Due: In my mailbox (1st floor Rosenwald) or in the drop box downtown by the start of class February 6/8. You can complete this assignment individually or in groups of up to 4 people (turn in one copy with all the names at the top rather than several separate copies, please).

1. Consider incumbent monopolists of the local loop in a world where there are two markets, San Francisco and Chicago. The marginal cost to the incumbent of providing the bottleneck is 8 in SF and 6 in Chicago. The marginal cost of providing the non-bottleneck service is 4 in both markets. The final price to consumers who buy the combined service is 18 in San Francisco and 19 in Chicago. This is summarized in the two graphs below. A potential entrant is considering entering the non-bottleneck portion of the market.

   San Francisco
   Bottleneck  Non-Bottleneck
   MC=8        MC=4
   Final Consumer Price = 18

   Chicago
   Bottleneck  Non-Bottleneck
   MC=6        MC=4
   Final Consumer Price = 19

   A. What would be the ECPR price of access to the bottleneck in each market?

   B. If there were no fixed costs, what would be the TELRIC price of access to the bottleneck in each market?

   C. Which pricing rule is more efficient if final good prices do not change? Which is more efficient if prices can change and all demand goes to the seller with the lowest price?

2. Why shouldn't regulators just set access prices at marginal cost, skipping the ECPR-versus-TELRIC-versus-other-rule debate and make up the losses with subsidies paid for out of general revenue?

3. Local phone companies are not allowed to enter the long-distance business until their local markets are open to competition but local cable companies are allowed to own cable programming companies (e.g., Time-Warner & CNN) even if they have very little competition. Should they be treated the same?

4. A recent estimate of the demand for Direct Broadcast Satellite put the own price elasticity at -2.8.
Your FCC report on cable prices indicates the DBS penetration rate is 14.7% or about 16.2 million households. If the average DBS price is $35 per month, what would be an estimate of the welfare gain from having access to DBS.