

FIRMS AND MARKETS IV

MPA 612: Economy, Society, and Public Policy

March 6, 2019

*Fill out your reading report
on Learning Suite*

PLAN FOR TODAY

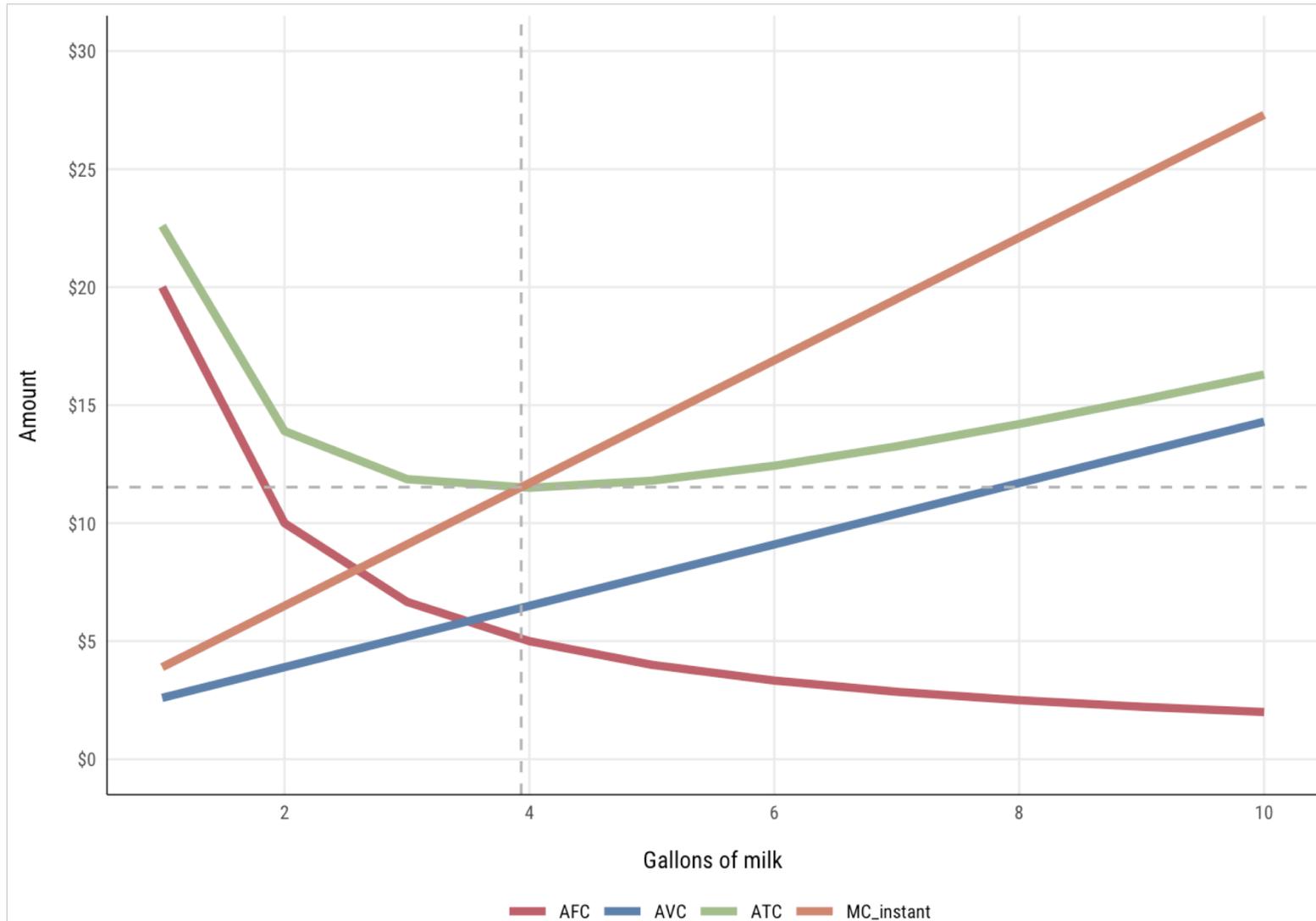
Price taking

Escaping the price taking world

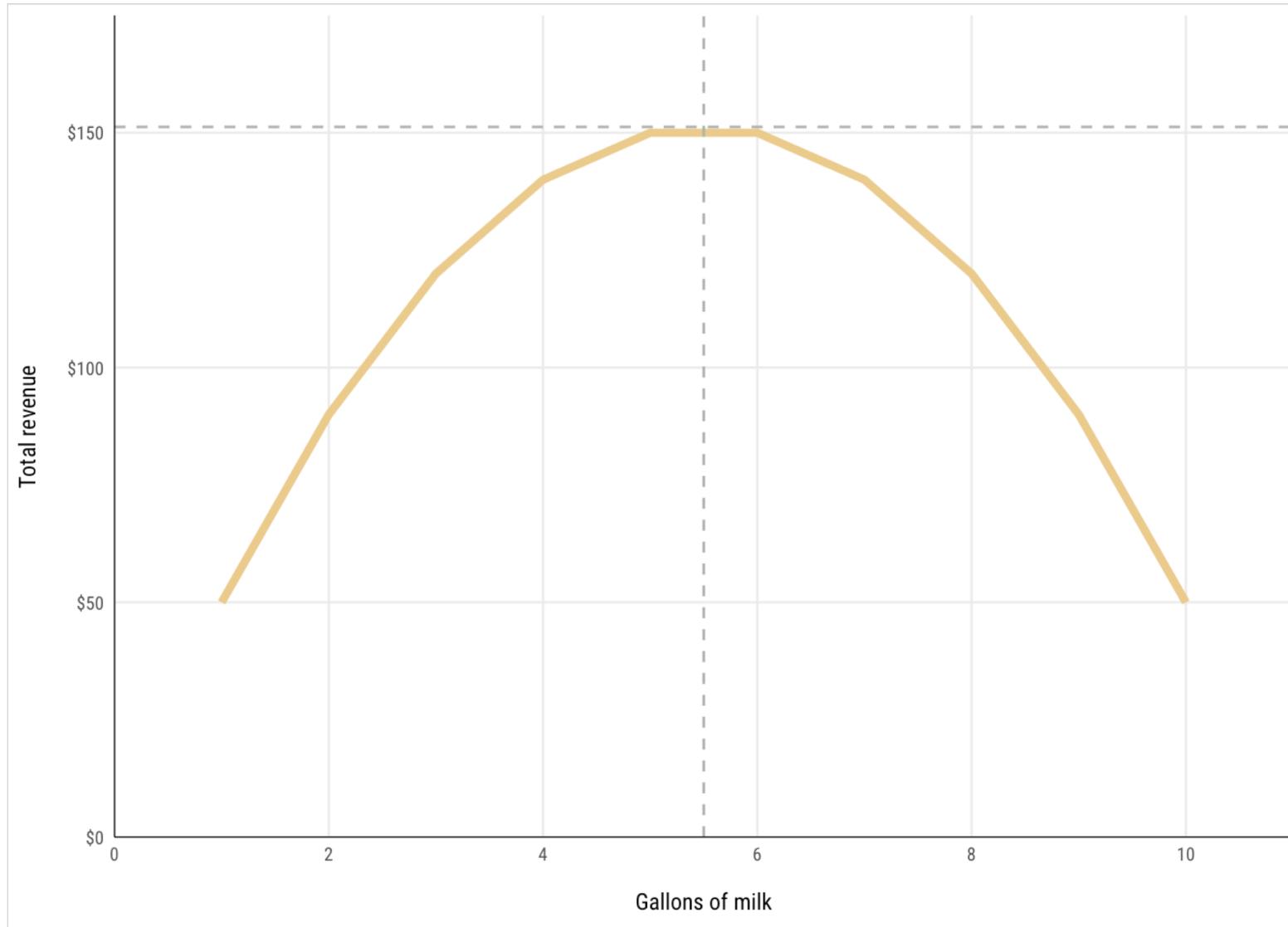
Competition and regulation

PRICE TAKING

