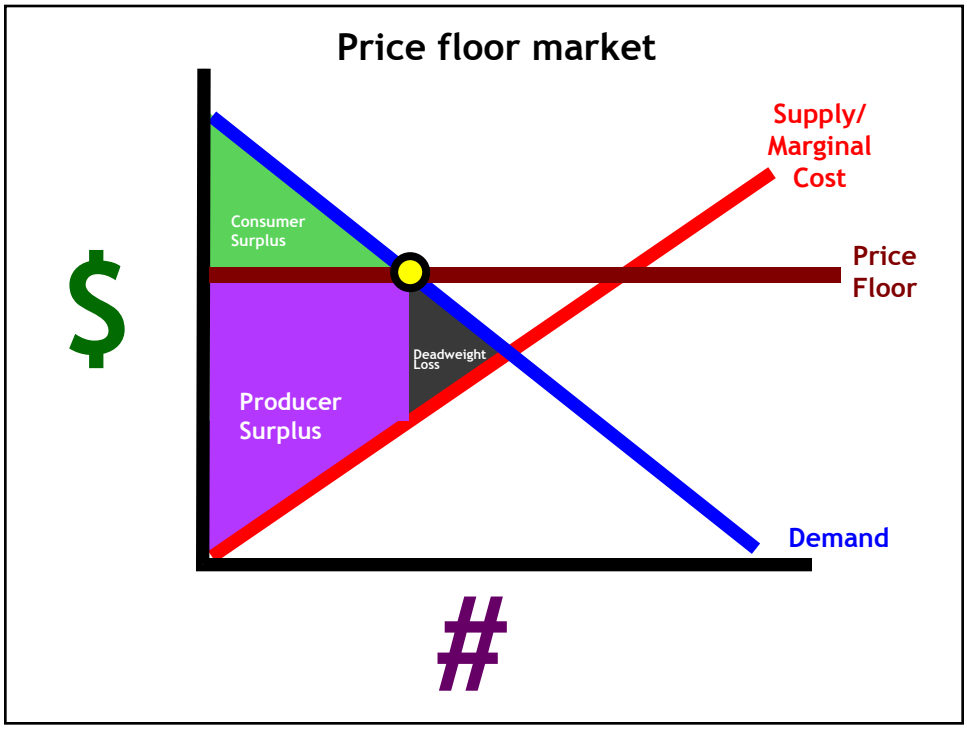

Monopoly
This is the market-wide view
This is a firm's viewpoint
It's both the market-wide view and the firm's viewpoint – because it's a monopoly!
Marginal Cost
Demand
#

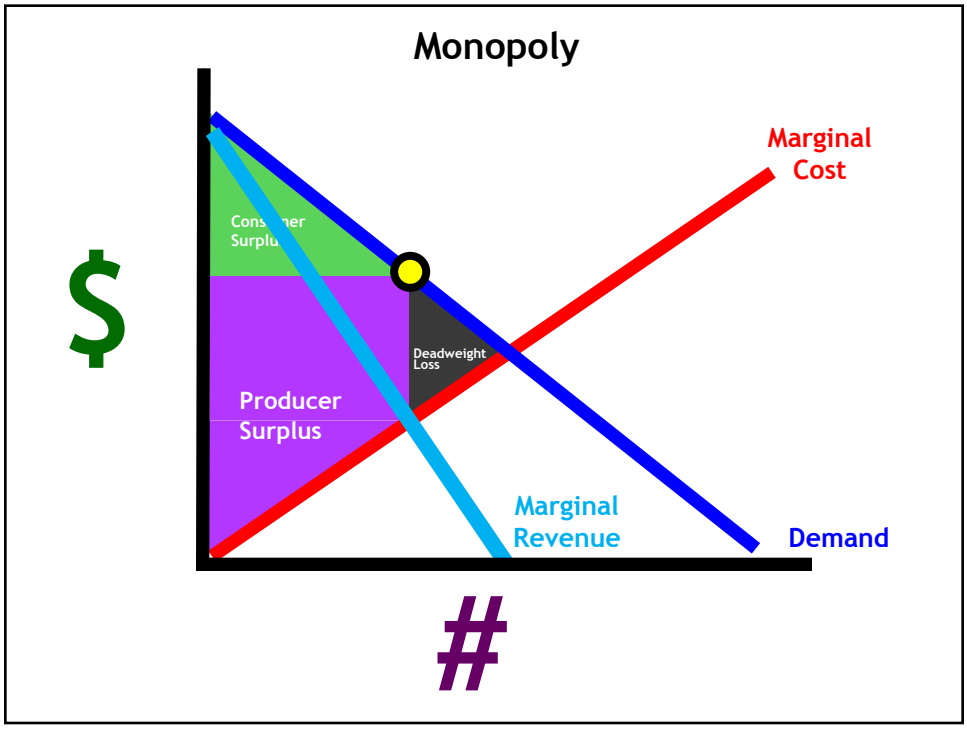

Monopoly
$
Marginal Cost
Deadweight Loss
Producer Surplus
Marginal Revenue
Demand
#

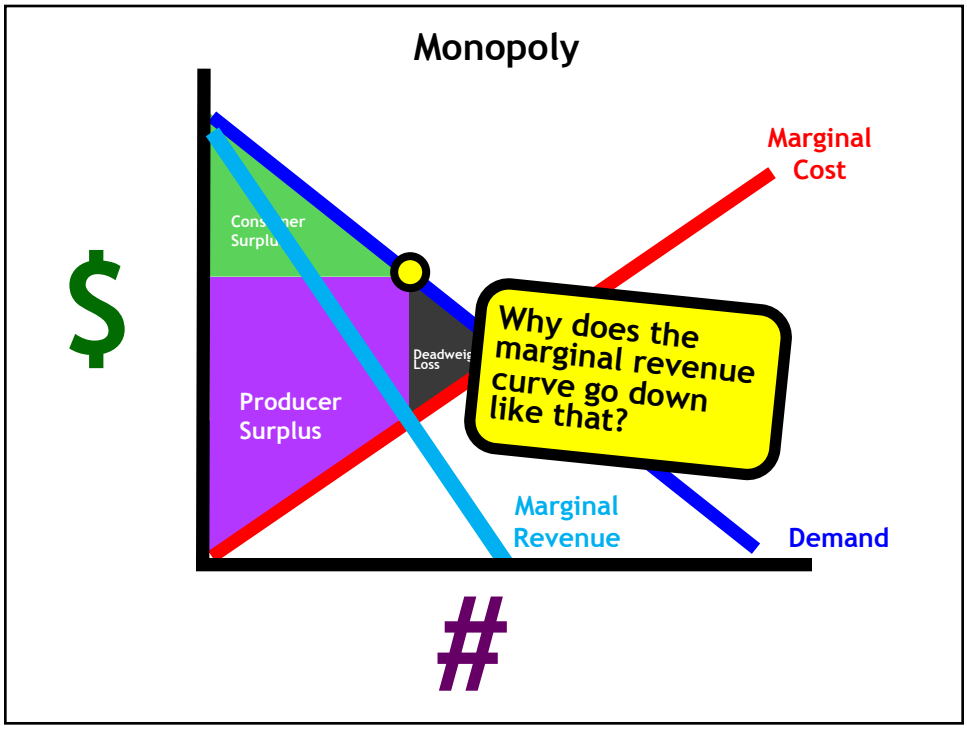

Cartel
Marginal Cost
$
Deadweight Loss
Producer Surplus
Marginal Revenue
Demand
#


Cartel
Monopoly and cartel are the same graph!
Marginal Cost
$
And they are troublesome for the same reasons!
Revenue
Demand
#

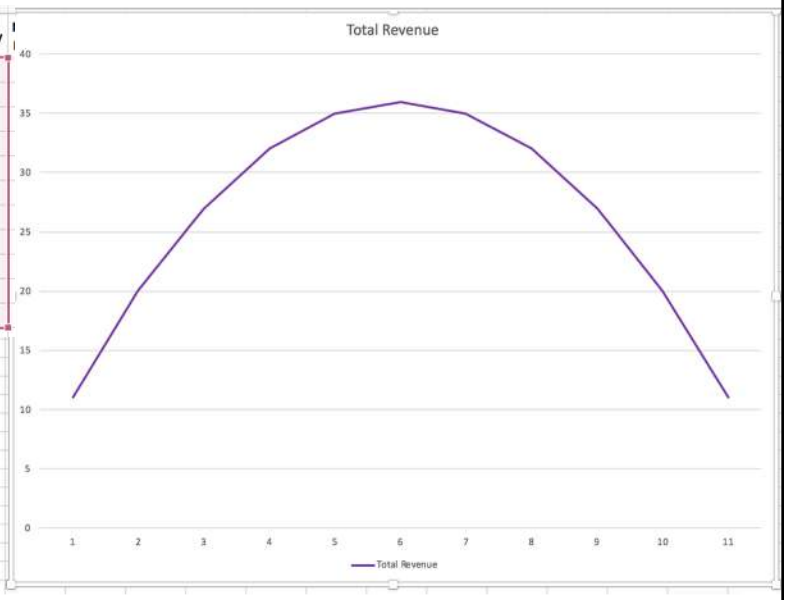

Price ceiling market
Supply/
Marginal
Cost
$
Consumer
Surplus
Deadweight
Loss
Price
Ceiling
Producer
Surplus
Demand
#


Price floor market
Supply/
Marginal
Cost
$
Consumer
Surplus
Price
Floor
Deadweight
Loss
Producer
Surplus
Demand
#

