

## Comments on “Perfecting Imperfect Competition”

Under imperfect competition a firm possesses market power that enables him to charge a price higher than the marginal cost. This results in a loss of welfare. The present paper proposes a tax scheme that provides the firms a trade off between tax burden and market power. In particular, under the scheme each firm is allowed to choose a profit tax rate equal to firm’s Lerner index. Social welfare unambiguously improves. In a special case competitive outcome is possible with zero tax rate and zero market power. Thus the paper provides a simple but theoretically interesting and novel idea. However, the following points may be considered with a view to improve the presentation.

1. The basic intuition of the result should be provided in the introduction. Given that MR is falling, and under monopoly equilibrium MC cuts MR from below, a lower output below monopoly level will result in a fall of absolute profit and an increase in the price-cost margin, whereas an increase in output above monopoly level will result a fall in absolute profit as well as price-cost margin. Hence net profit must go up at an output higher than monopoly level, and this will reduce deadweight loss.
2. Monopolies innovate in pursuance of achieving a higher profit. Associating ethical considerations with this seems inappropriate in the present context (refer to last few lines of the first paragraph of the introduction).
3. I don’t think Table 1 has to contribute anything positive, hence it may be dropped.
4. In the set up of the model, the paper assumes linear demand and quadratic cost functions, but the results are derived for the general demand and cost functions. Therefore, it is suggested that after formulating the general result, the paper should provide, as an example, the closed form solutions for the specific demand and cost functions (say, for the case of linear demand and constant marginal cost).
5. The basic result should be provided in a proposition.
6. The profit expressions (Equations (6) and (7)) include the case of  $Q > Q_c$ , but the paper provides no discussion on this.
7. Under the given tax scheme it is shown that (with a slight change of notation),  $\pi' |_{Q_m} > 0$ ; therefore,  $Q > Q_m$  should be optimum. In addition, if  $\pi' |_{Q_c} < 0$  (for example, if marginal cost is constant), equilibrium Will be  $Q_m < Q < Q_c$ . In general,  $\pi' |_{Q_c} \begin{matrix} > \\ < \end{matrix} 0$ ; therefore, in a special case when  $\pi' |_{Q_c} = 0$ , competitive equilibrium is at least one possible equilibrium. This whole part should be presented and explained more clearly. The denominator of Equation (11) will be  $p$ , not  $p^2$ .

8. In the “Applicability” section while the paper explains the limitations of the application of the result (for instance, MC is not observable, misreporting of costs possible, etc.), the author seems to be little ambitious over its application.