George Stigler’s Influence on Industrial Organization

by

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Economics of Information (1961)

- "...information is a valuable resource."

- Empirical observation: prices are not uniform. Rather price distributions for identical goods are the norm.

- Gain from information: lower price

- Cost of information: search costs

- Doesn’t use optimal search or derive equilibrium but identifies lots of insights
Economics of Information

• E.g., importance of change, reputation, repeat buying, role of advertising

• Generates enormous literature
  – Diamond paradox
  – theory literature on optimal search
  – empirical literature on price distributions
  – consumer protection-effects of advertising
  – What rules should one use to create a market?
Economics of Information

– What rules should futures markets use?

– How do information providers get paid?

– Is the socially optimal amount of information created (Stiglitz)?

– Enormous effect on other areas in economics

– “…our understanding of economic life will be incomplete if we do not systematically take account of the cold winds of ignorance.”
A Theory of Oligopoly (1964)

• “No one has the right, and few the ability, to lure economists into reading another article on oligopoly theory without some advance indication of its alleged contribution.”

• Uses the theory of information to say something new about oligopoly.

• Reaction against the endless literature of conjectural variations where behavior is assumed not derived.
A Theory of Oligopoly

• Starts from the observation that firms want to, if they could, behave as a monopolist.

• To do so there is a need for:
  – agreement
  – monitoring for cheating
  – some punishment

• Focus is on monitoring.
A Theory of Oligopoly

• Firms observe the flow of new customers, the loss of old customers, the flow of rivals’ customers.

• Cheating can be detected by unusual declines in one’s sales from a group of customers.

• Therefore, can list multitude of factors that will make competition more likely.

• Such factors include variability in overall demand, loyalty of customers, ability to estimate your market share, fluctuations in shares over time, size of buyers, transparency of price.
A Theory of Oligopoly

• Generates the HHI as an index of oligopoly pricing.

• leads to enormous literature:
  – dynamic games with trigger strategies
  – influence on antitrust-Posner(1976)
  – Merger Guidelines
  – Not clear the literature is headed in the direction Stigler wanted
A Note on Block Booking(1963)

- *US v Loew’s (1962)*
- Monopolist Of A and B:
  - person 1’s valuation     ($10,$7)
  - person 2’s valuation     ($7,$10)
  - bundle at $17 implies revenue of $34
  - sell each good separately at $7 implies revenue of $28
- Block booking is a method of price discrimination.
A Note on Block Booking

• “The antitrust laws do not permit a compounding of the statutorily conferred monopoly.”

• Relevance today:

  – Mixed bundling: set separate prices for A and B alone and for the bundle.
  
  – Peacehealth (2007): assign the bundled discount all to one product and see whether cost is covered.
Price and Non-Price Competition (1968)

• Will monopoly profits be dissipated if oligopolists collude on only price?

• Will profits be dissipated if oligopolists collude on only quality or advertising?

• Simple idea: it is easy to get lots of customers if a firm deviates from a monopoly price but hard to attract customers through advertising if your price and the others are the same.
Price and Non-Price Competition

• Relevance today:
  – European car makers sued for fixing quality
  – Two sided markets: $Q(p_1,p_2)$ not $Q(p_1+p_2)$.
    1. Firms fix freight but not base price
    2. Firms practice “drip” pricing
    3. Credit cards with rewards:
       $Q$( rewards, fee to merchant)
Economies of Scale (1958)

- Survivorship principle
- Lots of insights based on little data
  - in any industry, firms are very diverse in how they structure production and sales
  - different types of firms in the same industry will have very different patterns over the business cycle
  - adjustment costs matter a lot (Alchian)
Economies of Scale

• Critical of size distribution theories based on homogeneity of effects across firms

• “At least one finding—a wide range of optimum firm size is so general as to deserve to be taken as a general finding”

• Relevance today:
  – Haltiwanger’s work on start ups and growth rates by size and age
  – Syverson’s work on productivity differences across firms within the same industry
  – Melitz’s work on differences between export and non export firms
Monopoly and Oligopoly by Merger (1950)

• Why did the merger wave to monopoly occur around the turn of the century? Weren’t the gains to monopoly present before then?

– **Answer:** There developed a new skill together with capital markets -the ability to use capital to put together all the firms in one industry into one. Entrepreneurs such as J P Morgan who figured out how to do it earned huge sums for their skill.
Other topics

• Rigid Prices- Stigler and Kindahl (1971)
  – Response to Gardiner Means
  – Discovery that a price index based on transaction prices is more flexible that the BLS price index
  – Discovery that spot and long term prices move differently over the business cycle.

Rates of Return to Capital (1963)
  - Lots of heterogeneity
  - Slow but steady adjustments of rates of return to equality