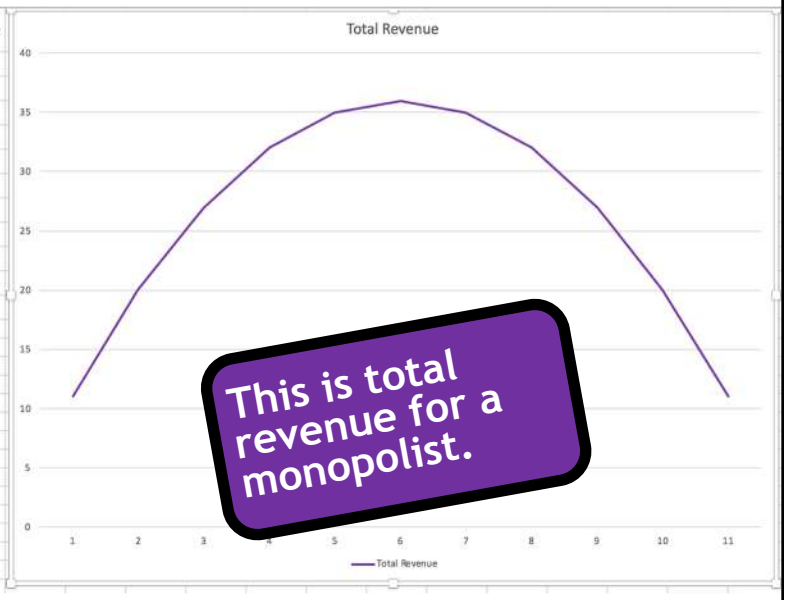

Monopoly
Marginal Cost
$
Consumer Surplus
Deadweight Loss
Producer Surplus
Marginal Revenue
Demand
#

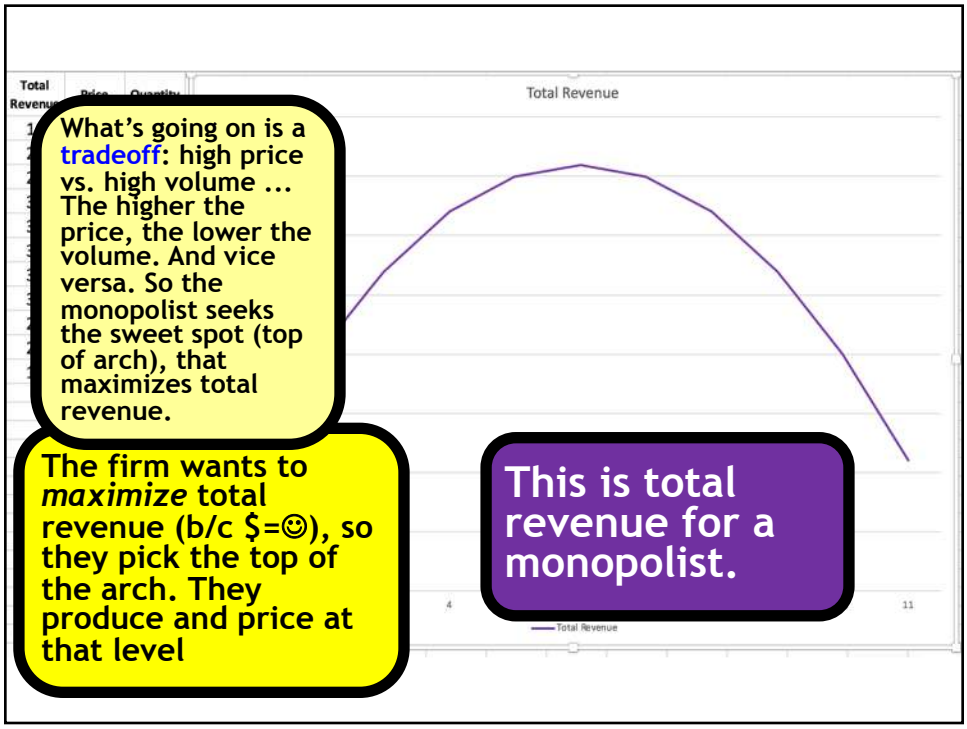

Monopoly
Marginal Cost
$
Consumer Surplus
Deadweight Loss
Producer Surplus
Why does the marginal revenue curve go down like that?
Marginal Revenue
Demand
#

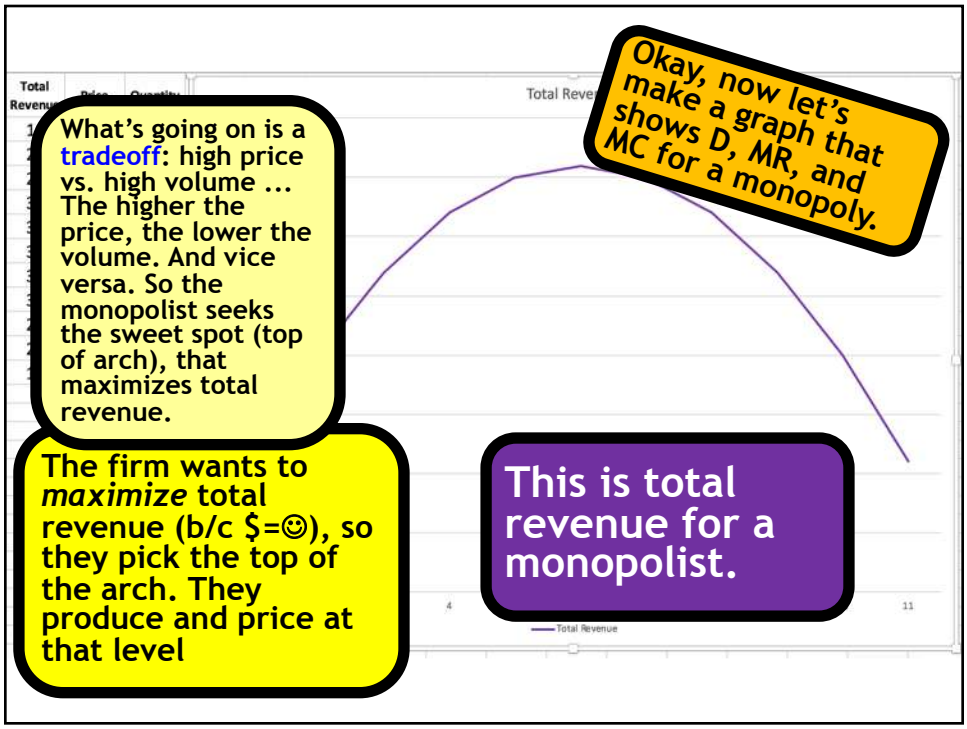
Total Revenue	Price	Quantity
11	11	1
20	10	2
27	9	3
32	8	4
35	7	5
36	6	6
35	5	7
32	4	8
27	3	9
20	2	10
11	1	11



Total Revenue	Price	Quantity
11	11	1
20	10	2
27	9	3
32	8	4
35	7	5
36	6	6
35	5	7
32	4	8
27	3	9
20	2	10
11	1	11




Total Revenue
What's going on is a tradeoff: high price vs. high volume ... The higher the price, the lower the volume. And vice versa. So the monopolist seeks the sweet spot (top of arch), that maximizes total revenue.
The firm wants to *maximize* total revenue (b/c $=☺), so they pick the top of the arch. They produce and price at that level
This is total revenue for a monopolist.


Okay, now let's make a graph that shows D, MR, and MC for a monopoly.
What's going on is a tradeoff: high price vs. high volume ... The higher the price, the lower the volume. And vice versa. So the monopolist seeks the sweet spot (top of arch), that maximizes total revenue.
The firm wants to *maximize* total revenue (b/c $=☺), so they pick the top of the arch. They produce and price at that level
This is total revenue for a monopolist.

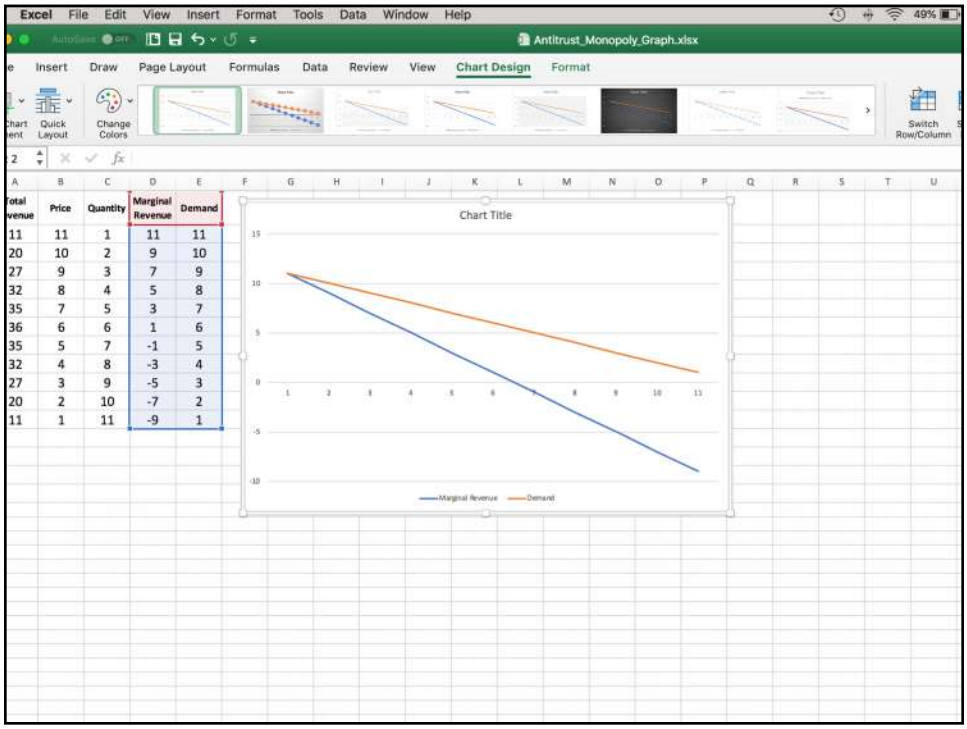
	A	B	C	D	E
1	Total Revenue	Price	Quantity	Marginal Revenue	
2	11	11	1		
3	20	10	2		
4	27	9	3		
5	32	8	4		
6	35	7	5		
7	36	6	6		
8	35	5	7		
9	32	4	8		
10	27	3	9		
11	20	2	10		
12	11	1	11		
13					

	A	B	C	D	E
1	Total Revenue	Price	Quantity	Marginal Revenue	
2	11	11	1	=B2	
3	20	10	2		
4	27	9	3		
5	32	8	4		
6	35	7	5		
7	36	6	6		
8	35	5	7		
9	32	4	8		
10	27	3	9		
11	20	2	10		
12	11	1	11		
13					

	A	B	C	D	E
1	Total Revenue	Price	Quantity	Marginal Revenue	
2	11	11	1	11	
3	20	10	2		
4	27	9	3		
5	32	8	4		
6	35	7	5		
7	36	6	6		
8	35	5	7		
9	32	4	8		
10	27	3	9		
11	20	2	10		
12	11	1	11		
13					

