## **Contents**

About th Preface	ne Authors	xiii xv
D4 I	Ministra III	
Part I	Microeconomic Foundations	1
1	Industrial Organization and Imperfect Competition: What, How, and	
	Why	3
1.1	What Is Industrial Organization?	3
1.2		4
1.3		6
	1.3.1 The "New" Sherman Act and the Dominance of	
	Structure-Based Analysis	9
	1.3.2 The Tide Changes: The Chicago School and Beyond	11
Sur	nmary	14
Pro	blems	14
Ref	erences	15
Ap	pendix—Excerpts from Key Antitrust Statutes	15
2	Basic Microeconomics	23
2.1	Competition versus Monopoly: The Poles of Market Performance	23
2.2	Intertemporal Considerations and Constraints on Monopoly Power	28
	2.2.1 Time and the Evolution of Industry Structure	31
	2.2.2 Durable Goods and the Coase Conjecture	33
	2.2.3 The Nonsurplus Approach to Economic Efficiency	35
Sur	nmary	36
Pro	blems	37
Ref	erences	37
3	Technology and Cost Relationships	38
3.1	Production Technology and Cost Functions for Single-Product Firms	38
	3.1.1 Cost Variables and Output Decisions	42
	3.1.2 Scale Economies, Sunk Costs, and Market Structure	43
3.2	Cost Relations for Multiproduct Firms	48
	3.2.1 Scope and Scale Economies for Multiproduct Firms	48
	3.2.2 Different Versions of the Same Core Product	53
3.3	Non-Cost Determinants of Market Structure	55
3.4	Empirical Application: Cost Function Estimation, Scale and Scope	
	Economies	56

	C		62
		nmary	62
		blems	
	References		63
	4	Market Structure and Market Power	65
	4.1	Measuring Market Structure	66
		4.1.1 Measurement Problems: What Is a Market?	68
		4.1.2 The Endogeneity of Market Structure	71
	4.2	Measuring Market Power—the Lerner Index Again	72
	4.3	Empirical Application: Monopoly Power: How Bad Is It?	76
	Sur	nmary	79
	Pro	blems	80
	Ref	erences	81
Part	П	Price and Nonprice Tactics for Firms with Market Power	83
	5	Price Discrimination and Monopoly	85
	5.1	The Feasibility of Price Discrimination	86
	5.2	First-Degree Price Discrimination	87
		5.2.1 Personalized Pricing	88
		5.2.2 Two-Part Pricing	90
		5.2.3 Block Pricing	92
	5.3	Price Discrimination with Less Information	94
		5.3.1 Group Pricing or Third-Degree Discrimination	94
		5.3.2 Third-Degree Price Discrimination and Social Welfare	97
		5.3.3 Group Pricing: An Application with Linear Demand	99
		5.3.4 A Caveat on Welfare and Third-Degree Price Discrimination	100
	5.4	6	101
		5.4.1 A Two-Part Tariff	103
		5.4.2 Menu Pricing	105
	σ.	5.4.3 Menu Pricing and Social Welfare	108
		nmary blems	110
		erences	111
	Kei	erences	112
	6	Price Discrimination, Product Variety, Bundling, and Tying	113
	6.1	Price Discrimination and Product Quality	114
		6.1.1 A (Relatively) Simple Example	114
		6.1.2 An Extension: Endogenous Quality	118
		6.1.3 A Further Extension: Damaged Goods	121
	6.2	Price Discrimination and Product Variety	123
	6.3	Bundling and Tying	128
		6.3.1 Bundling	128
		6.3.2 Required Tie-In Sales	133
		6.3.3 Bundling/Tying, Policy, and Competition	135
	6.4	Empirical Application: Price Discrimination, Product Variety, and	
		Monopoly versus Competition	137

