

own the good, someone's selling price (willingness to accept) for the same good would be upto 20 times the buying price (willingness to pay).

Further, the standard neo-classical assumption of human beings being capable of making complex calculations to compute their optimum best choice with all necessary information at their disposal is a seriously flawed one. Psychologists have long established that people, rather than using any consumer theory, depend upon their internal biases and certain 'rules of thumb' to make decisions. In making a decision between any two actions, if one is presented to us as a loss and the other as a neutral or a gain, we avoid the apparent loss i.e. framing a question differently would yield different responses even if the two outcomes are mathematically identical, such as :

1. Would you agree to undergo a medical procedure if your doctor tells you "Of those who have this procedure, 10% are dead after 5 years"?
2. Would you agree to undergo a medical procedure if your doctor tells you "Of those who have this procedure, 90% are alive after 5 years"?

Positively framing the question leads to more number of people confirming in an affirmative quite predictably but also irrationally since both the outcomes are mathematically identical.

Similar to this is the tendency to jump to conclusions based on our intuitions. An example of a mathematical problem where our intuition is often wrong finds mention in Kanhemman's paper.

"A bat and ball cost \$1.10 in total. The bat costs \$1 more than the ball. What is the cost of the ball?" Most people answer 10 cents including 50% of Princeton University students, which is wrong. All these are the different kinds of internal biases that may cloud the judgement of rational human beings while making decisions.

Examples such as this and the several ones that have been cited above clearly highlight the need for questioning the inherent irrationality of human behaviour, which is often left unexplained by standard economics. Under the telescope of behavioural economics, one finds that these apparent irrational acts are also systematic in a certain way and hence predictable and learning more about how the human mind ticks, requires that we modify conventional economics and try to have a new understanding of human nature and decision making using the forces of both economic rationality and psychological notions.

References:

- 1.<http://www.econlib.org/library/Enc/BehaviouralEconomics.html>
- 2.<http://www.neweconomics.org/publications/entry/behavioural-economics>
3. *Predictably Irrational*, Dan Ariely

Prepare for Judo Economics!!!

Aditi Singh III Year

Judo (meaning "gentle way") is a modern martial art created in Japan in 1882 by Jigoro Kano. A central principle of judo is that of *seiryoku zen'yō* (maximum

efficiency, minimum effort), which is illustrated with the concept of *jū yoku gō o seisu* (gentleness controls hardness). According to this concept, resisting a more powerful opponent will result in your defeat, whilst adjusting to and evading your opponent's attack will cause him to lose his balance, his power will be reduced, and you will defeat him. This can apply whatever the relative values of power, thus making it possible for weaker opponents to beat significantly stronger ones.

The term 'judo economics' was first used by economists Judith Gelman and Steven Salop. It is a strategy designed to give smaller companies an advantage by using the perceived advantages of a larger competitor - namely size - against the competitor. It consists of three components: movement (using the smaller size to act quickly and neutralize a larger competitor's advantages), balance (to absorb and counter the competitor's moves) and leverage (using the competitor's strengths against it). Here, the entrant deliberately chooses to target specific niches with low prices. The incumbent is at a disadvantage because a larger customer base makes it difficult for him to cut prices. Hence, the incumbent is actually weighed down by its existing customer base.

The Game

There are two players in this game. One is the incumbent firm, who is currently the market leader in our product. The other is the entrant, which is a firm with present market share in the concerned product of zero, who is trying to enter the market. Let the price of the product currently being charged by the incumbent be P_H (high price).

The entrant sets a lower price of P_L (low price) i.e. $P_L < P_H$. Let X denote the market

share of the incumbent firm. The entrant limits its capacity to serve only a small portion of the market (X_E) such that $X_E < X$. the entrant further signals the incumbent that it shall not drastically increase its capacity in the near future.

The incumbent now has two options. It can fight the entrant by setting its price marginally lower than that of the entrant's i.e. marginally lower than P_L . The incumbent will regain the entire market but will incur losses in the short run through price reduction equalling $(P_H - P_L)X$. The other option is to accept the incumbent and loose some profits by giving up market share (equal to X_E) to the entrant.

The incumbent will not attack the entrant if losses from accepting the entrant are less than the losses incurred through attacking the entrant. If the losses from accepting the entrant outweigh those from fighting them, then the incumbent shall retaliate i.e.

Attack if : $P_H X_E < (P_H - P_L)X$

Don't attack if : $P_H X_E < (P_H - P_L)X$

There are three factors here that influence the success of the entrant. The first is the size of the market share of the incumbent (X). If X is large, then the incumbent will not mind giving up a small portion to the entrant and will be less likely to deter entry. The second factor is the capacity of the entrant, which is reflected by the market share it is likely to usurp (X_E). The smaller is X_E , the less likely it is that the incumbent shall try to prevent entry. The last factor that influences the incumbent's decision is the price differential ($P_H - P_L$). The smaller is the value of $P_H - P_L$, i.e. the closer is the entrant's price to the incumbent's, the fewer the number of people who will buy the entrant's products, and hence the less likely will it be for the incumbent to attack.

The Rise of Amazon

This is the strategy adopted by online giant Amazon. Barnes and Nobel, founded in 1886, was the leading book retailer in the United States of America. In 1994, Amazon was founded by Jeff Bezos. It began as an online book retail store. Barnes and Nobel did not respond with their own online store, even though they had the potential to exclude Amazon. They feared that an online store would hurt sales through classical bookstores and would trigger an online price war, resulting in a Bertrand equilibrium. Gradually, Amazon began dragging customers away from classical bookstores. In the first two months of business, Amazon sold to all 50 states in the USA and to over 45 countries. Within two months, Amazon's sales were up to \$20,000 per week. Since then, it has risen to become the world's largest online retailer today. Amazon now sells not only books, but also DVDs, VHSs, CDs, video and MP3 downloads/streaming, software, video games, electronics, apparel, furniture, food, toys, and jewellery. The company also produces consumer electronics—notably the Amazon Kindle e-book reader and the Kindle Fire tablet computer—and is a major provider of cloud computing services. Amazon is considered the fourth most successful startup company of all time by market capitalization, revenue, growth and cultural impact.

References:

1. www.wikipedia.org

2. <http://www.investopedia.com/terms/j/judo-business-strategy.asp>
3. http://pages.stern.nyu.edu/~abranden/Judo_Strategy_Review.pdf

ANSWERS TO CROSSWORD ON PAGE

ACROSS-

1. per capita income
3. comparative advantage
5. Harrod Domar model
6. Milton Friedman
9. infant industry
11. Solow
12. advalorem tax
13. J curve effect

DOWN-

1. Paul Samuelson
2. cyclical
4. deadweight loss
7. leveraging
8. disinvestment
10. repo rate