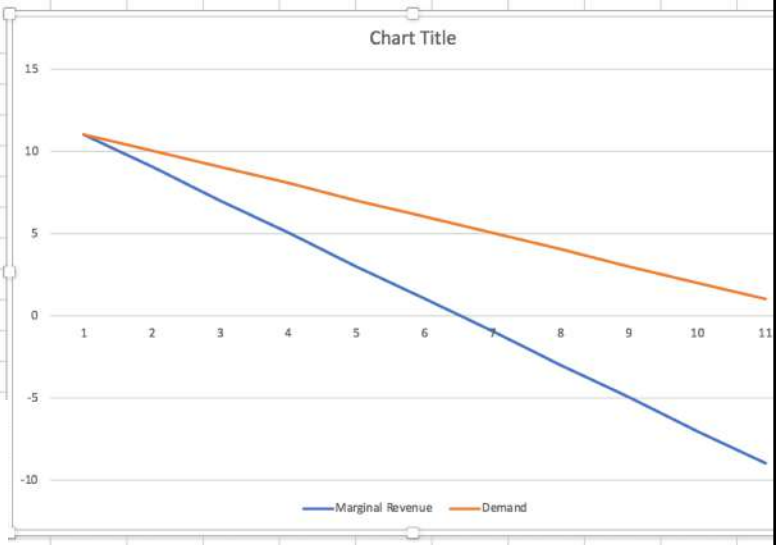
	A	B	C	D	E
1	Total Revenue	Price	Quantity	Marginal Revenue	
2	11	11	1	11	
3	20	10	2	=A3-A2	
4	27	9	3		
5	32	8	4		
6	35	7	5		
7	36	6	6		
8	35	5	7		
9	32	4	8		
10	27	3	9		
11	20	2	10		
12	11	1	11		
13					

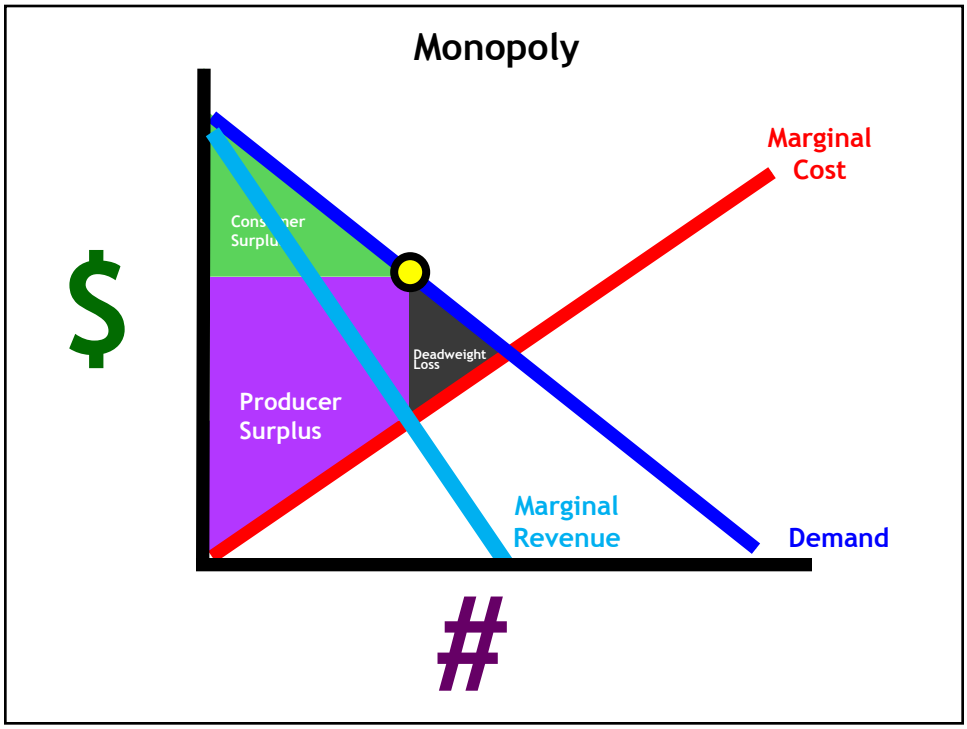
	A	B	C	D	E
1	Total Revenue	Price	Quantity	Marginal Revenue	
2	11	11	1	11	
3	20	10	2	9	
4	27	9	3	7	
5	32	8	4	5	
6	35	7	5	3	
7	36	6	6	1	
8	35	5	7	-1	
9	32	4	8	-3	
10	27	3	9	-5	
11	20	2	10	-7	
12	11	1	11	-9	
13					

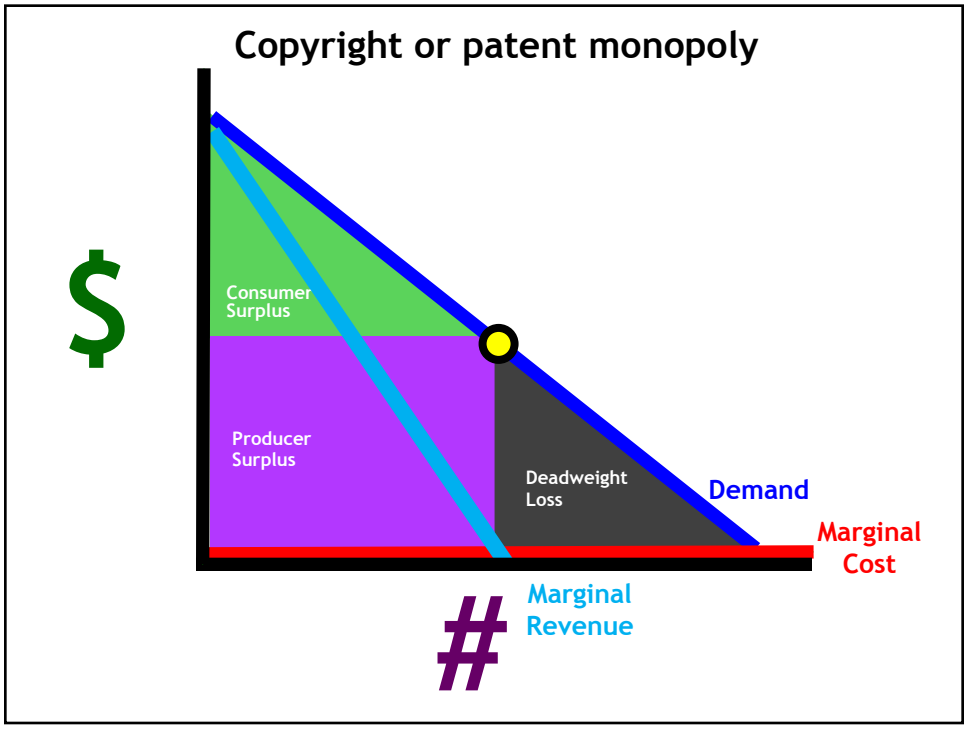


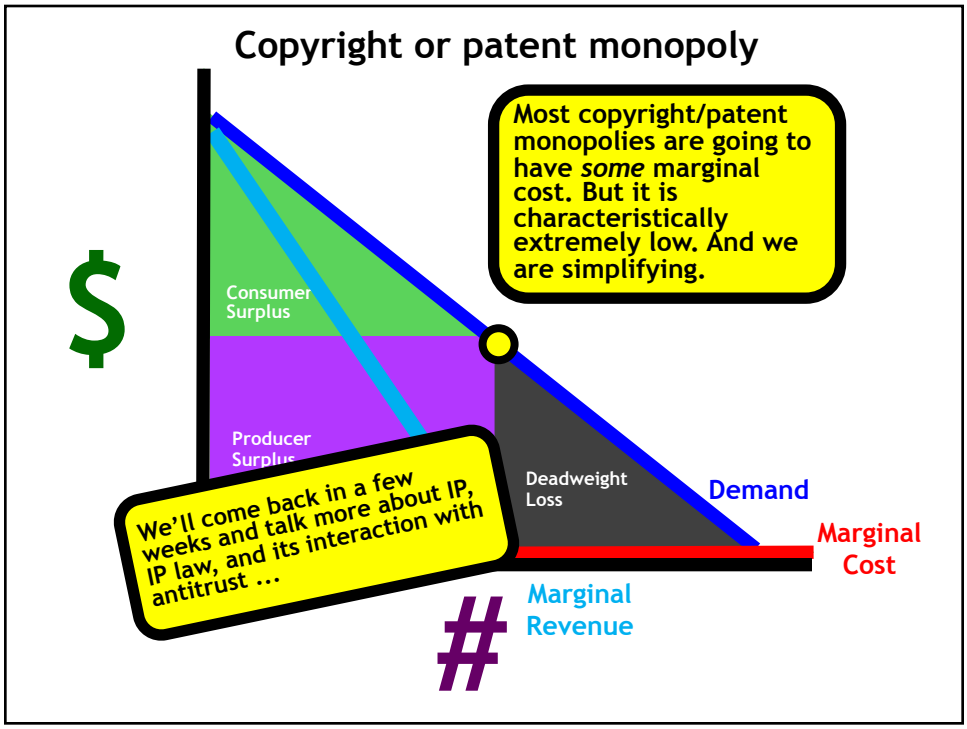
Marginal Revenue	Demand
11	11
9	10
7	9
5	8
3	7
1	6
-1	5
-3	4
-5	3
-7	2
-9	1

