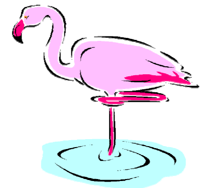
The Market for Pink Plastic Flamingos



During this demonstration you're going to try to make a profit by buying or selling (imaginary) pink plastic flamingos. At the beginning of the exercise you'll be given a personal information sheet indicating whether you will be a ***potential seller*** or a ***potential buyer*** of flamingos in each of several sessions.

If you're a potential seller, you may be able to make money by selling a flamingo to one of your classmates. You'll find your ***seller cost*** for a flamingo listed on your personal information sheet. For example, if in the first round you sell a flamingo for a price $\$P$ and your seller cost is $\$C$, then your ***profit*** is the difference $\$P - \$C$. If you don't sell a flamingo, your profit for that round is zero. Sometimes you might not be able to find a buyer who is willing to pay at least as much as your seller cost. In that case, you're better off not selling your flamingo and earning zero profit rather than selling for a loss.

If you're a potential buyer, you may be able to make a profit by buying a flamingo from one of your classmates. Your ***buyer value*** for a flamingo is listed on your personal information sheet. For example, if in the first round your buyer value is $\$V$ and you buy a flamingo for a price $\$P$, your profit will be $\$V - \$P$. One way to think about this is that you get $\$V$ worth of satisfaction from sticking a pink plastic flamingo in your front yard, so you can buy one for anything less then $\$V$ and still come out ahead. If you don't buy a flamingo, your profit for that round is zero. If you can't find a seller who is willing to sell you a flamingo for less than (or equal to) your buyer value, you're better off not buying a flamingo and earning zero profit rather than buying for a loss.

In any given round of trading, buyers cannot buy and sellers cannot sell more than one flamingo.

To make a purchase or sale, first find somebody who might be willing to make a deal with you. Potential sellers can only make deals with potential buyers, and potential buyers can only make deals with potential sellers. When a potential seller meets a potential buyer, the two can negotiate about the price any way they want. You don't have to reveal your seller cost or buyer value to your bargaining partner, but you can if you want.

When a seller and a buyer agree on a price, they come to the front of the room and fill out a sales contract in order to record the transaction. The sales contract will record the seller's cost, the buyer's value, and the price at which the sale was made. As sales contracts are filled out, the information will be displayed on the overhead so that people still bargaining can see it.

Once you've completed your transaction and filled out the sales contract, you should return to your seat.

The exercise will get more complicated as time goes on. In particular, in later rounds we'll recognize that pink plastic flamingos are ugly. So ugly, in fact, that every flamingo that's sold

This exercise is adapted from Bergstrom and Miller (2000).

imposes $1 of ***damage*** on everyone in the class. The intuition here is that lawn ornaments unsightly, and therefore lower the property value of everyone in neighborhood.

Some Advice for Traders

To maximize your profits, you should approach trading aggressively. Don't be afraid to shout or gesture for attention. Let people know how much you're willing to pay or the price at which you're willing to sell. If you think you could get a better price than someone offers you, don't hesitate to say so.

Remember that you'd like to "buy low, sell high." Potential buyers make greater profits the lower the price they have to pay for a flamingo. Potential sellers make greater profits the higher the price they get for their flamingo.

Seller costs will differ from one seller to another, and buyer values will differ from one buyer to another, so if someone tells you their value or cost, don't assume that everyone else's is the same.

Sometimes students get left out at the end of the market because all their potential trading partners have already traded with someone else. If you think you're getting a good deal, you should probably take advantage of it quickly so that you don't get left out. So long as you haven't traded yet, you should keep an eye on the prices that are posted on the overhead. This may give you an idea of what price to ask or offer in your own negotiations.

Warm-Up Exercises

1) Suppose that a potential seller with a seller cost of $20 meets a potential buyer who has a buyer value of $40.

   A) If this potential seller sells a flamingo to this potential buyer for $35, how much profit will the seller make? _____ How much profit will the buyer make? _____ What is the total profit obtained by both traders? (Find this by adding the buyer's profit to the seller's profit) _____

   B) What it the *highest* price that would permit both the seller and the buyer to make a profit of at least $1? _____ If this price is charged, what is the sum of the buyer's and seller's profits? _____

   C) What it the *lowest* price that would permit both the seller and the buyer to make a profit of at least $1? _____ If this price is charged, what is the sum of the buyer's and seller's profits? _____

2) Suppose that a potential seller with a seller cost of $35 meets a potential buyer who has a buyer value of $25. Is it possible for these two traders to find a price that allows them both to earn positive profits? If not, what should they do?

****** At the end of the demonstration, I'll randomly select one student ******
****** who will receive 10% of their total profit from all rounds in cash. ******