

Lecture Note 5

Armstrong, M., Cowan, S., Vickers J. (1994): Chapters 2

Please answer the following questions:

1. Explain the two caveats to the MC rule.
2. Why is average cost pricing needed (compared to MC pricing)? How is the welfare criterion specified.
3. Given the properties of MC and AC pricing, what is the advantage of two part tariffs? When could this argument fail and how could the problem be solved?
4. Given consumer tastes and imperfect information of the profit maximizing firm how does the welfare maximization under nonlinear tariffs look like? What are the different components of this welfare function?
5. How are fixed price regulation, cost reimbursement and linear price rules defined? Given the optimal amount of cost pass-through: when will a pure price cap be optimal, when price rules, and when cost reimbursement?