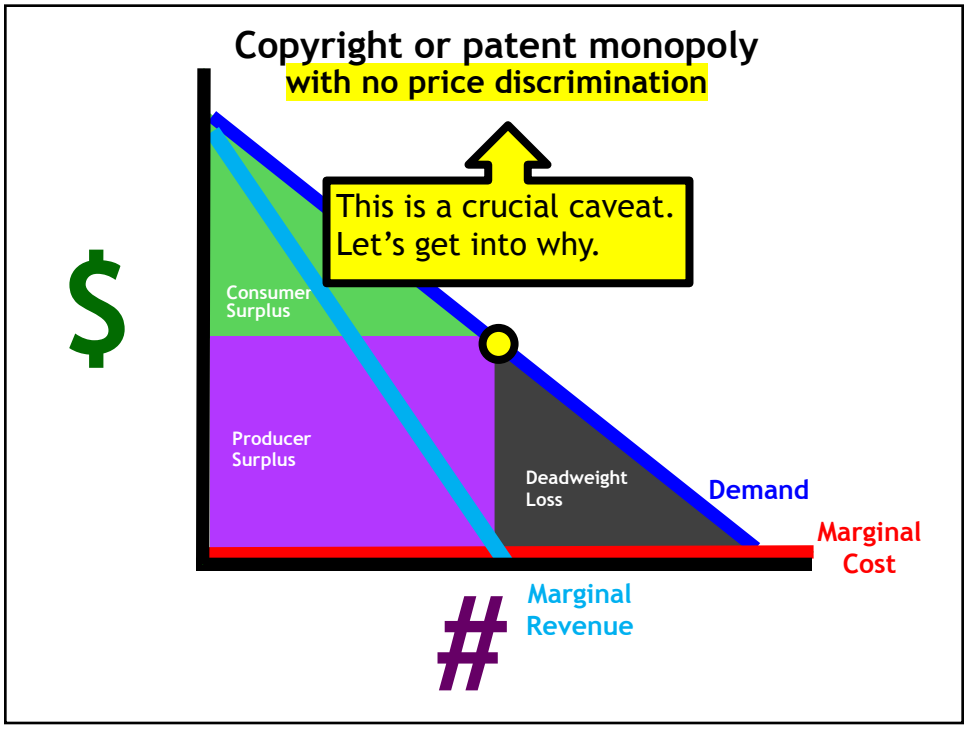
↑ Market-clearing price with each additional unit put out into the market

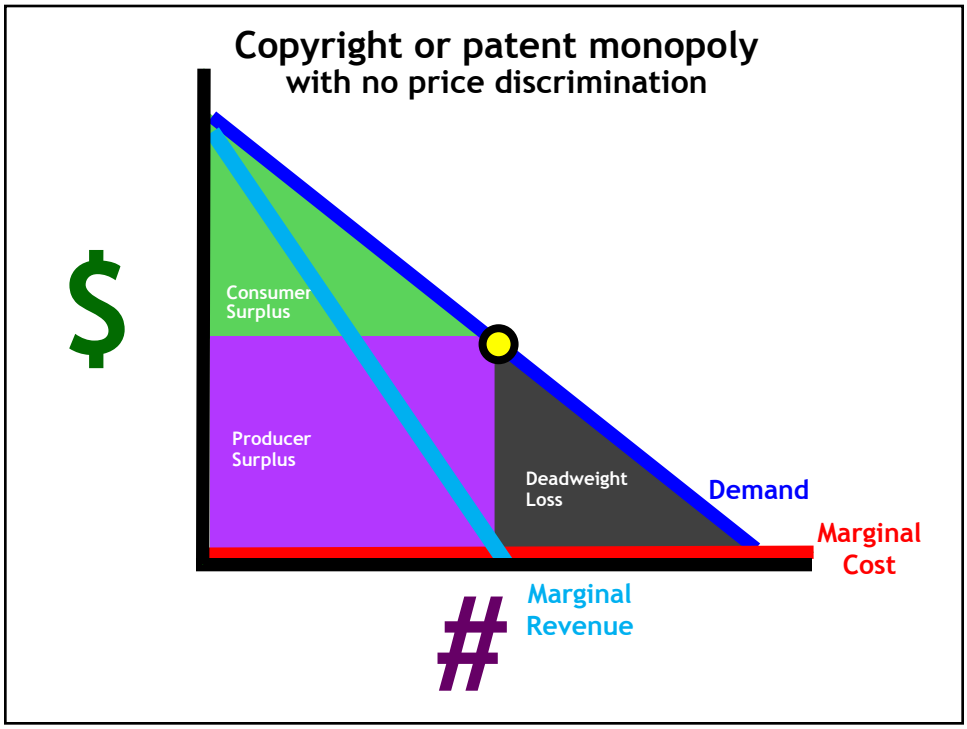


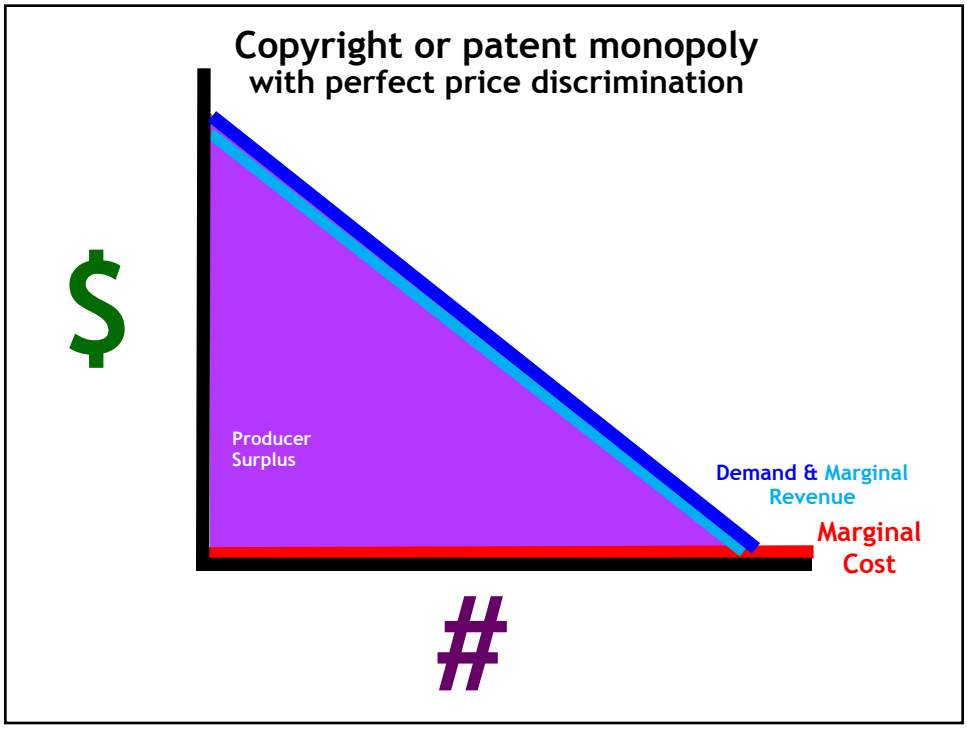


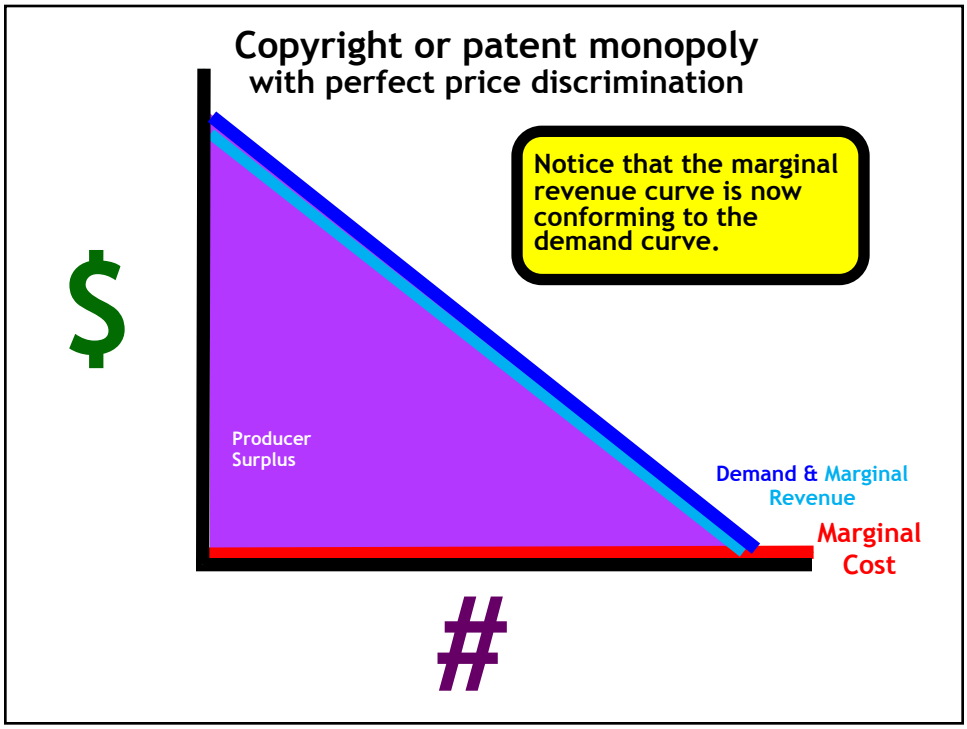

Copyright or patent monopoly
$
Consumer Surplus
Producer Surplus
Deadweight Loss
Demand
Marginal Cost
#
Marginal Revenue

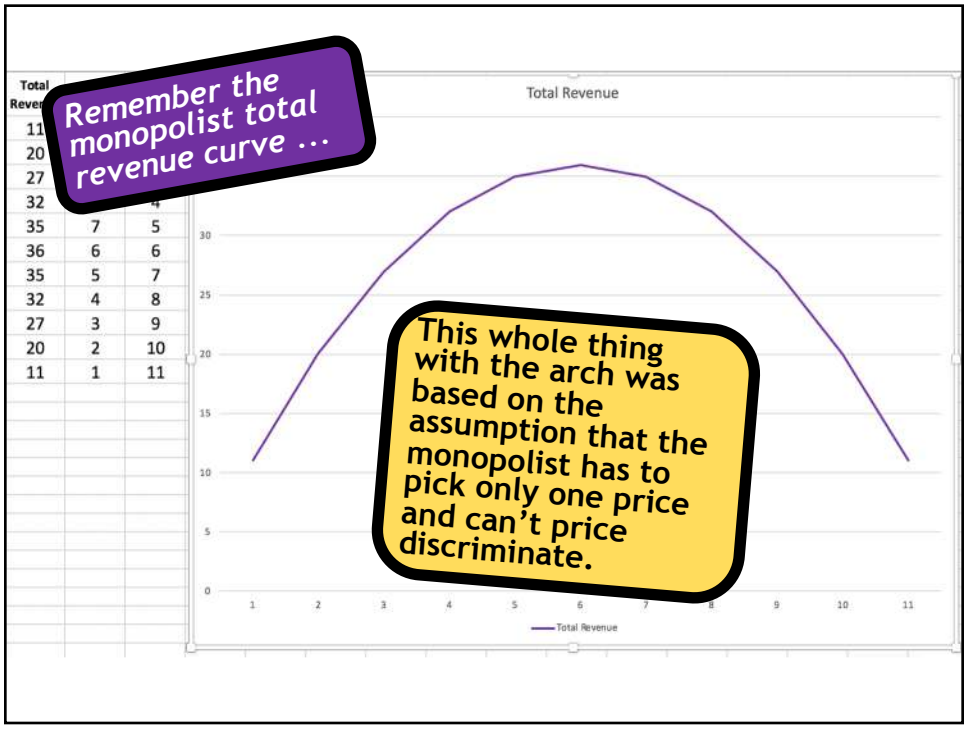

Copyright or patent monopoly
Most copyright/patent monopolies are going to have *some* marginal cost. But it is characteristically extremely low. And we are simplifying.
$
Consumer Surplus
Producer Surplus
We'll come back in a few weeks and talk more about IP, IP law, and its interaction with antitrust …
Deadweight Loss
Demand
Marginal Cost
#
Marginal Revenue

