

Economies of Scale

P.1

Dumping

Price Discrimination

Conditions: (1) imperfectly compet industry

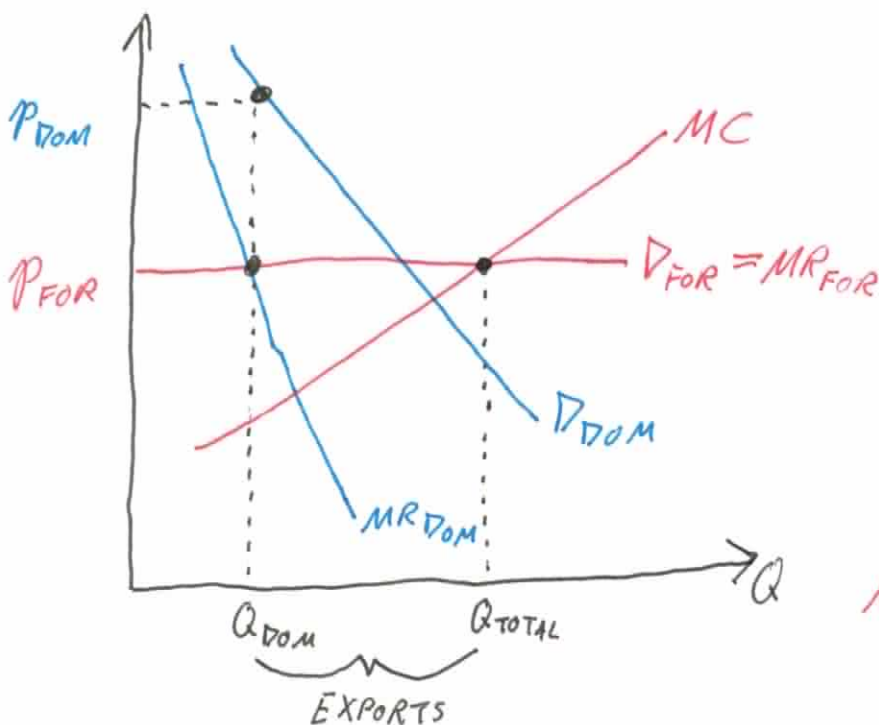
firms set prices

(2) markets are segmented

domestic consumers cannot easily purchase goods intended for export

Domestic firms usually have larger share of home markets than they do of foreign markets due to transport costs & protectionist trade barriers

ASSUME → firm a monopoly in domestic market
→ firm faces perf. comp in export market



→ Prod up to $MC = MR_{FOR}$
i.e. prod Q_{TOTAL}

→ Since P_{FOR} is firm's MC LEVEL, MC = MR condition met in dom mkt at intersection $MR_{DOM} = P_{FOR}$ where prod Q_{DOM} for the domestic mkt & charge price P_{DOM}

→ remaining output exported

NB: $P_{FOR} < P_{DOM}$
export price < domestic price

Reciprocal Dumping

P. 2

ASSUME: two monopolies produce same homogenous good
and share same MC

transportation cost \Rightarrow if firms ~~are~~ charge
the same price there will be no trade

- \rightarrow Since each firm a monopoly at home, additional sales to home mkt reduce price, at home BUT
- \rightarrow additional sales to foreign mkt the adverse effect of the lower price in the foreign mkt fall on the other firm (not itself)
- \rightarrow each firm has incentive to "raid" other mkt
INTRA-INDUSTRY TRADE even tho no initial diff in the price of the good
- \rightarrow Social Cost - wasteful to ship same good back and forth when transport costly
- \rightarrow Social Benefit - elimination of pure monopolies + emergence of competition

Theory of External Economies

(p. 3)

external economies arise when economies of scale occur at the industry level, individual firms can still be small perfect competitors

examples: Silicon Valley - semiconductors

NYC Financial Dist

Hollywood - entertainment industry

why might clusters of firms be more efficient than individual firms in isolation?

→ specialized suppliers - development of new products requires specialised equipment or support services, but individual company cannot support employment of suppliers

SOLUTION: if many similar companies in region, the combined demand supports wide range of specialised suppliers

→ labor market pooling - variable demand for a firm's product

EXAMPLE: 2 identical firms + 200 workers
when demand high firm wants 150 workers
when demand low firm wants 50 workers

→ if two locations + each has 1 firm + 100 workers
then periods of excess labor demand + excess labor supply

→ if one location, low labor demand by one firm may be offset by high demand from other

→ Knowledge spillovers - informal exchange of ideas that takes place at personal level \Rightarrow diffusion of knowledge occurs most effectively when industry concentrated in region

(p. 9)

