

ECON 5103 Unit 6, Video 2

Nature of an Industry: Market Power

Lerner index :

$$L = (P - MC) / P$$

Example: It costs Bill's Dry cleaner \$1 to dry clean each additional shirt that customers bring in. Meanwhile, Bill charges these customers \$1.20 to dry clean each shirt.

$$L = (1.20 - 1) / 1.20 = 0.1667$$

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Example: It cost Microsoft \$5 to produce and sell each additional unit of Microsoft Office. Microsoft charges \$200 to each customer who wants to buy a copy of Microsoft Office.

$$L = (P - MC) / P$$

$$L = (200 - 5) / 200 = 0.975$$

L ranges between 0 and 1. When it's close to ZERO (say, .25 or lower) then firms have very little market power in their industry. When it's closer to 1 (say, .5 or higher) then firms have a lot of market power in their industry.

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TABLE 7-5 Lerner Indexes and Markup Factors for Selected U.S. Industries

Industry	Lerner Index	Markup Factor
Food	0.26	1.35
Tobacco	0.76	4.17
Textiles	0.21	1.27
Apparel	0.24	1.32
Paper	0.58	2.38
Printing and publishing	0.31	1.45
Chemicals	0.67	3.03
Petroleum	0.59	2.44
Rubber	0.43	1.75
Leather	0.43	1.75

Source: Michael R. Baye and Jae-Woo Lee, "Ranking Industries by Performance: A Synthesis," Texas A&M University, Working Paper No. 90-20, March 1990; Matthew D. Shapiro, "Measuring Market Power in U.S. Industry," National Bureau of Economic Research, Working Paper No. 2212, 1987.