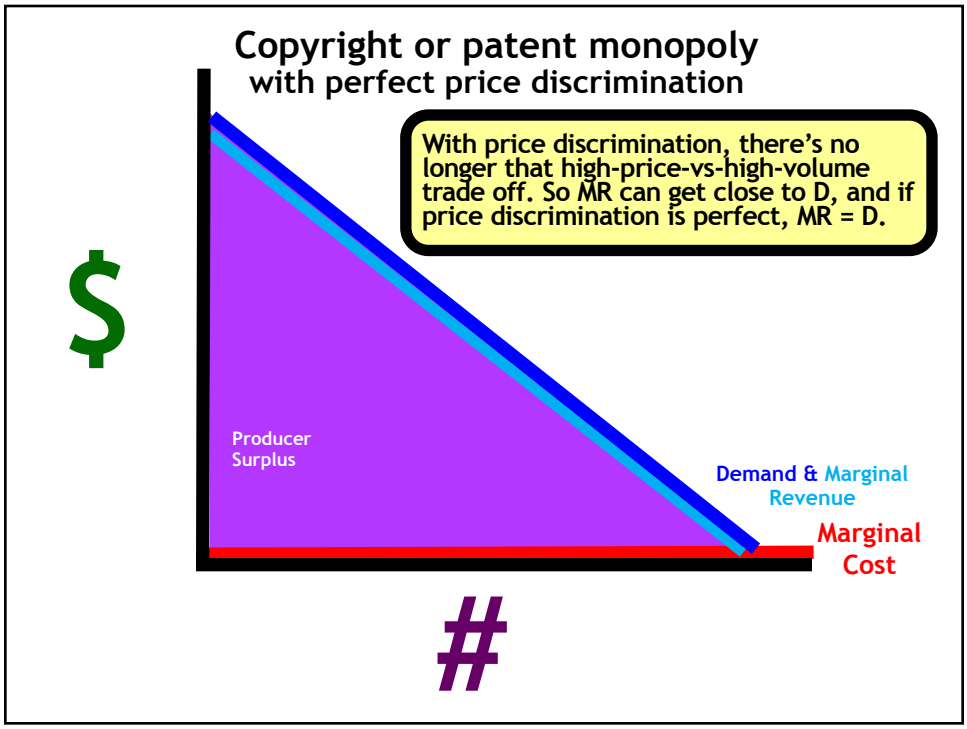

Copyright or patent monopoly
with no price discrimination
This is a crucial caveat.
Let's get into why.
$
Consumer Surplus
Producer Surplus
Deadweight Loss
Demand
Marginal Cost
#
Marginal Revenue

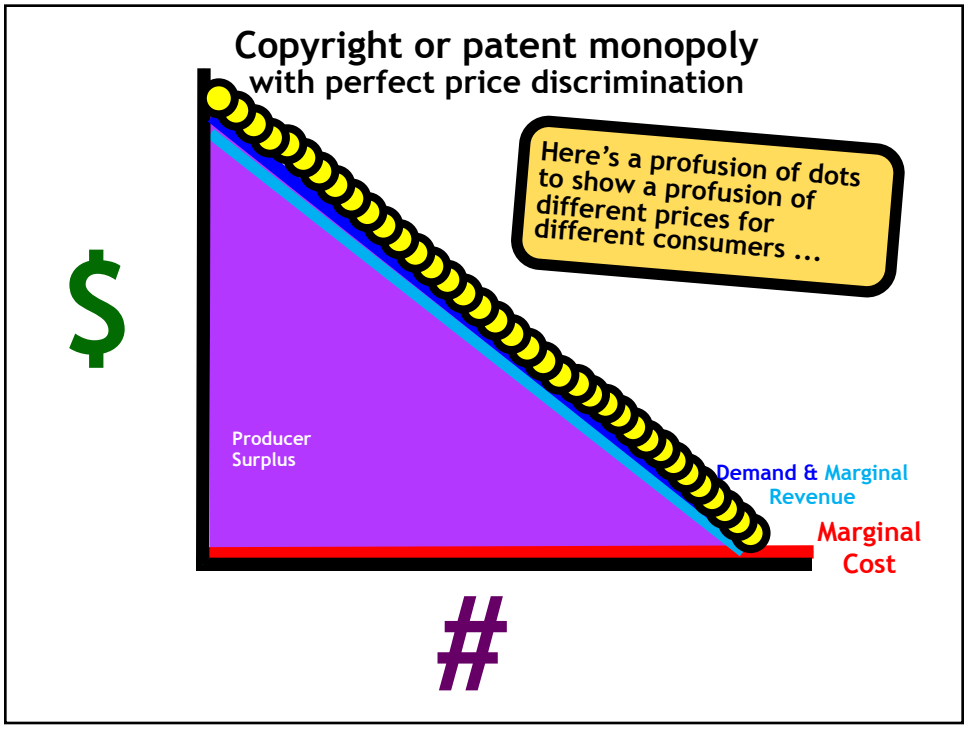

Copyright or patent monopoly
with no price discrimination
$
Consumer Surplus
Producer Surplus
Deadweight Loss
Demand
Marginal Cost
#
Marginal Revenue


Copyright or patent monopoly
with perfect price discrimination
$
Producer
Surplus
Demand & Marginal
Revenue
Marginal
Cost
#


Copyright or patent monopoly
with perfect price discrimination
Notice that the marginal revenue curve is now conforming to the demand curve.
$
Producer
Surplus
Demand & Marginal
Revenue
Marginal
Cost
#


Remember the monopolist total revenue curve …
Total Revenue
This whole thing with the arch was based on the assumption that the monopolist has to pick only one price and can't price discriminate.
Total Revenue


Copyright or patent monopoly
with perfect price discrimination
With price discrimination, there's no longer that high-price-vs-high-volume trade off. So MR can get close to D, and if price discrimination is perfect, MR = D.
$
Producer Surplus
Demand & Marginal Revenue
Marginal Cost
#


Copyright or patent monopoly
with perfect price discrimination
Here's a profusion of dots to show a profusion of different prices for different consumers ...
$
Producer Surplus
Demand & Marginal Revenue
Marginal Cost
#