External Economies + Increasing Returns

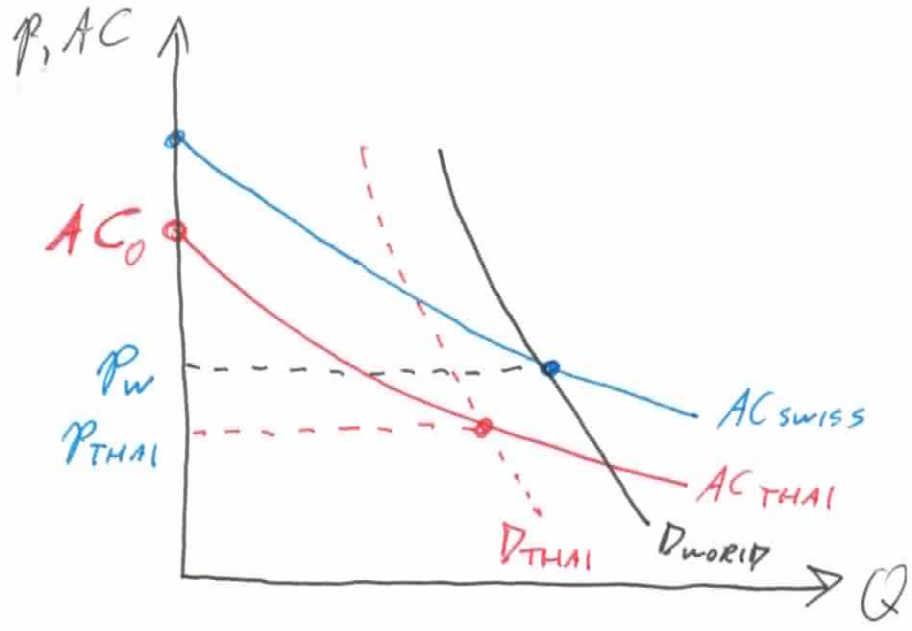
→ the larger the industry's output, the lower the price at which firms are willing to sell their output

External Economies + Int'l Trade

→ strong external economies confirm existing patterns of int'l trade (countries that start out as large producers remain large producers even when another country can produce the goods more cheaply)

→ EXAMPLE: many small firms in perfect competition
increasing returns at industry level
constant returns at firm level
competition $\Rightarrow p = AC$

If the AC of initial output in "Thailand" exceeds the AC of current output in country with head start "Switz" then Switz will retain its position even tho Thailand could potentially produce at lower AC



→ with free trade Thailand blocked by high initial AC, so Thailand made *worse off* by free trade

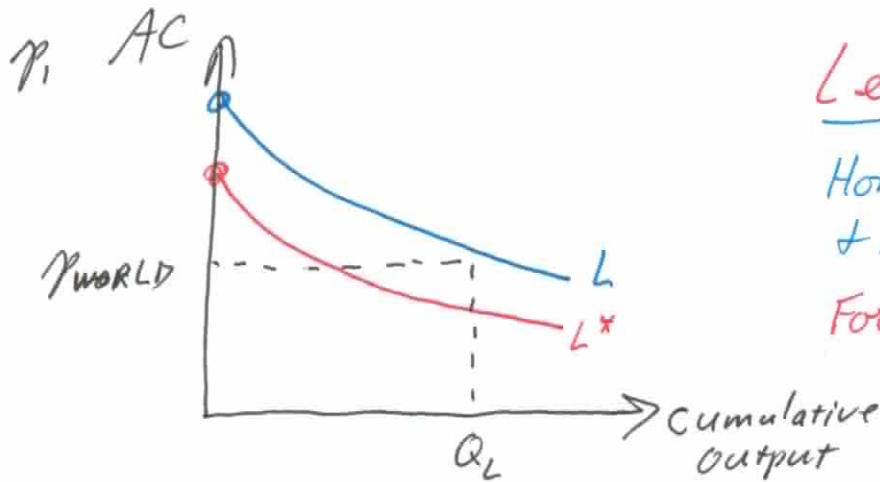
→ but if Thailand protected ~~worst~~ sector, Thailand ~~their own~~ would produce ~~worst~~ & Thai consumers would benefit from lower prices

→ NOTE that D_{THAI} must be very large rel to D_{WORLD} to justify protection

Dynamic Increasing Returns

(p.6)

- external economies may arise from the accumulation of knowledge
- industry costs may depend on experience (as measured ~~by~~ by cumulative output)
- dynamic external economies can lock in an initial advantage or head start in an industry



Learning Curve

Home has extensive experience
& ~~therefore~~ therefore has lower AC
Foreign blocked from entry

- potential justification for protection
infant industry argument