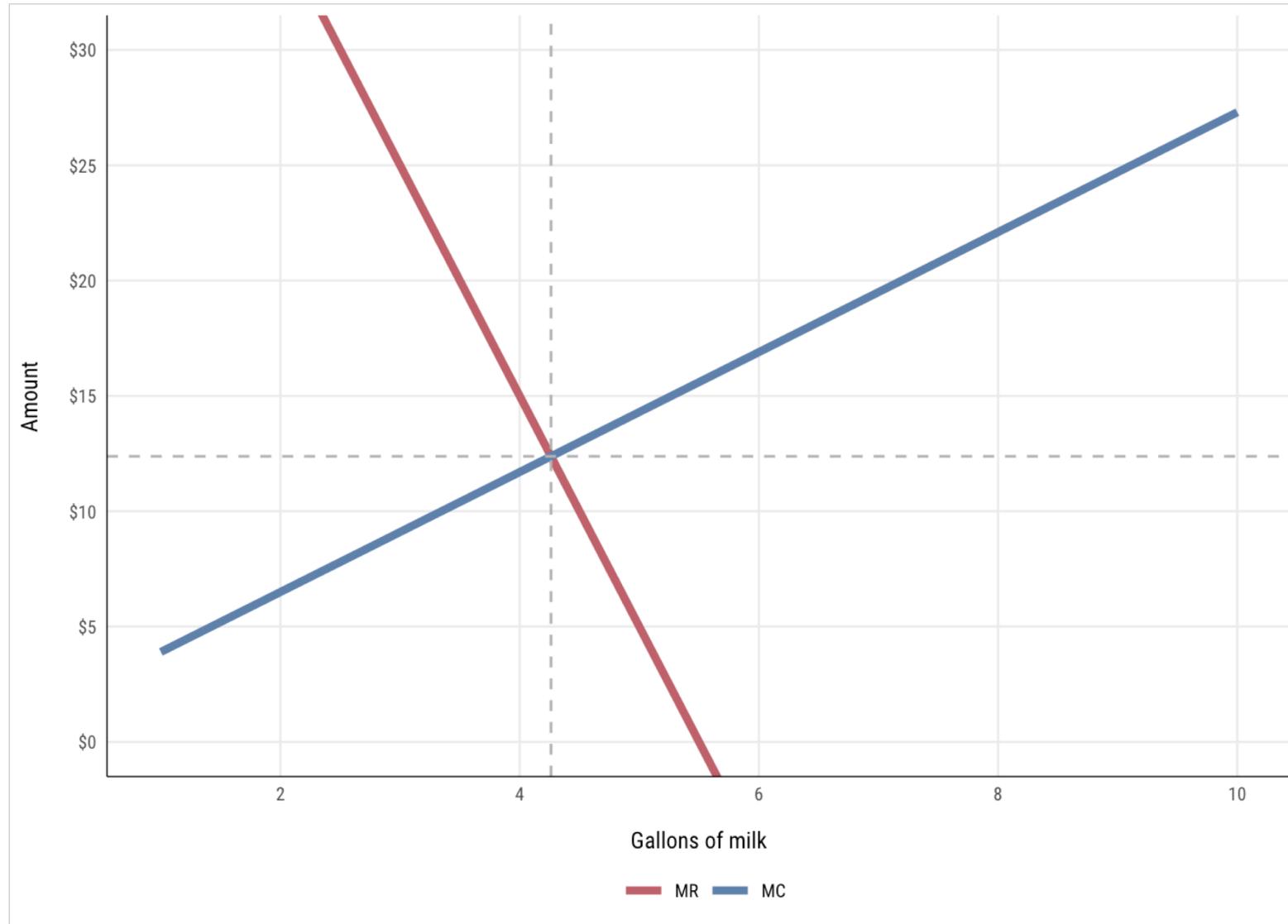
COST MINIMIZATION



REVENUE MAXIMIZATION



PROFIT MAXIMIZATION



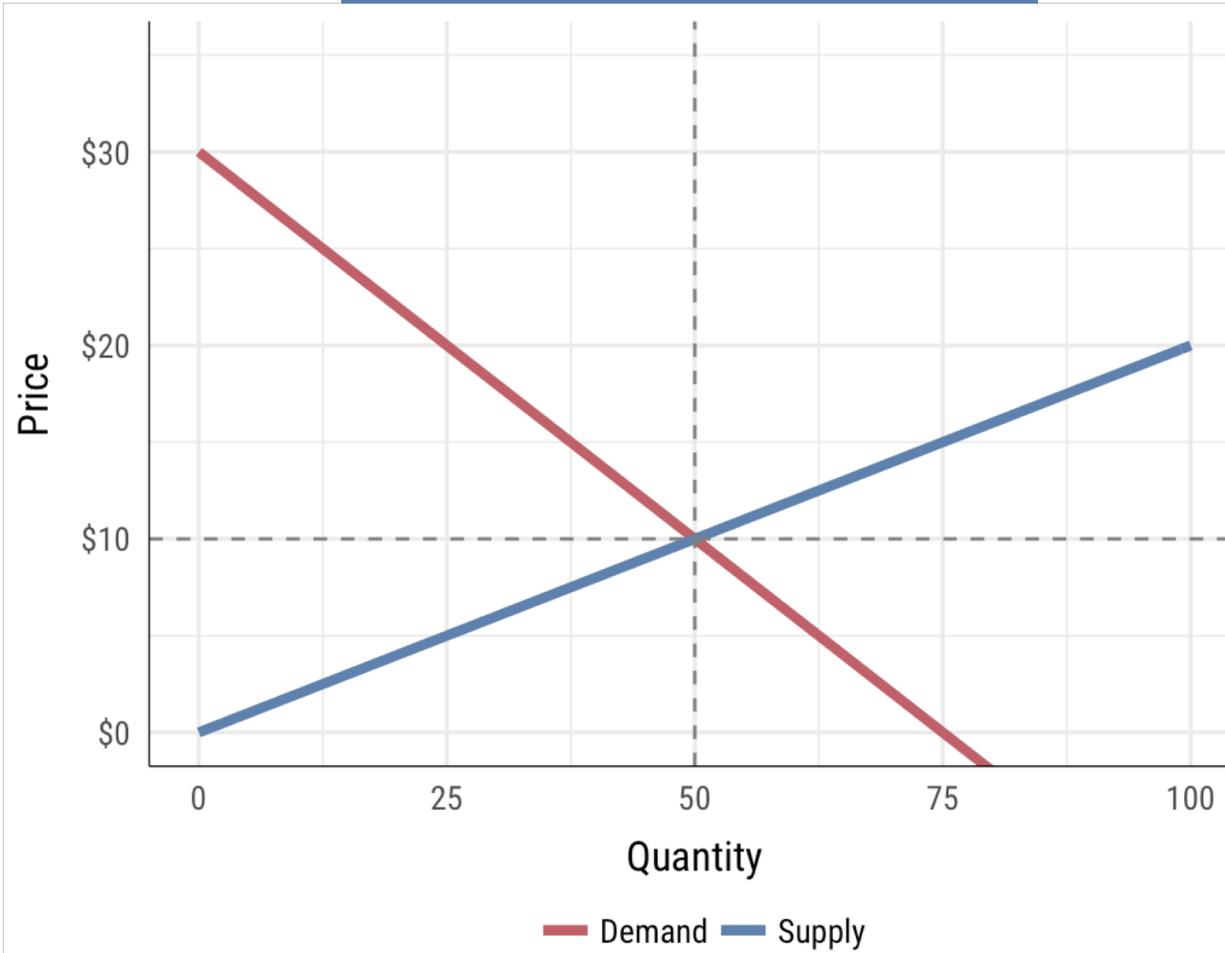
OPTIMAL THINGS

Max π : $MC = MR$

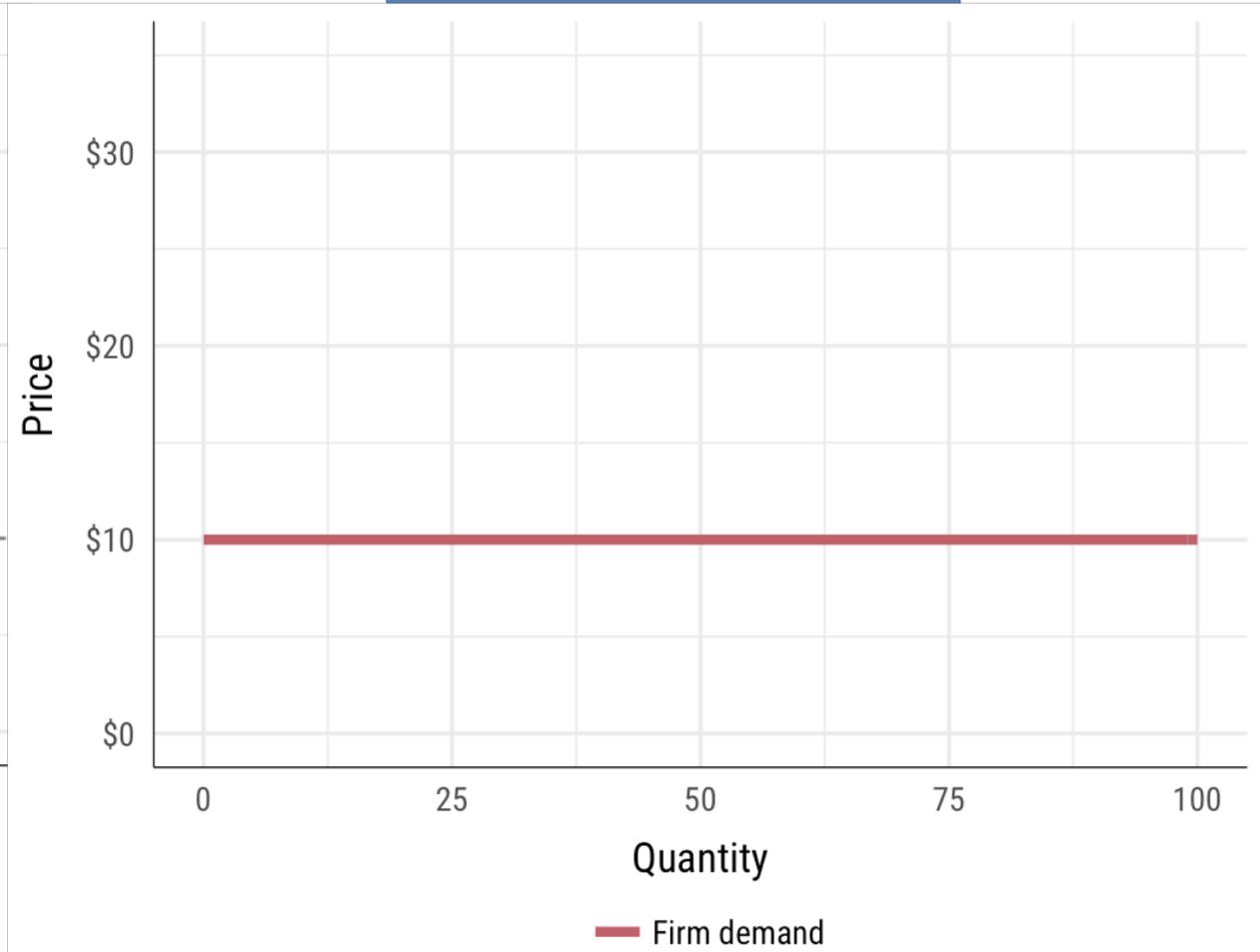
Best Q: Demand = MC

**In perfect competition,
Demand = MC = MR = P**

Market demand



Firm demand



PRICE TAKING

Firm decisions have no impact on the price of a good

You're stuck with whatever the prevailing market price is \pm some markup

BUT WHAT IF???

What if you could affect the price?

Would you want to?

Costs matter.

Set the price to *your* MC, maximize *your* profit.

**ESCAPING THE
PRICE TAKING
WORLD**

Escape with market power!