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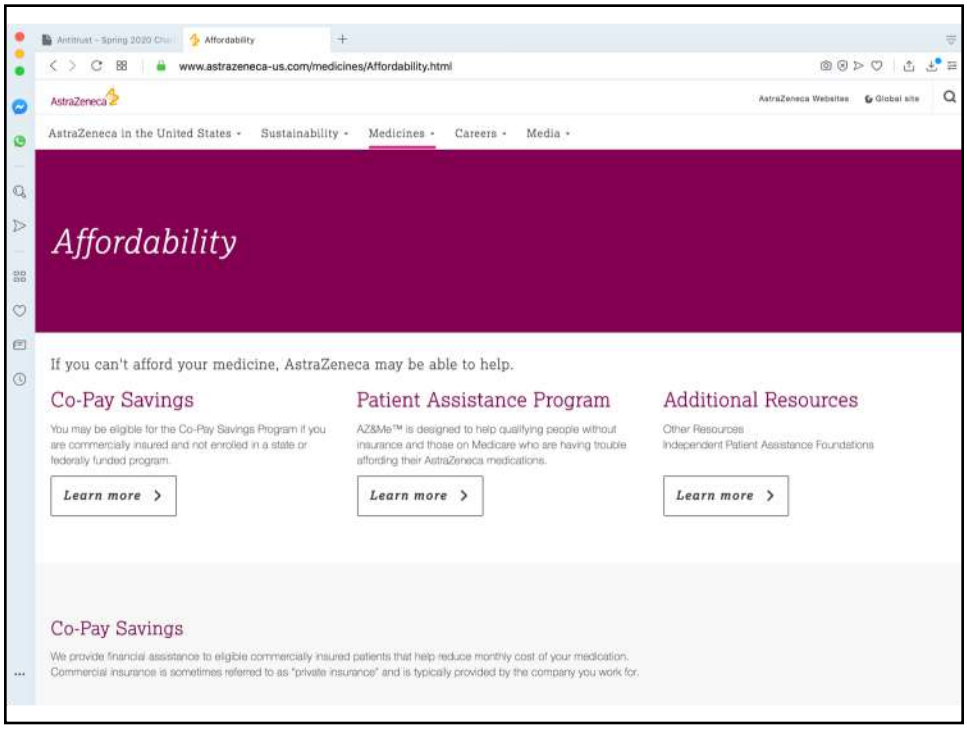
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AstraZeneca Websites
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You may be eligible for the Co-Pay Savings Program if you are commercially insured and not enrolled in a state or federally funded program.
Learn more
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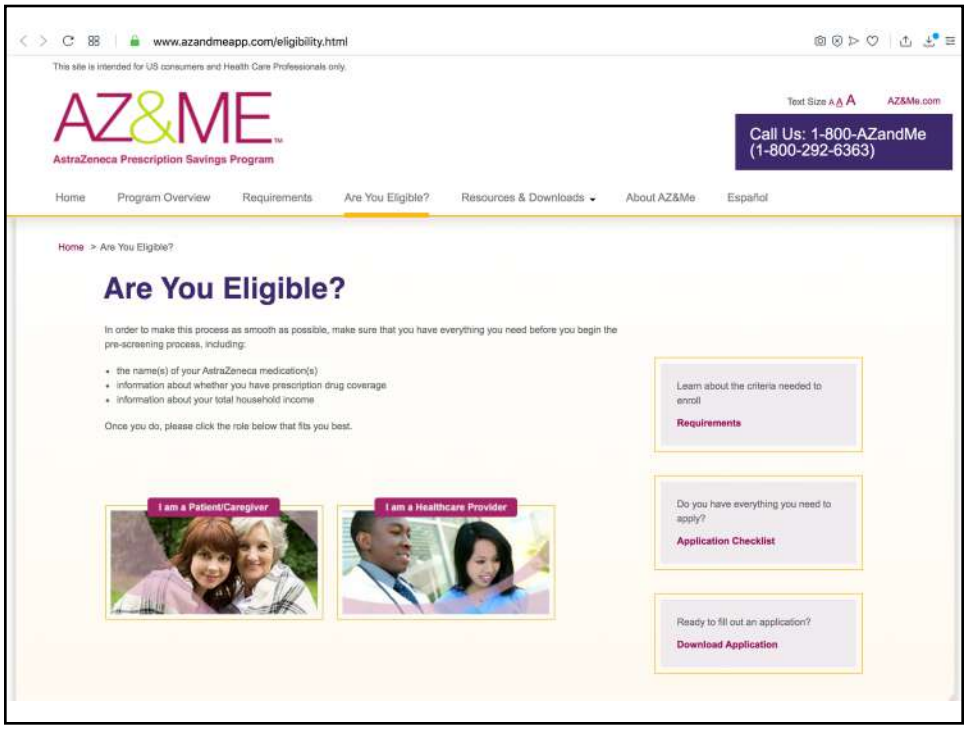
AZ&Me™ is designed to help qualifying people without insurance and those on Medicare who are having trouble affording their AstraZeneca medications.
Learn more
Additional Resources
Other Resources
Independent Patient Assistance Foundations
Learn more
Co-Pay Savings
We provide financial assistance to eligible commercially insured patients that help reduce monthly cost of your medication.
Commercial insurance is sometimes referred to as "private insurance" and is typically provided by the company you work for.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AstraZeneca Prescription Savings Program
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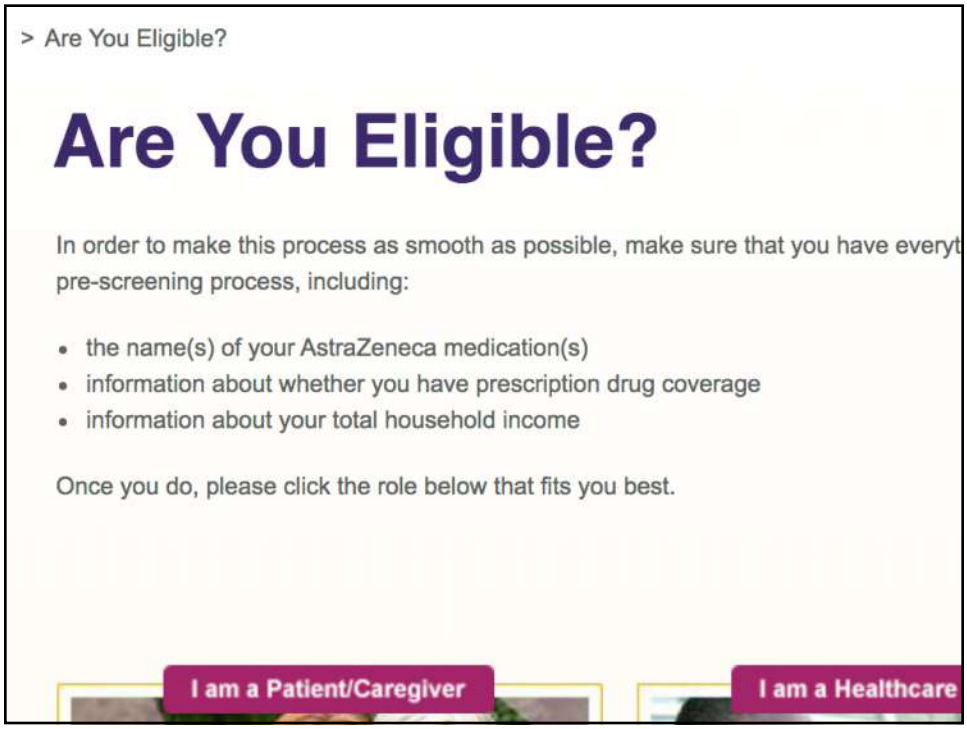
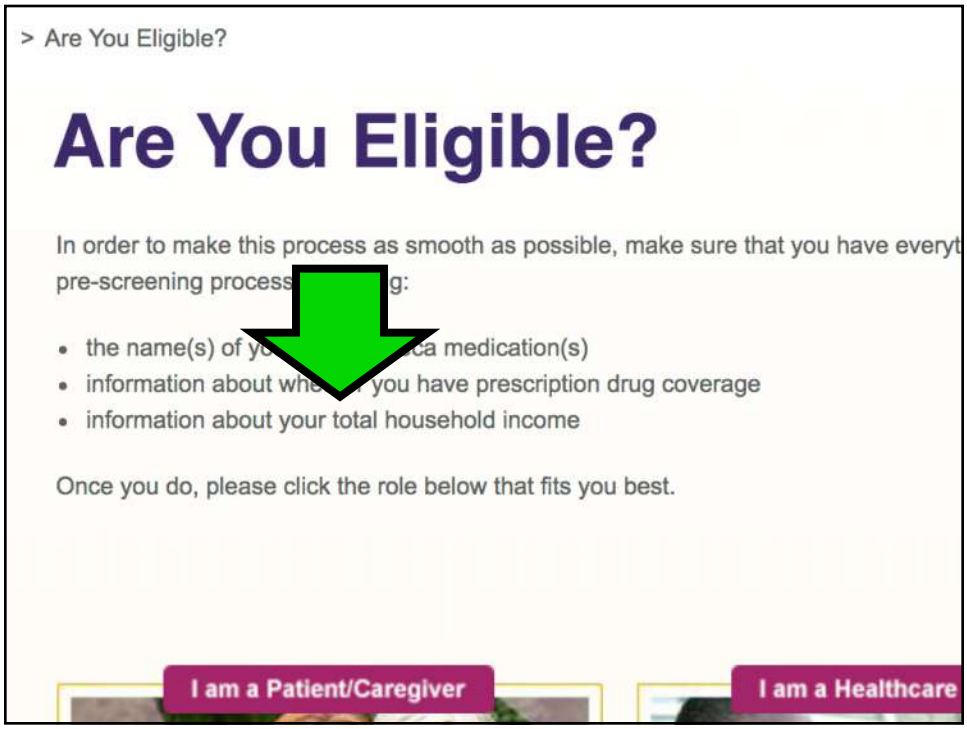
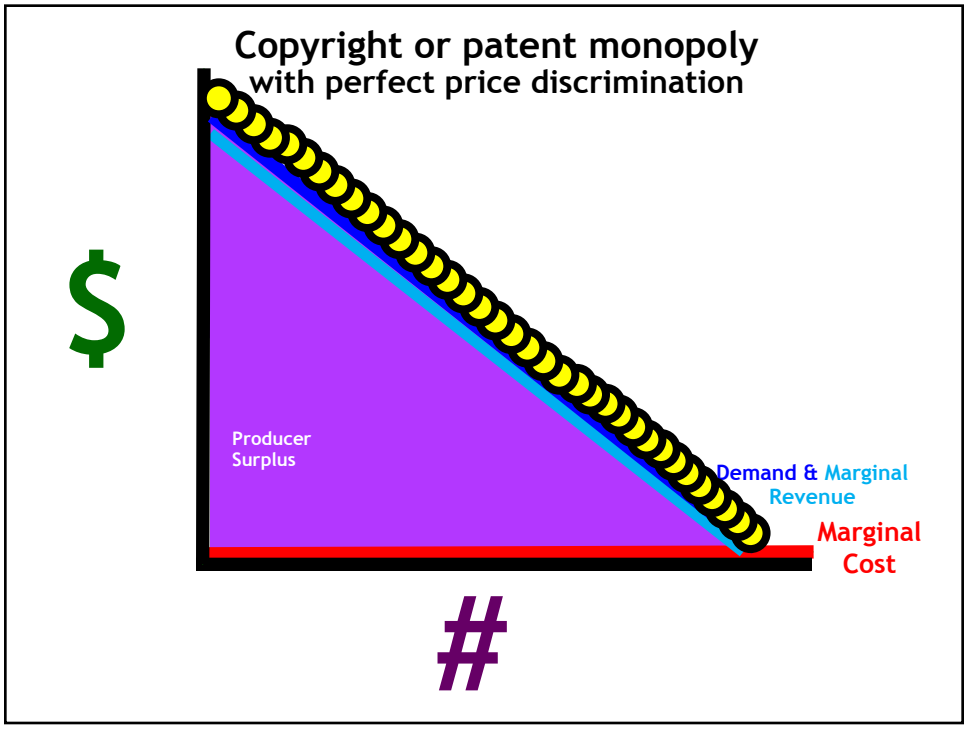
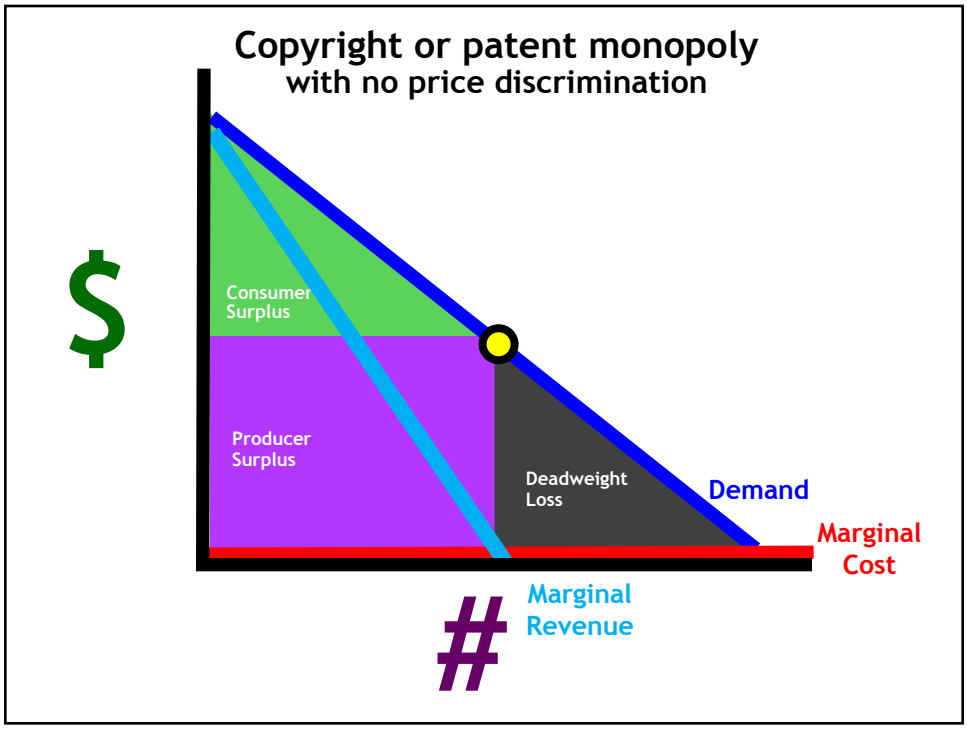
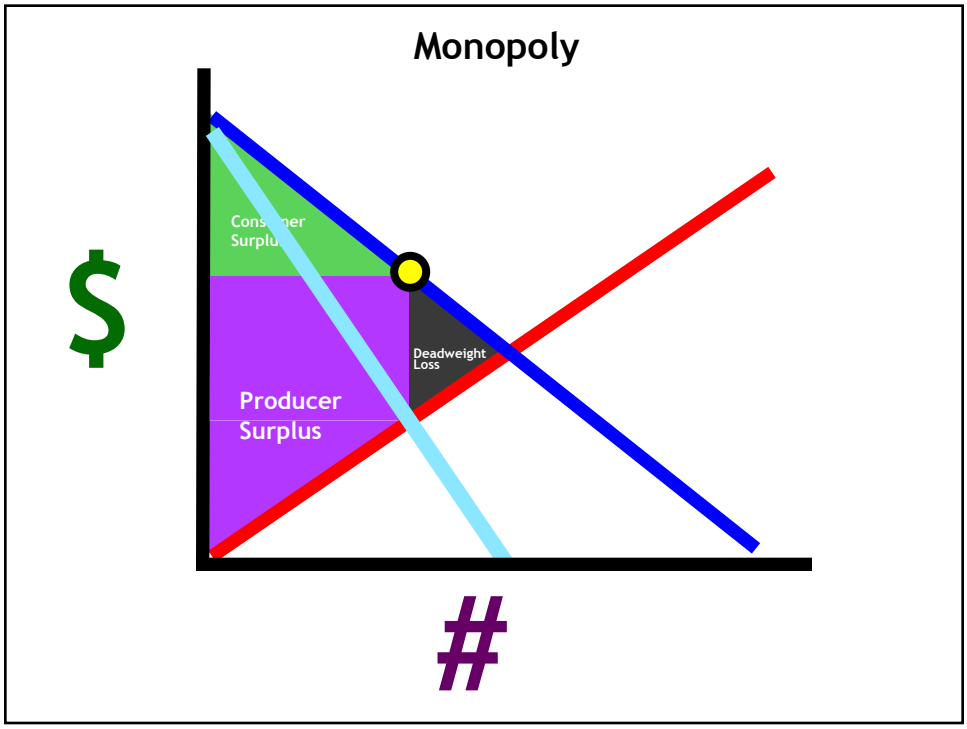
Are You Eligible?
In order to make this process as smooth as possible, make sure that you have everything you need before you begin the pre-screening process, including:
the name(s) of your AstraZeneca medication(s)
information about whether you have prescription drug coverage
information about your total household income
Once you do, please click the role below that fits you best.
I am a Patient/Caregiver
I am a Healthcare Provider
Learn about the criteria needed to enroll
Requirements
Do you have everything you need to apply?
Application Checklist
Ready to fill out an application?
Download Application

