

# Industrial Organization, Economics 121

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Lecture 1

## What you know

- Perfect competition is efficient
  - because it ensures  $\text{price} = \text{MC}$
- Monopoly is inefficient
  - because it ensures  $\text{price} > \text{MC}$

## So What?

- Does perfect competition ever happen?
- Is imperfect competition fairly efficient?
  - How imperfect does it tend to be?
    - How can we tell?
  - Compared to what?
    - Couldn't government keep price near MC?
- Anyway, why obsess over prices?
  - Isn't it more important that things be run efficiently and imaginatively?
  - Answer to bullet #2 suggests so?

## You need this class

- It's your best chance to learn answers to those questions
  - Otherwise, you wasted that Econ 101 time
- It's where microeconomic analysis meets the real world of business and policy
  - Competitive strategy
  - Procurement
  - Antitrust
  - Regulation

## Why you need this class (2)

- It's far more interesting than econ 100/101, which you voluntarily took
- But don't come to me to add the class
  - Why that's a bad idea
  - A much better idea

## Pause for diagnostics

- Cournot oligopoly model?
- Bertrand model?
  - Differentiated?
- Vertical integration?
- Horizontal mergers?
- Partial derivative?
- Linear regression?
- Herfindahl index?

## The Big Themes

- What competition is (and isn't) good at
- How much competition there is
  - What determines/affects this
  - How to tell
- What we do about it
  - Antitrust, regulation
- Prices
- How things are organized
  - Lost luggage and yield management
  - Does market system sort-of evolve to efficiency?

## Lost luggage and yield management

- Are airlines run by incompetent morons?
- Are they run by ruthless bastards?
  - And why would ruthlessness lead to bad customer service?
    - Adam Smith on the baker
- Am I atypical?
- Am I wrong?
- Technocratic second-guessing and incentives analysis
- Starting to think like an economist

## Modularity and the Internet

- Cable companies provide most residential high-speed internet access in US
  - Little regulation
  - Less and less regulation on phone companies' internet access products too
- Will Comcast do a deal with Travelocity?
  - Excluding Expedia
  - Incentives
  - Would it be so bad? How does that relate?

## (B) Class Organization

- You **must attend class and section**
  - Reading the textbook is *not* a good substitute
    - It's not my linear algebra class
  - Attendance will be noted
  - Active participation will be noted
- Grading
- Office hours
- Class representation

## (C) What is a Firm?

- Zone of command-and-control embedded within market economy
  - Fuzzy idea: incentives within firms; long-term deals across firm boundaries. Nevertheless...
- Biggest unit whose behavior we *assume* to be maximizing something (profit)
  - Do firms actually maximize?
  - Is there a better way to analyze economics?

## Costs (C&P chapter 2)

- You know this material from 101
  - How long ago?
  - Don't worry about multi-product costs yet
- We'll use it, not focus on it
- Don't let jargon obstruct thought
  - Potential energy
  - Short-run and long-run
  - How costs feature in predation policy, trade policy

## Warm-up exercises on costs

- Baggage handlers
- Diagnosing fat in gold mining

## Economies of Scale

- Traditional IO theme
  - Concentration bounded (determined?) by scale economies
  - Too bad about the market power, but...
- Stalin, Mao, and the steel industry
- An envelope argument for economies of scale
  - Is this right? What is missing?

## For Next Time

- Read C&P chapter 3—as carefully as you have time for, but read it
  - You already largely know it
  - There will be time to go back to it later
  - Don't obsess over definition of entry barrier
  - First part of page 76 is garbled: how?
- We will discuss welfare economics of competition more broadly