**Ability to influence
market prices**

This is why people get MBAs;
move market away from perfect competition price

WAYS TO ESCAPE

Price discrimination

Monopolies

Switching costs

Branding and differentiation

Cost and input controls

Government regulation

PRICE DISCRIMINATION

With perfect information,
firms can set individualized
demand curves for customers

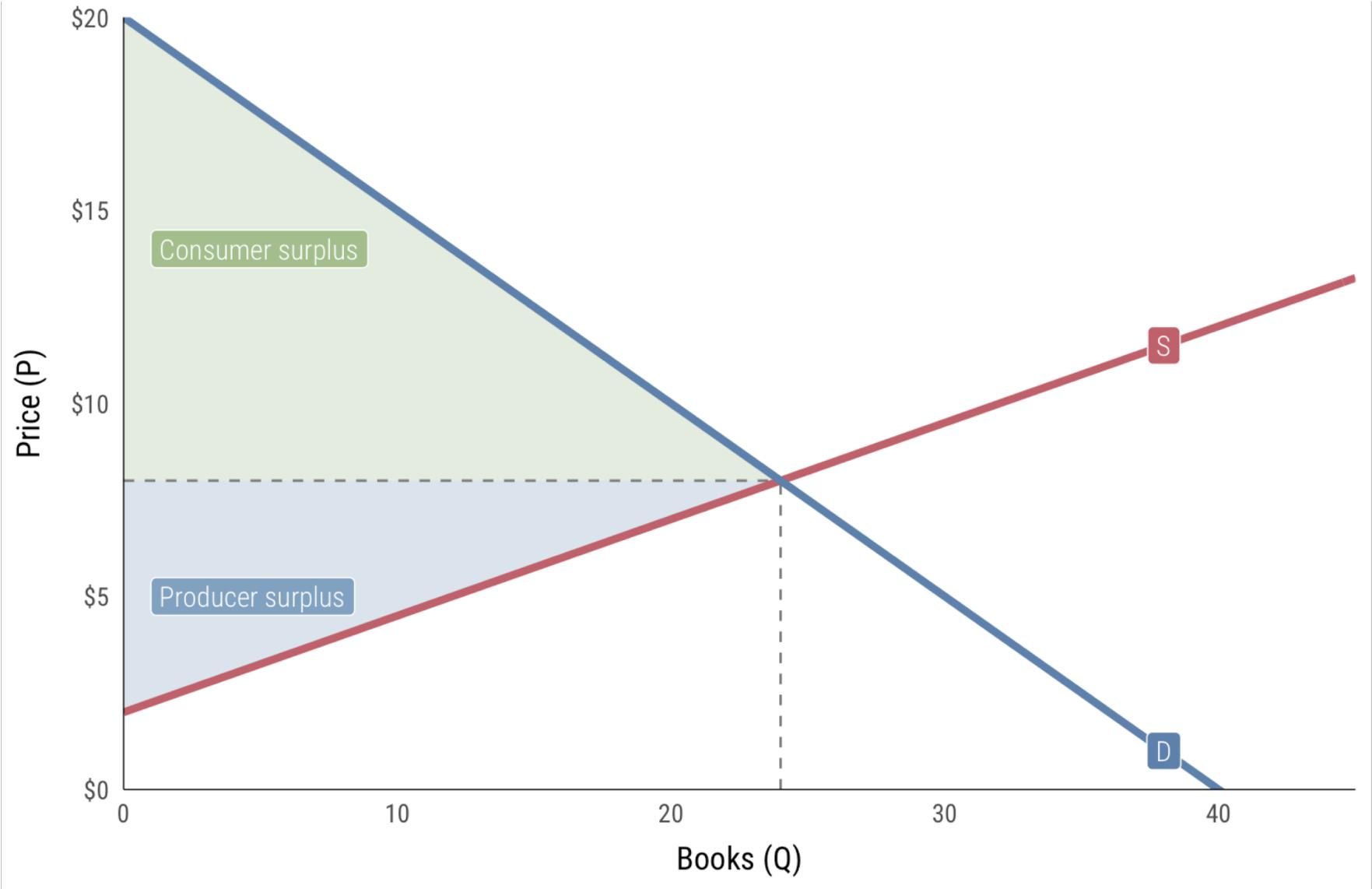
Price = WTP

Lyft/Uber

Airplane tickets

Amazon

PRICE DISCRIMINATION



MONOPOLIES

**The whole market is only one firm,
so market demand *is* firm demand**

Monopolists will naturally produce less quantity at higher prices than firms in competitive markets

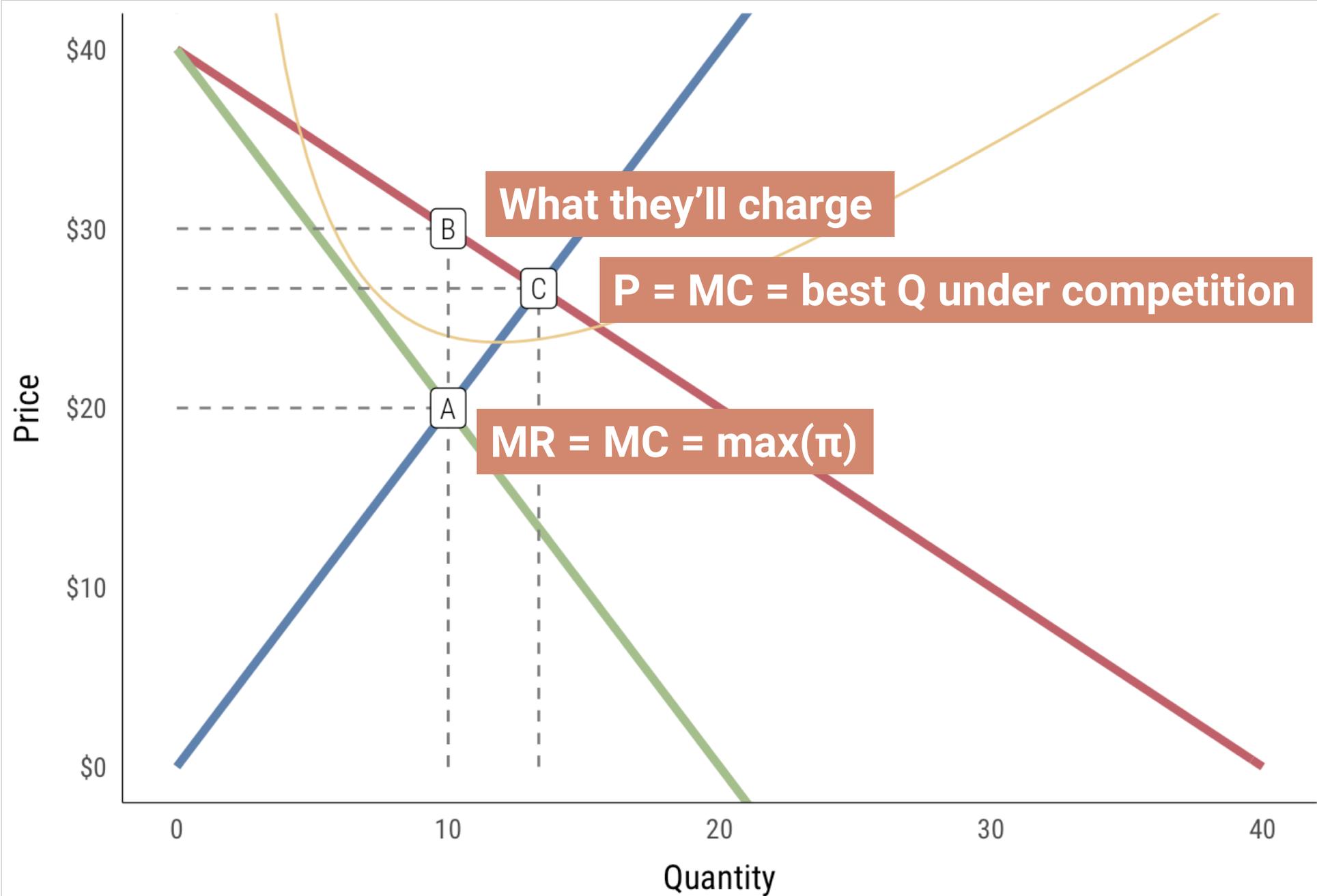
Creates deadweight loss, just like taxes