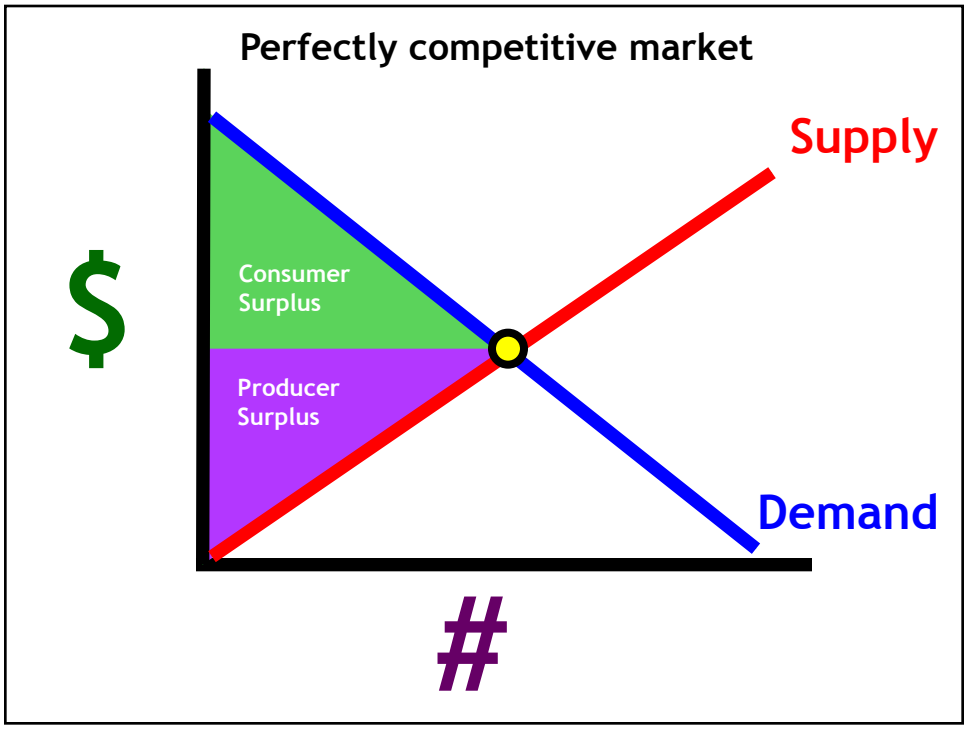

> Are You Eligible?
Are You Eligible?
In order to make this process as smooth as possible, make sure that you have everyt
pre-screening process, including:
the name(s) of your AstraZeneca medication(s)
information about whether you have prescription drug coverage
information about your total household income
Once you do, please click the role below that fits you best.
I am a Patient/Caregiver
I am a Healthcare


> Are You Eligible?
Are You Eligible?
In order to make this process as smooth as possible, make sure that you have everyt
pre-screening process
the name(s) of y
ca medication(s)
information about wh
you have prescription drug coverage
information about your total household income
Once you do, please click the role below that fits you best.
I am a Patient/Caregiver
I am a Healthcare


Copyright or patent monopoly
with perfect price discrimination
$
Producer Surplus
Demand & Marginal Revenue
Marginal Cost
#


Copyright or patent monopoly
with no price discrimination
$
Consumer Surplus
Producer Surplus
Deadweight Loss
Demand
Marginal Cost
#
Marginal Revenue


Monopoly
$
Producer Surplus
Deadweight Loss
#


Perfectly competitive market
Supply
$
Consumer Surplus
Producer Surplus
Demand
#

Dominant Market Power

- Short of a monopoly, a dominant firm can have some power over prices.
- This can happen because:
  - Rivals have capacity constraints.
  - Rivals have higher costs.
- This can allow a dominant firm to raise prices to supracompetitive levels.
- The bottom-line is, you don't need a monopoly or a leak-proof cartel to have the power to raise prices and create deadweight loss.

Dominant Market Power and Mergers

- Mergers that don't create a monopoly can still create dominant market power.
  → This can increase producer surplus, which is good for the firm and incentivizes the merger.
  → This can decrease allocative efficiency, which is bad for society.
- Mergers can allow firms to avoid wasteful, duplicative costs, and thus create beneficial efficiencies.
  → This can increase producer surplus, which is good for the firm and incentivizes the merger.
  → This can increase productive efficiency, which is good for society.
- Gains in productive efficiency can be offset by losses in allocative efficiency.
- If we are looking out for society, we need to figure out whether a merger raises productive efficiency more than it lowers allocative efficiency.

Allocative and Productive Efficiency

- **Productive efficiency** is that we are being as productive as we can be with regard to one thing we want without any offset reduction in producing something else we want.
- **Allocative efficiency** is that all production and consumption is efficiently allocated.
  - Goods go to their highest and best uses.
  - Capital and labor go to their highest and best uses.

Allocative and Productive Efficiency

"**Productive efficiency** means that, given the available inputs and technology, it is impossible to produce more of one good without decreasing the quantity that is produced of another good."

"**Allocative efficiency** means that the particular combination of goods and services on the production possibility curve that a society produces represents the combination that society most desires."

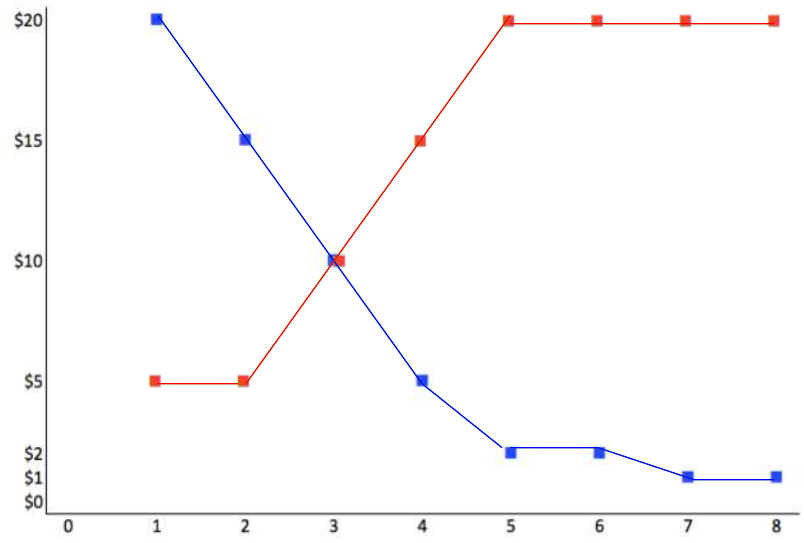
- POE 2d ed. p. 35

Example: Windchimes in Wendover on Wednesday

An economy with just eight people and one day:

- Allen, who adores windchimes and would pay $20 for one.
- Bonnie, who thinks windchimes are okay, and would pay $15 for one.
- Chuck finds windchimes uncharming, but he would buy one at $10 just to have the option of annoying his neighbor, Darla, if Darla's incense burning was annoying him.
- Darla hates windchimes and she would only pay $5 for one, which she could use for smashing with a hammer to let off steam. If the price were $2, she'd buy two. For $1, she'd get up to 5 and smash them all.
- Wendy loves making windchimes, and she's good at it. She can churn out two out for $5 each.
- Xavier likes making things out of metal and clay. It would be worth it for him to make one set of windchimes if it could fetch $10.
- Yvonne like playing video games and not working. It would only be worth it for her to make one set of windchimes if she got $15 for it.
- Zendaya is a successful celebrity actor and singer. For it to be worth it to her to make windchimes, she'd have to be paid $20 each, and even then she'd mostly do if for Instagram value. But she's a fast worker, so she could make four.

