

Prof. Bryan Caplan

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Econ 370

Industrial Organization Syllabus

Course Focus:

"Industrial organization" is the branch of economics that studies the production and sale of economic goods. While many IO classes focus almost entirely on the economic analysis of antitrust law, this class will cover a much broader range of topics. We will not use much mathematics in the course, but you will need a firm grounding in microeconomic theory to keep up.

The course is divided into three main parts. The first part covers "Competition and Monopoly." The second, "The Economics of Special Markets," deals with the economics of markets that are unusual in interesting ways. The final section, "Markets, Regulation, Socialism, and Privatization," compares and contrasts real markets to real regulation to real government ownership as alternative systems for the production of economic goods.

Prerequisites:

We will not use much mathematics in the course, but you will need a firm grounding in microeconomic theory to keep up. If you did reasonably well in intermediate micro, you should be well-prepared.

Texts:

There was no one text on the market that covered everything I wanted to cover, so we will be using a reader (*available in the basement of Barnes and Noble in the Johnson Center*), and parts of three books:

- Stephen Landsburg, *The Armchair Economist*
- David Friedman, *Hidden Order*
- W. Michael Cox and Richard Alm, *Myths of Rich and Poor*

We will not have much time to discuss these readings in class, but questions based on the readings will be on the exams.

Readings that I did not have time to include in your reader are marked with a *. I will hand them out in class.

Grading and Exams:

There will be one midterm and a final exam. The midterm counts 30% each; the final exam is 45%; homework counts for the remaining 25%. These weights are fixed - improvement on later exams will not retroactively raise your grades on earlier exams.

There is no formal grade for participation, but if you are one of the students who (in my judgment) contributes most to the quality of class discussion your grade will be increased by one-third of a grade (e.g. B- to B, B+ to A-).

Homework:

There will be five homework assignments during the semester. Depending upon how good a job you do, your homework will receive a check-plus (4 points), a check (3 points), or a check-minus (2 points) if you turn it in; otherwise you receive 0 points. Late homework loses one point. *Late homework is no longer accepted after I pass out my suggested answers for a given assignment.*

Office Hours

The best way to contact me is by email at bcaplan@gmu.edu. Many questions and requests can be satisfied by going to my homepage at <http://www.bcaplan.com>. My office is in 8 Carow Hall; my office number is 3-2324. My official office hours are MTh 1:30-3:00, but you can also schedule an appointment or just drop by and see if I'm available.

Tentative Schedule:

My proposed schedule for the semester follows. If it proves too ambitious, I will try to *simply say less about each topic* rather than cut the topics for the final weeks.

PART I: Competition and Monopoly

Week 1: Varieties and Benefits of Competition

- Perfect competition
- Imperfect ("Bertrand") competition
- contestable monopoly
- cost curves
- allocative and productive efficiency

Readings:

Steven Landsburg, *The Armchair Economist*, pp.60-72 ("Why Taxes are Bad").

Week 2: Government as a Cause of Monopoly

- government-imposed ("exogenous") monopolies and cartels
- varieties of
- efficiency of
- political competition

Readings:

David Friedman, *The Machinery of Freedom*, chapter 7: "Monopoly II: State Monopoly for Fun and Profit"

Murray Rothbard, *Power and Market*, pp.40-55.

Arthur Schlesinger, *The Coming of the New Deal*, pp.62-67; 116-128.

Week 3: Market Monopoly?

- market ("endogenous") monopolies
- collusion - and why it's difficult
- predation - and why it's difficult
- (non-legal) barriers to entry
- natural monopolies
- the concentration-profits relation

Readings:

Robert Bork, *The Antitrust Paradox*, pp.310-311.

David Friedman, *The Machinery of Freedom*, chapter 6: "Monopoly I: How to Lose Your Shirt"

Week 4: Antitrust

- antitrust law
- antitrust violations
- antitrust enforcement, private and government
- price discrimination
- antitrust and market monopoly

Readings:

Steven Landsburg, *The Armchair Economist*, pp.157-167.

PART II: Special Markets

Week 5: Markets with Externalities

- Negative externalities (aka "public bads")
- Ex: Pollution
- Positive externalities (aka "public goods")
- Ex: Defense
- Bad but popular examples
- Good but unpopular examples
- Externalities, efficiency, and fairness
- Coase, property rights, and externalities
- Application: Regulation versus tradeable permits

Readings:

David Friedman, *Hidden Order*, pp.260-78.

Week 6: Markets for Research and Development

- dynamic efficiency
- how productive efficiency increases
- innovation and externalities
- patents, innovation, and non-patentable innovation
- coordination games and path-dependence

Readings:

Cox and Alm, chapters 6 and 8

Richard Posner, *Economic Analysis of Law*, pp.37-45

F.M. Scherer, *Industrial Market Structure and Economic Performance*, pp.621-630.

* Steven Landsburg, *Fair Play*, pp.143-160.

MIDTERM

Week 8: Markets for Variety and Quality

- differentiated competition
- quality competition
- black markets and prohibition
- crime and externalities
- economics of organized crime

Readings:

Cox and Alm, chapter 2

Robert Bork, *The Antitrust Paradox*, pp.312-314.

Week 9: Markets for Information

- search theory
- advertising
- insurance and moral hazard
- adverse selection

- advantageous selection

Readings:

Robert Bork, *The Antitrust Paradox*, pp.314-320.

David Friedman, *Hidden Order*, pp.275-277.

Week 10: Signaling

- signaling
- warrantee example
- education example
- externalities and signaling
- why subsidize signaling?

Readings:

none

PART III: Markets, Regulation, Socialism, and Privatization

Week 11: Making Fair Comparisons

- fallacies of comparison
- fair comparisons: real markets vs. real regulation vs. real government ownership; ideal markets vs. ideal regulation vs. ideal government ownership
- comparing ideal systems: problems of ability and knowledge

- comparing real systems: additional problem of incentives

Readings:

Ludwig von Mises, *Socialism*, pp.483-488.

Week 12: Problems with Regulation

- ideal vs. real regulation
- ability and knowledge problems with regulation
- incentive problems with regulation
- public choice theory
- regulatory capture
- regulation as a cure and cause of externalities

Readings:

David Friedman, *Hidden Order*, pp.289-297.

Week 13: Problems with Government Ownership

- ideal vs. real government ownership
- ability and knowledge problems with government ownership
- incentive problems with government ownership
- central planning and socialism
- government ownership as a cure and cause of externalities

- tragedy of the commons

Readings:

Murray Rothbard, *For a New Liberty*, chapter 10: "The Public Sector, I: Government in Business"

Robert Conquest, *The Harvest of Sorrow: Soviet Collectivization and the Terror-Famine*, chapter 16: "The Death Roll"

Week 14: Freeing Markets

- rebirth of the ideal of laissez-faire
- de-regulation
- weak privatization - sub-contracting
- strong privatization - turning industry over to the market

Readings:

Ludwig von Mises, *Human Action*, pp.730-732.

Milton Friedman, *Free to Choose*, pp.148-160.

Alfred Kahn, "Airline Deregulation"

Madsen Pirie, "Privatization"

Peter Murrell, "How Far Has the Transition Progressed?" pp.25-30.

Week 15: Radical Privatization

- pushing the limits of privatization
- case for free-market defense and judicial services

Readings:

Murray Rothbard, *Power and Market*, chapter 1: "Defense Services on the Free Market"

FINAL EXAM