MONOPOLIES

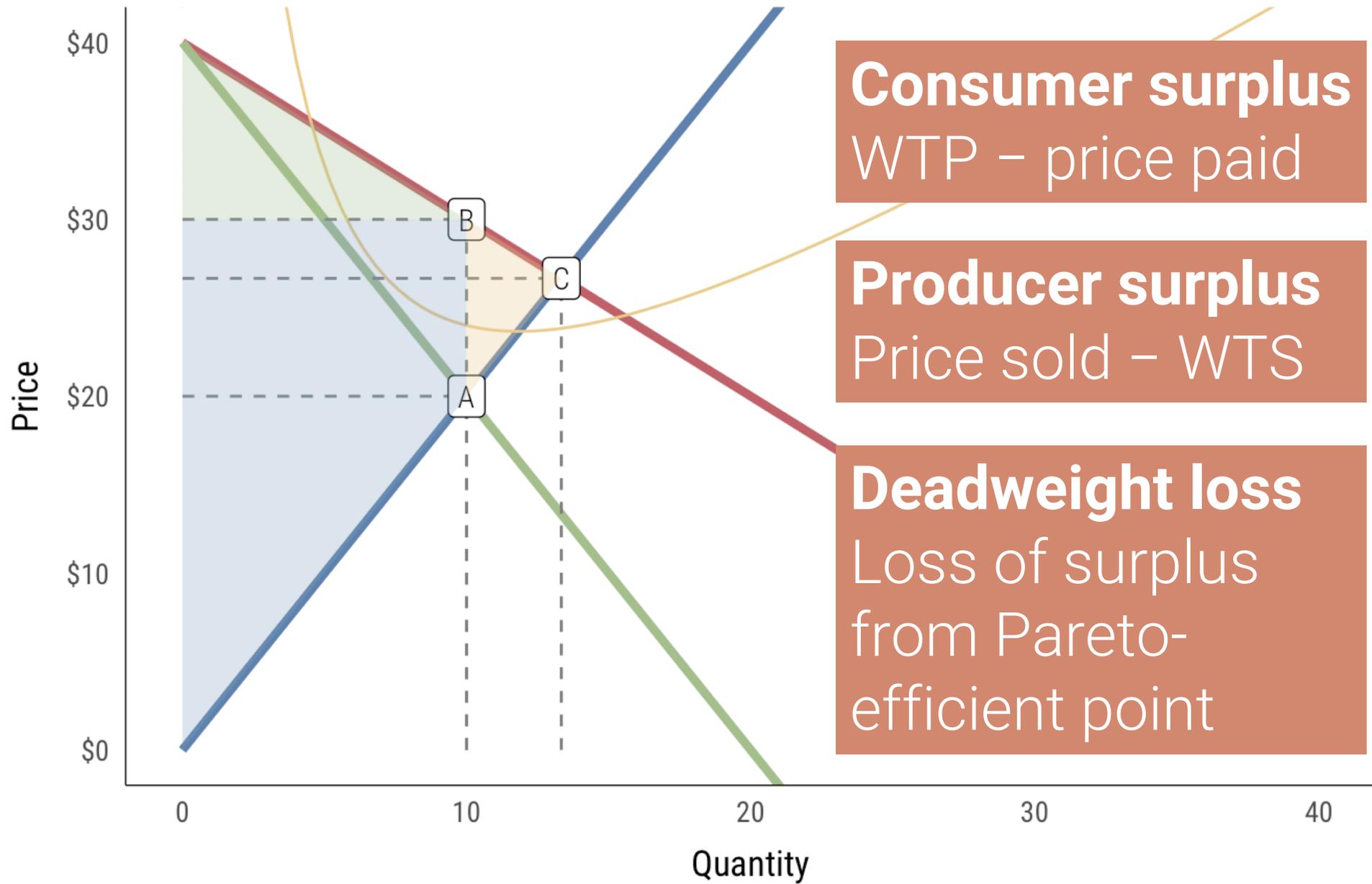
Math time!

$$P = -Q + 40$$

$$TC = Q^2 + 140$$



— Average total cost
 — Demand
 — Marginal cost
 — Marginal revenue



Consumer surplus
 $WTP - \text{price paid}$

Producer surplus
 $\text{Price sold} - WTS$

Deadweight loss
 Loss of surplus from Pareto-efficient point

- Average total cost
- Marginal cost
- Consumer surplus
- Producer surplus
- Demand
- Marginal revenue
- Deadweight loss

