THE SODA POP MONOPOLY, OR HOW I LEARNED TO LOVE PEPSI:

Observations from the Dismal Science

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How is it possible for a soda pop company to make money on a deal with a university whereby it is guaranteed a monopoly on soda pop but has to give the university tens of thousands of dollars in donations and cut its price at the pop machine by twenty-five cents a bottle to boot? Didn't we all learn in Econ 201 that monopolies drive prices up not down? How can they afford to pony up those "donations" and still come out ahead?

Let's eliminate two plausible sounding answers; at least I want to persuade the reader that these two aren't as plausible as they sound. Is Pepsi giving money away; is this giant corporation revealing its heart to be the heart of an altruist? The technical, jargon-full, economic answer is that an altruistic donation is consistent with several maximizing goals, but it is logically tortuous and historically unlikely. The non-technical economic answer, freed of all unnecessary jargon is: "Get serious!"

Another plausible sounding answer is that Pepsi will bide its time and then jack up the price after it has us all hooked on Pepsi. Sure, this is possible, and it is similar to the kind of predatory pricing that courts adjudicate in other settings. However, there are two flaws in that theory: 1) Pepsi doesn't have to wait, as long as their agreement is solid, Pepsi could have raised prices right away; and, more importantly, 2) Pepsi doesn't have to raise prices to make an extra profit.

The day Coke disappeared from campus many Coke lovers undoubtedly switched to Pepsi. I know I did; it's not bad, actually. The extra demand is sufficient to explain the extra profit; and, that demand also makes it possible to gain enough extra profit to fork over a "donation" to the university to sweeten the deal.

So, nobody loses and everybody gains, right? Wrong! The people who lose are the people who prefer Coke to Pepsi. Their losses could be measured in principle by finding out how much they would be willing to pay to get Coke back on campus. This is essentially the economist's method of measuring the value of some marketable good foregone; but this would be a very difficult task and costly in time as well as money.

Only a student rebellion is likely to make a change, but are students likely to do any more than grouse good-naturedly about the situation? The problem is that it is hard for students or anyone to take the issue seriously enough to bring a revolt. The lack of freedom to choose between Pepsi and Coke has to be considered a "tragedy" only by the most pampered among the world's population; it's doubtful the Oakland community would qualify.

We can't conclude, however, that sweet monopoly deals benefit the campus community. As an abstract principle, it all depends on the relative importance of the two goods to the consumer (usually measured by the consumer's percentage responses to price changes). For example, consider something of more importance but still not of super importance. Suppose that the university struck a deal with Burger King giving it the sole and monopoly proprietorship at the Food Court. Suppose that Burger cut its prices somewhat and made big donations to the university. What would the fans of tacos, salads, pizza, Chinese and stir fry have to say about it? Rebellion? OK, maybe but maybe not even then.

How far could it go before the consumer rebelled? Maybe an ultimate case would go something like this: Your physician has cut a sweet deal with a company that provides a new concoction to remedy pneumonia made mainly of "hot

tea with honey." Now suppose you have pneumonia and your physician tells you that he prescribes this concoction for pneumonia and he will have none of this nonsense about your wanting antibiotics. I'll bet you would at that point rebel and find another physician.

Lastly, there are sometimes side effects to sweet monopoly deals; by "side effects" I mean things the sometimes but not always come along as part of the overall deal. Such side effects aren't monopolies themselves, but they probably wouldn't be around (at least not as likely) if it weren't for the monopoly deal. For example, it's probably the case that the big Pepsi sign at the corner of Walton and Adams came to us as a side effect of the Pepsi/university monopoly agreement. Call me a cynic, but I don't expect to see a Coke sign out there, do you?

Does Pepsi advertising cause any harm? Suppose that your "vibrations" when passing the sign are generally negative, should the dismal science ignore these negative feelings because they are too "touchy feely?" Or are they just as important to consider as the various money costs? Why shouldn't feelings count, too—does only money and that sort of thing get counted by economists on the cost side?

Feelings count. In fact Nobelist Gary Becker continually points this out, and he shows that this applies even to advertisements like the big Pepsi sign. Becker's new reasoning explains that advertising "works" by helping people to enjoy their favorite product; for example, Bud lovers may love the droll lizards on TV, and Marlboro smokers may enjoy think of themselves ridin' the range.

So what happens if you dislike the product and/or the advertisement? What if you even think the advertisement is sort of undignified? In this case, Becker points out to economists what to many non-economists is already obvious: then the advertising can be a net harm to the community. The rest is straightforward: If the monopoly is a net loss in satisfaction to consumers and if the side effect were also negative, then the monopoly wouldn't be as good a deal as it had seemed to be at first.