

ECON 318, Arrow: Allocation of Resources for Invention

1. Read the the introduction.
2. Skim quickly the section “Resource Allocation under Uncertainty;” just read the last paragraph quickly. The “moral factor” is what we now call “moral hazard.”
3. Skim the section “Information as a Commodity.” The most important concept here is *incomplete appropriability* discussed at the bottom of page 615.
4. Read carefully the section “Invention as the Production of Information.” Pay attention to the reasons why the amount of invention (or information production) is likely to be too low in a market economy.
5. Read carefully the section “Competition, Monopoly, and the Incentive to Innovate.” As you read page 620, you could draw two conventional monopoly diagrams, with downward-sloping demand, twice-as-steep marginal revenue which is here called $R(x)$, and constant marginal cost. The first diagram is the *drastic innovation* where the post-innovation monopoly price p'_m is less than the pre-innovation marginal cost c . The second diagram is the *non-drastic innovation* where $p'_m > c$. On each diagram, you could show the change in profits if a monopolist makes the innovation and if a new-entrant firm makes the innovation.
6. Read the section “Alternative Forms of Economics Organization and Invention.”