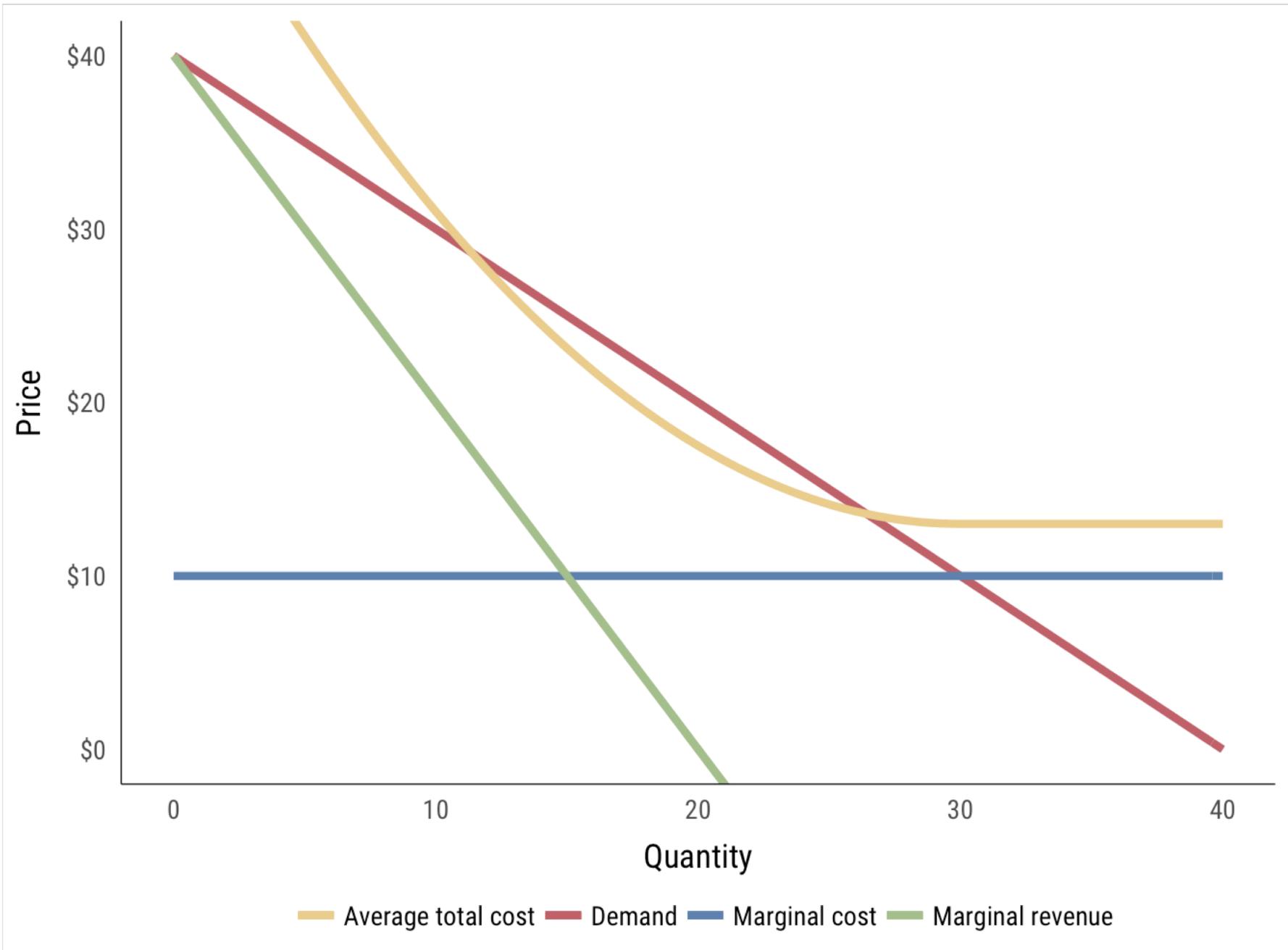
NATURAL MONOPOLIES

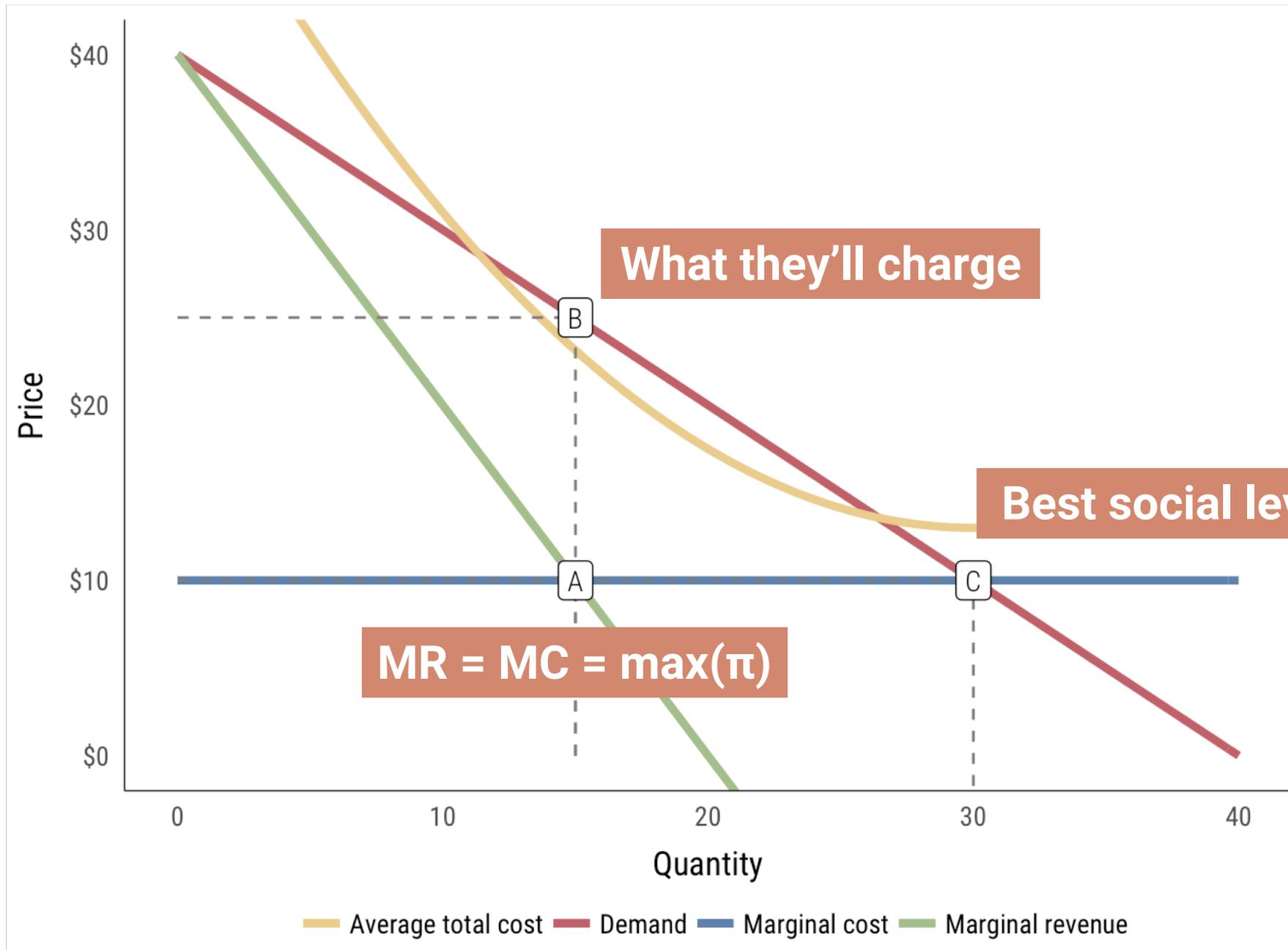
Big expensive things with large capital outlays and low marginal cost

