Group Assignment 1

A) Seminar questions:

1. What is Market power? How does this compare to "power"?

Market power- companies relative ability to manipulate prices

Power-ability to acquire goods for less than market price

market power-selling goods < -- > power-obtain goods

2. What are some ways economists have of measuring market power? Can you think of other ways?

Four firm concentration ratio- measures the percentage of total industry output attributable to the top four companies

monopoly=100%

perfect competition=0%

Herfindahl-Hirschman Index- measures the size of firms in relation to the industry, it is calculated by summing the squares of the percentage market share of all participants in the market.

perfect competition=0

$\leq$1500 - competitive market

1500-2500 - moderately concentrated market

2500< - concentrated

monopoly=10 000

Lerner Index- measures the percentage mark-up the firm is able to charge above marginal cost (MC)

L=(P-MC)/P

3. Give 5 examples of market power(not in the lecture)

economies of scale- specialization, division of labor, bulk buying, financial economies, transport economies, large machines, promotional economies

Natural monopoly-there are only enough economies of scale to support one firm

Legal barriers- firm is given a legal right to be the only producer in an industry (patent) (national textbooks such as in Hungary)

Brand loyalty- (Apple)

Anti-competitive behavior- monopolist may adopt restrictive practices (legal/illegal)- e.g. price war- reduces price excessively

Product differentiation- has a very unique product, that fills a hole in the market (Labello)

4. Why might market power be a good thing? Why might it be a bad thing?

Pros	**Cons**
creates competition finally- for example if a company can sell its product with high profit, other players will join the industry, reducing the resulting mark up goods.	too much pricing power
Network effect- everyone uses the same service, the quality therefore improves(airbnb, Facebook, Internet)	entry barriers for other firms
Monopolist produce at higher output and at lower price→ opportunity for R&D	declining product quality (since there is no alternative)

5. What is the difference between antitrust and regulation?

Antitrust- regulations that encourage competition by limiting the market power of any particular firm

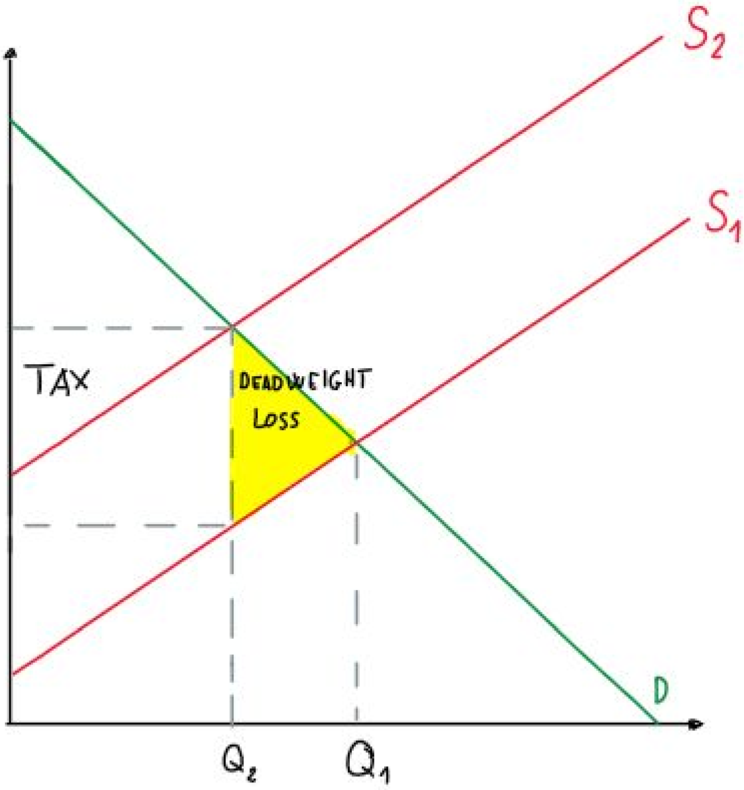
Regulation- grants participants special privileges (consumer rights, safety standards for products, Environmental Protection Agency)

6. What is the Deadweight loss triangle? Read the wiki page

(Links to an external site.)

measure of loss of economic efficiency

supply and demand are not in an equilibrium



7. (Preparation for next session) Watch at least two videos from Khan Academy on the Nash Equilibrium here

(Links to an external site.)