What is the efficient number of windchimes for this society to produce?



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If three windchimes are produced, and they all go to Darla, is that allocative inefficiency or productive inefficiency?

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A. allocative inefficiency
B. productive inefficiency
C. i.d.k.
D. I'm lost

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Example: Windchimes in Wendover on Wednesday

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What is the efficient number of windchimes for this society to produce?

If Wendy would use a sharper knife that she forgot she has in the garage, she could turn out two more windchimes a day – is that allocative inefficiency or productive inefficiency?

A. allocative inefficiency
B. productive inefficiency
C. i.d.k.
D. I'm lost

Example: Windchimes in Wendover on Wednesday

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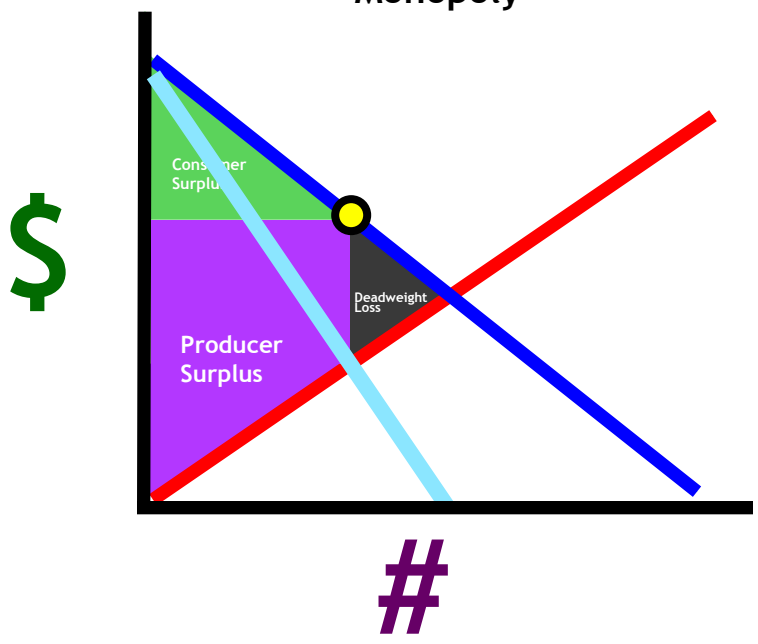
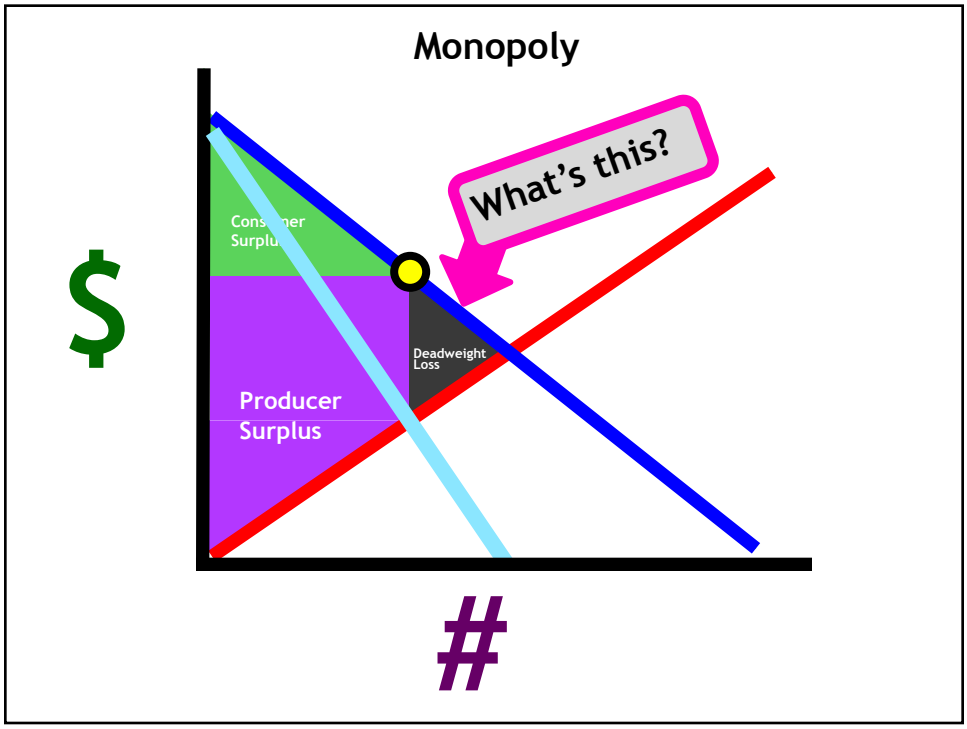
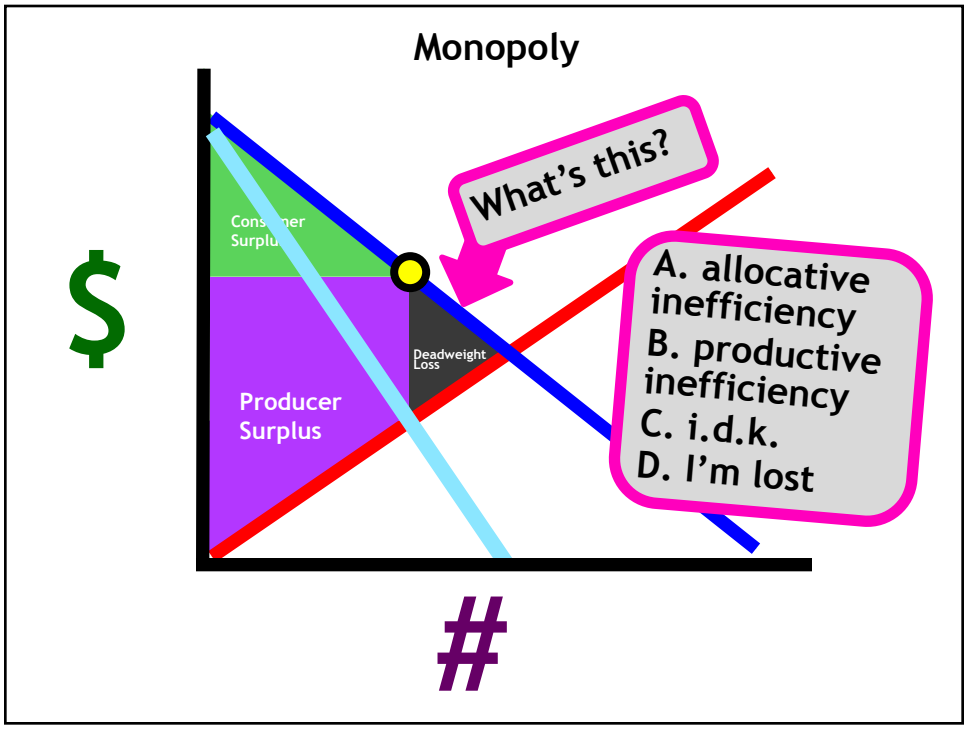
Monopoly




Monopoly
What's this?
Consumer Surplus
Deadweight Loss
Producer Surplus
$
#


Monopoly
What's this?
A. allocative inefficiency
B. productive inefficiency
C. i.d.k.
D. I'm lost
Consumer Surplus
Deadweight Loss
Producer Surplus
$
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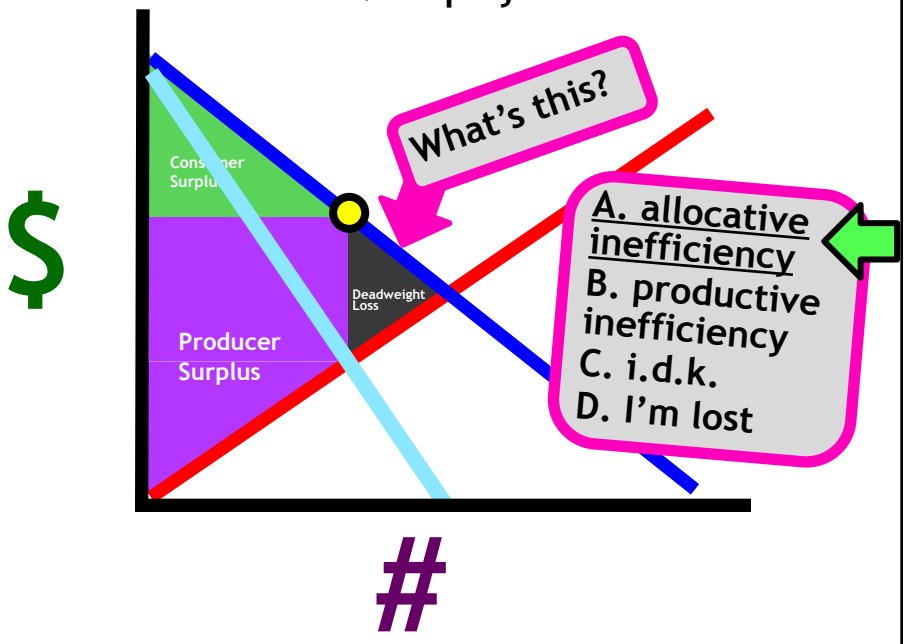
Monopoly



Dominant Market Power and Merger

Repeat ...

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