Generally more efficient to just have one firm handle it

Utilities

Public transportation



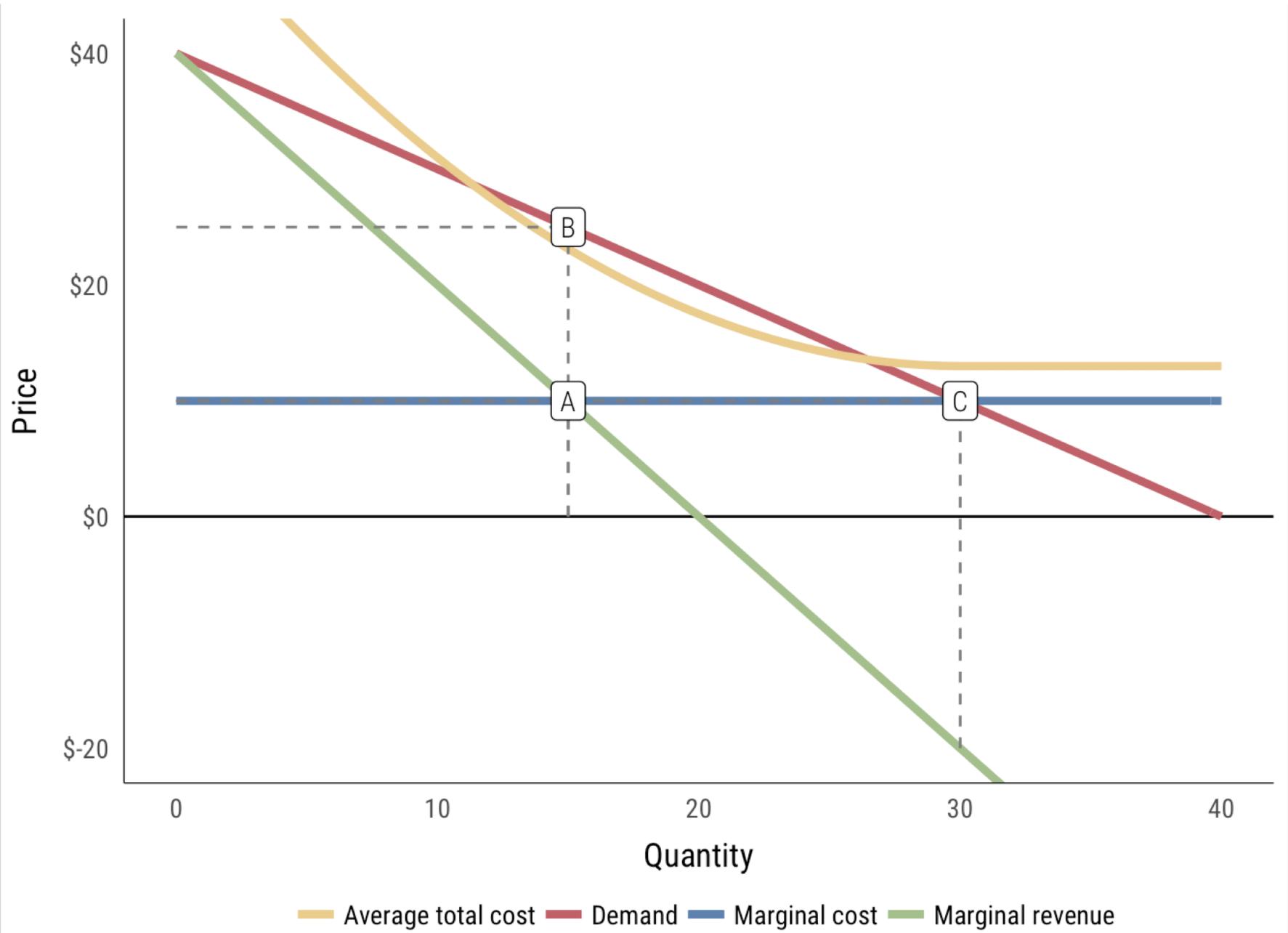


What they'll charge

Best social level

MR = MC = max(π)