B) Popular questions:

1. Which example Friedman gives is most convincing and why?

tariff protection- applies to all phenomena, proves that without this monopolies could not sustain themselves

2. What is Friedman's solution to the monopoly problem? Can you think of pros and cons to his solution?

Solution: free trade

Pros	Cons
no domestic monopoly, firms with best price/quality enters the the market and	international monopoly-third world countries have no chance to compete

performs well => lower prices, higher quality	with global firms, no economic development
incentive for domestic firms to improve in order to compete with foreign firms	domestic firms lose their influence-less added value domestically-unemployment, lower gdp
same product quality in many countries	cannot control working, environmental standards efficiently abroad
	transportation-polluting

3. Can you think of some examples where the monopoly problem is especially prevalent?

Facebook - purchases all competitors (Instagram, Whatsapp), if they ban someone unilaterally those who were banned have no alternative

Google- has too much power, bargaining position against governments, because there is no alternative to it. Example: Australia- the government wants new regulations (data protection), Google does not favor it, therefore it can threaten to leave the market, and thus Australians become excluded from essential services, such as Gmail. Therefore, Australia does not want the disappearance of Google, does not regulate

C) Academic questions:

1. Read the abstract and introduction of the two papers below and write 400-500 words summarizing their main points and purpose.

The first paper investigated the pricing strategy of monopolists under different circumstances and introduces the dynamic Theory of Monopoly and the Conjecture of Coase.

In the Dynamic Theory of Monopoly two conditions have to be met: consumers must anticipate prices correctly, and sellers should not be able to increase their profit if they do not price the way that is expected by consumers. In this theory it is not possible to make commitments to prices. It is not the monopolist’s interest to announce the price of the next period, because this way consumers will expect that in the future the prices will be even lower, so will not purchase at the beginning.

According to the paper the consumers know that the valuation and the utility of a certain product differs among consumers, and the monopolist first wants to sell to those who have a higher valuation, in other words want to price discriminate. Then, they expect that the monopolist wants to reach lower valuation consumers soon, so the prices will drop. Therefore, they postpone their purchase. The paper introduced the concept Conjecture of Coase, which means that the monopolist has to set prices low at the beginning. Otherwise, if prices were high, people would wait until they are lowered.

Then, the paper analyses different scenarios with different players on the market. In the case of bilateral monopoly the bargain is set immediately only with discounting.

If there are more buyers there are two scenarios: minimum valuation of consumers exceeds or does not exceed unit cost. If it exceeds, the paper predicts a decreasing sequence of prices until exhaustion. If it does not, the market will remain open forever.

The second paper investigated the intricacies associated with the revenue maximizing mechanism for a monopolist who expects her buyers to resell, introducing two types of reselling, and how the monopolist can influence the resale outcome by designing an allocation rule.

In the first scenario the paper analysis is to resell the goods to a 3rd party in the secondary market. First, the monopolist may adopt a stochastic selling procedure, randomizing the allocation. This procedure includes the participant and the secondary market. The potential buyer can either have a low or a high valuation. Using the stochastic selling procedure the monopolist can sell to the high type with certainty and to the low type with positive but sufficiently low probability to induce the third party to offer a high release price. Contrary with deterministic procedure, there would be no surplus in prices.

Second, the optimal mechanism may require the adoption of a disclosure policy. The advantage of disclosing additional information stems from the possibility of increasing the level of trade with the low type. If the buyer’s valuation is known to the monopolist, then she could sell it to both types with certainty while controlling the beliefs of the third party with only the stochastic disclosure policy. However, it can get complicated when the buyer’s valuation is not known to the monopolist. This can increase the level of trade while the monopolist can’t sell to both types with certainty.

2. Answer the following question using the papers and other resources(200-300 words): What is the relationship between the Coase Conjecture and giving the ability to consumers to resell their goods?

In our opinion, the main connection between Coase Conjecture and giving consumers the ability of reselling their goods is the misallocation of the product and not knowing the buyers' valuation.

The first paper states that Coase Conjecture means the market will start at a close to zero price. The reason for that is that the buyers with a lower valuation will not buy the given product at a high price, which would not be a problem. However, buyers with a higher valuation who would be willing to pay a larger amount are aware of the fact that the monopolist intends to eventually sell to the lowest valuation buyer as well. Consequently, they will wait for the price to drop to the lower valuation level and buy it then.

The same problem occurs when buyers are given reselling rights. There are a lot of high valuation buyers who cannot acquire the product in the first market which connects right tot he previously mentioned price problem. The main consequence of this is that in the second it will not be valued due tot he fact that it was not valued by the first buyer.

In conclusion, their relationship is based on the financial incentive of buyers trying to pay less for a given product and consumer bargaining power.