

Econ 4390

The Economic Theory of Advertising

Simon P. Anderson

TENTATIVE COURSE OUTLINE, FALL 2018

Lectures: T, R, 1100-1215, Wilson Hall 214

Office Hours: W 1330-1430 or by appointment.

Office: Monroe, 236A, tel. 4-3861; sa9w@

Dates: first class T, 8-28; last class T, 12-6;

no classes 10-9, 11-22; final exam T 12-18, 0900-1200.

Grading: 10-15 quizzes (25%); presentation (20%); final (50%); discretionary/participation (5%). All parts of the course are compulsory.

Failure to complete any part will result in failing the course.

I will drop the 3 lowest quiz scores. All quizzes before the Drop Date are compulsory.

Because I will be out of town after the end of classes it will not be possible to take the final at any other time. If you cannot take the final at the scheduled time you should drop this class.

Requirements: 3010 / 3110 (Grade B or better suggested), active calculus.

4010 and 4190 are useful, though not necessary.

No laptops, 'phones, Ipads, newspapers PLEASE

Preliminary reading for Media material:

The Media and Advertising: a tale of two-sided markets: S. P. Anderson and J. J. Gabszewicz:

<http://economics.virginia.edu/sites/economics.virginia.edu/files/anderson/fullfinaltale.pdf>

You can check out some of my other media and ads related papers if you want to:

<http://economics.virginia.edu/people/profile/sa9w> under Other Research Papers

For the state of the art in Media Economics:

Handbook of Media Economics (eds. S. Anderson, D. Stromberg and J. Waldfogel) in Elsevier Handbook series (overall Editors Ken Arrow and Mike Intrilligator), Jan 2016 provides in-depth coverage of main themes by forefront authors in Media Economics
Some is more / less under-grad accessible

In the economics of advertising,

Recent advances in the Economics of Advertising (ed. S. Anderson), Edgar Elgar, Jan 2016 collects the best papers since 2000; though many of the classic papers are earlier

Course Objectives:

The course will consider the economic functions of advertising and the explanations that economists have proffered as to its mechanisms.

The first part of the course will look at advertising and the media, especially the economic performance of markets in which finance through advertising is important (commercial television, radio, magazines). It then considers information congestion.

The second part of the course will consider advertising at the industry level. We shall consider informative and signaling models of advertising, as well as persuasive ads.

The main emphasis of the course will be theoretical. The course uses simple (multi-variate) calculus. If you are not at ease with this, you are advised to take the course at a later date.

Remember though that the Math is a tool to better convey the economics.

Outline:

This course covers an area that is not treated in dedicated Economics texts (although you will find some treatment in IO texts.) The course therefore relies on Notes and papers available on the Collab web-page. Further references will be given as needed. Some sub-topics are not covered by readings, and are covered only in the class itself.

Below is a tentative course outline of topics that may be covered. The actual order may differ. It is strongly recommended that you read the text assignment BEFORE the lecture (plus any additional readings assigned in class).

KEY: Collab – the 4390 site, using the numbered topics below

Papers – my online downloadable papers at

<http://economics.virginia.edu/people/profile/sa9w> under Other Research Papers

Introduction (and math diagnostic test)

1) Review of Surplus analysis, competition, and market power.

Readings: your 3010/3110 text and notes; my CS and PS articles with Engers, Papers:

[Consumer Surplus](#) and [Producer Surplus](#) (with Maxim Engers) Articles for *International Encyclopedia of the Social Sciences 2nd Ed* (2007) Ed. William A. Darity Jr

2) billboard competition. Reading: Billboards, Collab

3) Advertising and the media. Duplication and the Lowest Common Denominator.

Reading: Steiner, Beebe articles and Norway notes on Collab;

Steiner, Peter, "Program Patterns and Preferences and the Workability of Competition in Radio Broadcasting", *The Quarterly Journal of Economics*, 66(2) (May, 1952), pp. 194-223.

Beebe, Jack, "Institutional Structure and Program Choices in Television Markets", *The Quarterly Journal of Economics*, Vol. 91, No. 1. (Feb., 1977), pp. 15-37.

4) Spatial competition model, fixed prices.

Reading: Eaton and Lipsey, RES 1975, especially sections 1, 2 ("Eaton" on Collab)

Eaton, B.C. and Lipsey, R., "The Principle of Minimum Differentiation Reconsidered", *Review of Economic Studies*, Vol. 42, No. 1. (Jan., 1975), pp. 27-49.