Average total cost Demand Marginal cost Marginal revenue



— Average total cost — Demand — Marginal cost — Marginal revenue

SWITCHING COSTS

**Make it harder for consumers
to switch away from you**

Brand-exclusive benefits

Technology constraints

Search costs

Network costs

BRANDING + DIFFERENTIATION

Make your stuff nonsubstitutabile

Advertising

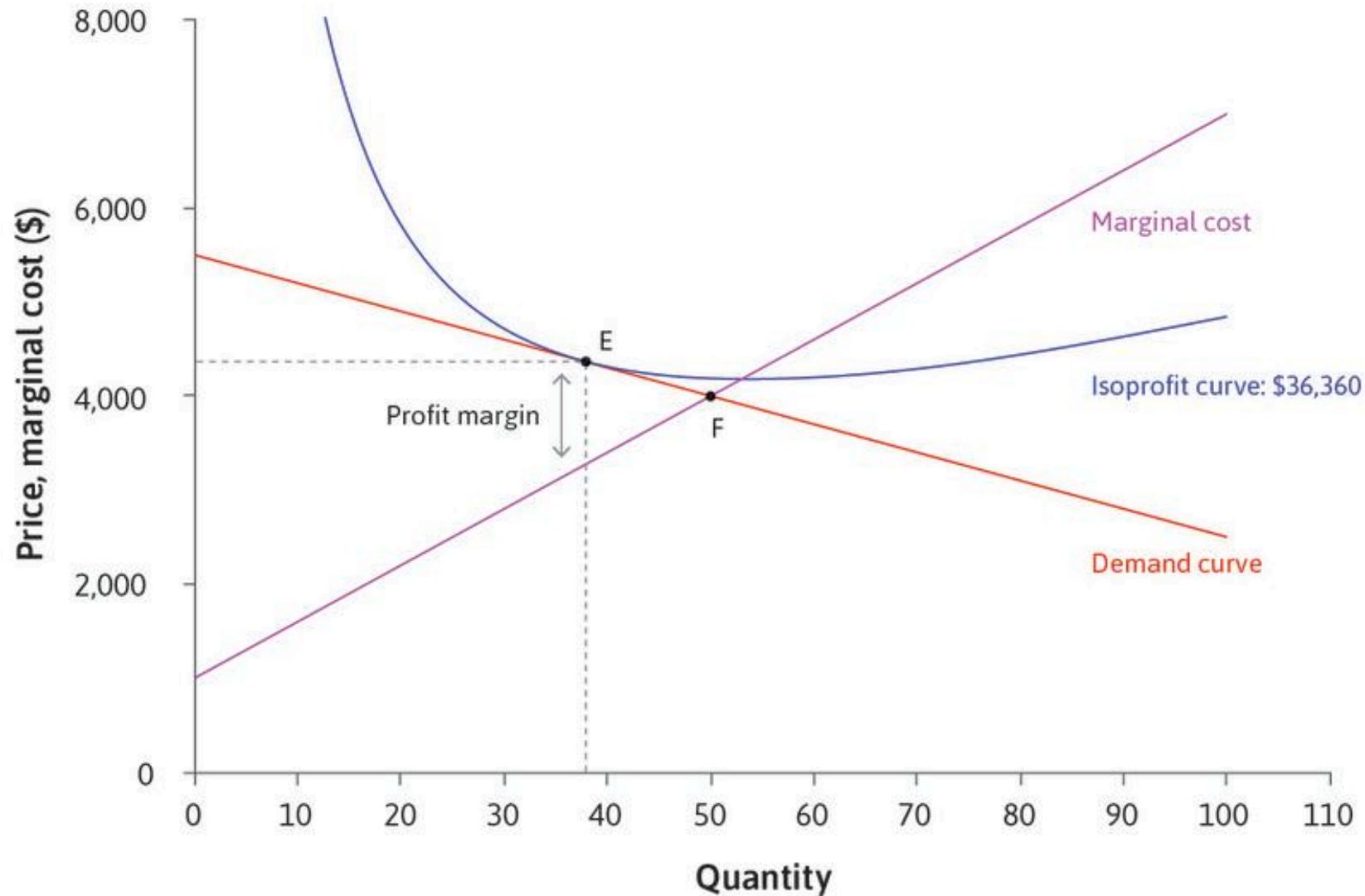
Brand loyalty

BRANDING + DIFFERENTIATION

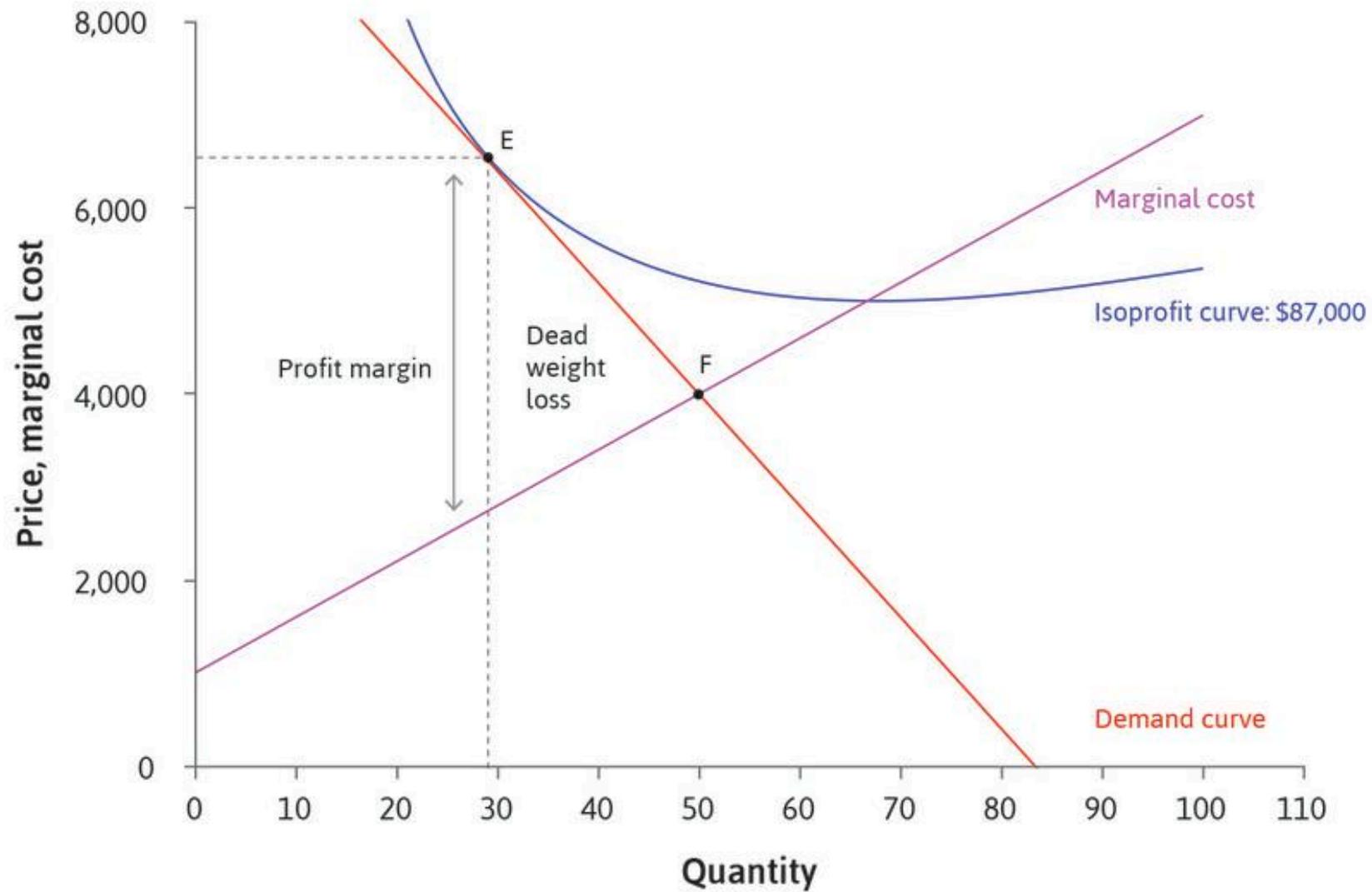
If people are stuck with you
(or like you a lot, or believe in your product,
or if your stuff generally isn't substitutable)
you can charge them more

**Markup depends
on elasticity**

ELASTIC DEMAND



INELASTIC DEMAND



COST AND INPUT CONTROLS

Own the means of production

Control scarce inputs

Control cheap supply chains

GOVERNMENT REGULATION

Make the government stop others from competing with you

Patents and intellectual property

Licensing

Prohibition of competition

COMPETITON AND REGULATION

**Sometimes you have to mess
with capitalism and competition
to make markets more
capitalistic and competitive**

Continued Existence Of Edible Arrangements Disproves Central Tenets Of Capitalism

3/31/11 8:00am • SEE MORE: OUR ANNUAL YEAR 2011 ▾

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Economists say the franchise "goes against all we previously held to be true about the concept of supply and demand."

Price-making firm

Sets P and Q to maximize π

$$MC < P$$

Deadweight loss

Advertising and marketing

Lobbying to influence politics

Research, innovation,
prevention of copying

Price-taking firm

Sets Q to maximize π , given P

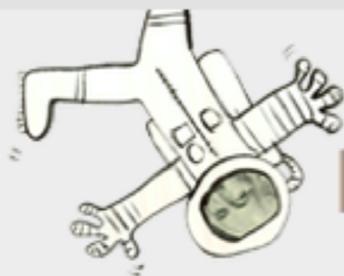
$$MC = P$$

Pareto efficient

Little advertising (public good)

Little lobbying (public good)

Little incentive for innovation
because of risk of copying



planet money

THE ECONOMY EXPLAINED



15:51

GOVERNMENT

Episode 657: The Tale Of The Onion King

October 14, 2015 · 9:10 PM ET

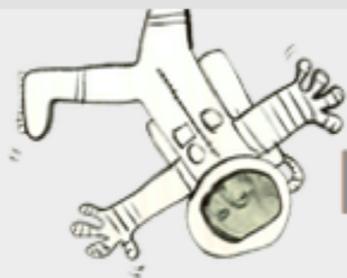
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planet **money** THE ECONOMY EXPLAINED



20:38

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TRADE

Episode 438: Mavericks, Monopolies And Beer

February 23, 2013 · 11:00 AM ET



FIXING MONOPOLIES

State ownership

Pro: Better Q

Con: Waste (x-inefficiency)

Regulated monopolies

Pro: Incentive to be efficient

Con: Incentive to maximize capital
(gold-plated water coolers)

FIXING MONOPOLIES

Competitive bids

Pro: Incentive to be efficient

Con: Incomplete contracts

Antitrust laws

Pro: Increases competition

Con: Bad for natural monopolies

FIXING MONOPOLIES

Let the market go wild

Pro: If monopolist can price discriminate, probably okay

Con: Perfect price discrimination not possible + raises equity concerns



Is competition always good?

MARCH 25TH 2013