Sum	nmary	140
Prob	plems	141
Refe	erences	142
art III	Oligopoly and Strategic Interaction	143
7 :	Static Games and Quantity versus Price Competition	145
7.1	A Brief Introduction to Game Theory	145
	Dominant and Dominated Strategies	147
7.3	The Static Cournot Model	150
	7.3.1 Cournot Variation 1: Many Firms	153
4	7.3.2 Cournot Variation 2: Many Firms and Different Costs	154
7.4	The Bertrand Model	156
	7.4.1 Bertrand Competition—Capacity Constraints	157
75	7.4.2 Bertrand Competition—Product Differentiation	160
7.5 7.6	Strategic Substitutes and Complements Empirical Application: Brand Competition and Consumer	162
7.0	Preferences—Evidence from the California Retail Gasoline Market	164
Sum	mary	167
	lems	168
	erences	169
8 I	Dynamic Games and First and Second Movers	171
8.1	The Stackelberg Model of Quantity Competition	172
8.2	Sequential Price Competition	175
8.3	Sequential Quality Choice	178
8.4	Commitment and Credibility in Dynamic Games	180
8.5	The Chain-Store Paradox	184
	mary	186
Prob		186
Refe	rences	187
9 E	Entry Deterrence and Predation	189
9.1	Market Structure over Time: Random Processes & Stylized Facts	190
9.2	Deterring Entry	193
	9.2.1 Limit Output and Limit Price Models	193
	9.2.2 Capacity Expansion as a Credible Entry-Deterring	105
	Commitment	195
0.2	9.2.3 Evidence on Predatory Capacity Expansion Predation and Asymmetric Information	203 205
9.3	9.3.1 Asymmetric Information and Limit Pricing	205 206
	9.3.2 Predation, Asymmetric Information, and Financial	200
	Constraints	211
9.4	Long-Term Contracts as a Barrier to Entry	219
<b>∕.</b> ⊤	9.4.1 Long-Term Contracts, Penalty Fees, and Entry Deterrence	219
	9.4.2 Naked Exclusion	221
9.5	Predatory Conduct and Public Policy	223

	9.6	Empirical Application: Entry Deterrence in the Pharmaceutical	
		Industry	225
	Sum	mary	229
	Prob	plems	230
	Refe	erences	231
	10	Price Fixing and Repeated Games	234
	10.1	The Cartel's Dilemma	237
	10.2	Repeated Games	241
		10.2.1 Finitely Repeated Games	242
		10.2.2 Infinitely or Indefinitely Repeated Games	245
		10.2.3 Some Extensions	248
	10.3	1 11	250
	10.4		254
		10.4.1 Factors that Facilitate Collusion	254
		10.4.2 Facilitating Practices	261
	10.5	· ·	264
		10.5.1 Antitrust Policy: Investigation versus Fines	264
		10.5.2 Antitrust Policy: Detecting Cartels	266
	10.	10.5.3 Antitrust Policy: Leniency/Amnesty Programs	269
	10.6		275
	~	Programs	275
		omary	278
		blems	279
	Kere	erences	281
Part	IV	Contractual Relationships between Firms	283
	11	Horizontal Mergers	285
	11.1	Horizontal Mergers and the Merger Paradox	287
	11.2	Mergers and Cost Synergies	291
		11.2.1 Fixed-Cost Savings	291
		11.2.2 Variable Cost Savings	292
	11.3	$\epsilon$	293
	11.4		298
	11.5		301
		11.5.1 Bertrand Competition with Linear Demand	301
		11.5.2 Mergers in a Spatial Market	304
	11.6	· ·	313
		11.6.1 Coordinated Effects of Mergers	315
		11.6.2 Consumer versus Producer versus Total Surplus	316
	11.7		210
		Simulation	318
		mary	320
		plems	321
	Rete	erences	322

	12	Vertical and Conglomerate Mergers	324
	12.1	Procompetitive Vertical Mergers	325
	12.2		328
	12.3	Vertical Mergers, Oligopoly, and Foreclosure	332
	12.5	12.3.1 Vertical Integration and Foreclosure in a Cournot Model	334
		12.3.2 Vertical Mergers in a Differentiated Products Setting	338
	12.4	A Reappraisal: The GE-Honeywell Merger Once More	343
	12.5	A Note on Conglomerate Mergers	344
	12.6	Empirical Application: Vertical Integration in the Ready-Mixed	246
	C	Concrete Industry	346
	Sumi		348
	Probl		349
	Refe	rences	350
	13	Vertical Restraints	351
	13.1	Vertical Price Restraints and Antitrust Policy: A Brief History	351
	13.2	Vertical Price Restraints and Suppressed Competition	354
	13.3	Arguments in Support of Vertical Price Restraints	355
		13.3.1 Vertical Price Restraints as a Response to	
		Double-Marginalization	355
		13.3.2 RPM Agreements and Retail Competition with Price	000
		Discrimination	358
		13.3.3 RPM Agreements to Ensure the Provision of Retail Services	360
	13.4	Retail Price Maintenance and Uncertain Demand	368
	13.5	Nonprice Vertical Restraints	371
	13.3	13.5.1 Exclusivity to Limit Free Riding	371
			373
	12.6	13.5.2 Exclusivity and the Suppression of Competition	
	13.6	Aftermarkets	376
	13.7	Empirical Application: Exclusive Dealing in the U.S. Beer Industry	380
	Sumr	· · · · · ·	384
	Probl		385
	Refe	rences	386
Part	<b>V</b> 7	Topics in Nonprice Competition: Advertising and Research and	
	]	Development	389
	14	Advertising, Market Power, and Information	391
	14.1	Advertising and Monopoly Power: The Dorfman-Steiner Condition	392
	14.2	Advertising as Consumer Information	394
		14.2.1 Advertising and Quality Signaling	395
		14.2.2 Suppressed Information Advertising Content	400
	14.3	Advertising, Information, and Competition	402
	11.0	14.3.1 Advertising, Information, and Competition in a	.02
		Product-Differentiated Market	403
		14.3.2 Advertising and Wasteful Competition	407
	1 4 4	Complements, Advertising, and Brand Names	407
	14.4	Complements, Advertising, and Drand Names	400