5) Price and locations, application to advertising ("Hotelling" notes on Collab)

6) Preference Externalities

Anderson-Waldfoegel Ch 1 in Handbook (Collab)

7) 2-sided market models of ad-financed media

Reading: Anderson-Gabszewicz article on Papers:

<http://economics.virginia.edu/sites/economics.virginia.edu/files/anderson/fullfinaltale.pdf>

Collab: ppt on theme of ad regulation

8) 2-sided market models of ad-financed media: multi-homing consumers, and other recent developments. On Collab:

Anderson-Jullien Ch2 of Handbook (Collab) – some material is more difficult, read sparingly

And (also a version on papers):

Competition for Advertisers and for Viewers in Media markets

(Anderson with Oystein Foros and Hans Jarle Kind)

9) Information congestion: junk mail, spam, and telemarketing.

Reading: Information Congestion paper on Papers; Collab items

10) advertising: overview

Introduction to *Recent advances in the Economics of Advertising*; on Collab

11) a useful organizing paradigm?

reading: Dixit and Norman (on Collab)

Dixit, Avinash and Norman, Victor, "Advertising and welfare", *The Bell Journal of Economics*, Vol. 9, No. 1. (Spring, 1978), pp. 1-17.

we are unlikely to cover the oligopoly analysis. You may also wish to look at these (on Collab) and the papers to which they were replying; though this is not necessary

Dixit, Avinash and Norman, Victor. "Reply", *The Bell Journal of Economics*, Vol. 10, No. 2. (Autumn, 1979), pp. 728-729.

Dixit, Avinash and Norman, Victor, "Another Reply", *The Bell Journal of Economics*, Vol. 11, No. 2. (Autumn, 1980), pp. 753-754.

Fisher, Franklin and McGowan, John, "Advertising and Welfare: Comment", *The Bell Journal of Economics*, Vol. 10, No. 2. (Autumn, 1979), pp. 726-727.

Shapiro, Carl. "Advertising and Welfare: Comment", *The Bell Journal of Economics*, Vol. 11, No. 2. (Autumn, 1980), pp. 749-752.

12) Informative advertising;

the monopoly case. Class Notes.

You might also want to look at (on Collab)

Shapiro, Carl. "Advertising and Welfare: Comment", *The Bell Journal of Economics*, Vol. 11, No. 2. (Autumn, 1980), pp. 749-752.

informative advertising and oligopoly. (Butters and Grossman-Shapiro models).

Reading: Tirole excerpt (Collab)

13) **STUDENT PRESENTATIONS** around here: November, 2 weeks before Thanksgiving

14) complementary goods approach (due to Stigler-Becker and Murphy: we will apply Spence's analysis of quality provision).

Reading: my notes and Tirole excerpt on Collab

The classic piece is Stigler-Becker (de Gustibus is non disputandum), and

Becker, Gary S. and Murphy, Kevin S., "A simple theory of advertising as good or bad", *The Quarterly Journal of Economics*, Vol. 108, No. 4. (Nov., 1993), pp. 941-964.

But we won't work through it

15) signaling models.

Reading: Nelson, "SigComp", Tirole excerpt on Collab

Classic works are Nelson (worth a look!) and

Milgrom, Paul and Roberts, John, "Price and advertising signals of product quality", *The Journal of Political Economy*, Vol. 94, No. 4. (Aug., 1986), pp. 796-821.

But we will not go through the finer details

16) Advertising: the persuasion game reading: (due to Milgrom)

Reading: "Unravel" on Collab

17) content analysis and Advertising Content.

Reading: Anderson and Renault, "Advertising Content" on Papers

Likely time will not permit! But...

18) Further topics (Comparative advertising: see Papers;

Media Bias, Media Mergers, Search and Advertising, Gatekeepers ...)

19) conclusions

Class Honor Policy Statement

I trust every student in this course to fully comply with all of the provisions of the UVA honor system. That institution is one of the glories of Mr. Jefferson's University, and provides important benefits to the whole community. Each of us has an obligation to help maintain it.

On every exam, please write "Pledged", and sign your name. On every homework assignment you hand in, please write "Pledged". If you work with a Study Group, each member of your Study Group should sign beneath it.

In addition to pledging that you (or your Study Group) have neither received nor given aid while taking your exam or doing your homework, your signature also affirms that you have not accessed anyone else's notes, study outlines, problem sets, old exams, answer keys, **or the textbook while taking an exam, and that you have not obtained any answers from another student's exam.**

Plagiarism is an Honor offense. The Honor Committee provides a very straightforward discussion, "Fraud and the Honor System", at:

www.virginia.edu/honor/proc/fraud.html

If, in my judgment, it is beyond a reasonable doubt that a student has committed an honor violation with regard to a given exam, that student will receive an immediate grade of 'F' for that exam, regardless of any subsequent action taken by the Honor Committee.

Simon Anderson