<ul><li>14.4.1 Advertising and Building Brand Value</li><li>14.4.2 Advertising and Extending the Reach</li></ul>	410 411	
14.4.3 The Nature of Advertising, Product Prices, and Wel	fare 412	
14.5 Empirical Application: Advertising, Information, and Prestig		
Summary	419	
Problems	419	
References	420	
15 Research and Development	422	
15.1 A Taxonomy of Innovations	424	
15.2 Market Structure and the Incentive to Innovate	426	
15.2.1 Competition and the Replacement Effect	426	
15.2.2 Persistence of Monopoly and the Efficiency Effect	429	
15.2.3 A Possible Synthesis	430	
15.3 A More Complete Model of Competition and Innovation	436	
15.4 Evidence on the Schumpeterian Hypothesis	438	
15.5 Product and Process Innovation: Cournot versus Bertrand	439	
15.5.1 Product R&D	441	
15.5.2 Process R&D	442	
15.5.3 Product and Process R&D	443	
15.6 R&D Cooperation between Firms	443	
15.6.1 Noncooperative R&D	445	
15.6.2 Technology Cooperation	447	
15.7 Empirical Application: R&D Spillovers in Practice	451	
Summary	454	
Problems	455	
References	456	
16 Patents and Patent Policy	458	
16.1 Optimal Patent Length	460	
16.2 Optimal Patent Breadth	463	
16.2.1 Gilbert and Shapiro	463	
16.2.2 Klemperer	466	
16.2.3 Some Conclusions	472	
16.3 Patent Races	473	
16.4 Monopoly Power and "Sleeping Patents"	477	
16.5 Patent Licensing	479	
16.5.1 The Incentive to License a Nondrastic Innovation	479	
16.5.2 Licensing, Drastic Innovations, and Monopoly Power	er 483	
16.5.3 Patent Licensing, Social Welfare, and Public Policy		
16.6 Recent Patent Policy Developments	486	
16.7 Empirical Application: Patent Law and Patent Practice in the	e	
Semiconductor Industry	489	
Summary	491	
Problems		
References	493	

Part VI	Special Topics: Networks and Strategic Trade Policy	495
17	Network Markets	497
17.1	Market Provision of a Network Service	497
	17.1.1 Monopoly Provision	498
	17.1.2 Competitive and Optimal Provision of a Network Service	500
17.2	Networks, Competition, and Complementary Services	501
	17.2.1 Price Competition with Network Effects	502
	17.2.2 Network Competition and Complementary Services	503
17.3	Systems Competition and the Battle over Industry Standards	506
	17.3.1 A Simple Model of Compatibility and Competition	507
	17.3.2 Compatibility, Standards, and Competition	509
17.4		
	Software—Spreadsheets	513
	mary	517
	lems	517
Refe	rences	518
18	Strategic Commitments: Confronting Potential Entrants and	
	International Rivalry	520
18.1	The Strategic Value of Commitment	521
18.2	Strategic Complements and Substitutes: Cats, Dogs, and the Lean	
	and Hungry Look	522
	18.2.1 Strategic Complements and Competition: Fat Cats and	
	Puppy Dogs	523
	18.2.2 Strategic Substitutes and Competition: Top Dogs and the	
	Lean and Hungry Look	526
	18.2.3 Commitments and Strategies	528
18.3	Strategic Commitments in International Markets	529
	18.3.1 Strategic Subsidies in an International Cournot Model	531
	18.3.2 Strategic Tariffs and Scale/Scope Economies	532
	18.3.3 Strategic R&D Subsidies	534
18.4	$\boldsymbol{\varepsilon}$	535
	mary	537
Prob		538
Refe	rences	539
Answers 1	o Selected Problems	541
Index		551