Chapter 10

Market Power, Collusion, and Oligopoly

10.1 Acquiring Market Power

1. Mergers

• Horizontal integration
  – Produce the same good but merge
  – Examples
    * Dell, Gateway, and IBM
    * United and Continental merger
  – Reason: Isolate economies of scale and capture monopoly power
  – Competing welfare concerns... (1) reducing costs and (2) creating monopoly power

[Insert Exhibit 11.2 here]

• Vertical integration
– Merge so produce inputs to produce outputs

– Examples
  * Livestock feeding and packing industries
  * Dell and Intel

– Two monopolists merge
  * Eliminate monopoly power
  * Benefit consumers
  * Increase total surplus after merger

– Other types of vertical integration
  * Good or bad
  * Depends on specifics of market structure
  * Shapes of demand and cost curves

[Insert Exhibit 11.3 here]

2. Antitrust policies

  • Examples: Sherman Act of 1890 and Clayton Act of 1914
  
  • Preventing mergers tends to increase competition

  • Controversy over antitrust criteria
    
    – Economic Inefficiency
    
    – US Supreme Court versus European antitrust position

3. Predatory Pricing

  • Set prices artificially low to damage rival firms (i.e., dumping)

  • Forms of price discrimination

  • Skepticism about use in marketplace (profit motive)

  • Robinson-Patman Act
Prohibits predatory price discrimination
- Pricing below marginal cost

4. Resale price maintenance

- Producer
  - Set retail price and forbid any retailer to sell at discount

- Benefits
  - Wholesaler
  - Retail
  - Consumer

- Prices or services kept high

[Insert Exhibit 11.4 here]

10.2 Collusion and the Prisoner’s Dilemma

- Collusion - Set price and output agreed upon by firms (e.g., oil cartel, diamond)

- Cartel - Engage in collusion

1. Breakdown of cartels

- Price initially set above MC (provides incentives to cheat - undercut price)

- Competitive output level

- Analogous to prisoner’s dilemma (see exhibit 11.6)

- Enforcers - government, monopoly retailer
10.3 Regulation

1. Examples of regulation
   - Quantity
   - Quality
   - Information
   - Prices
   - Business/Production Practices

10.4 Oligopoly

1. Assumptions
   - Few large firms
   - Firms influence market conditions
   - Firms decisions impact competitors
   - Firm decisions affected by competitor decisions

2. Contestable Market
   - Firms enter and exit at low cost
   - Exhibit 11.8

3. Models of Strategic Behavior
   - Cournot model
     - Take rivals output as given
   - Bertrand model
     - Take rivals price as given
– MC and pricing move toward competition

[Insert Exhibit 11.9]

10.5 Monopolistic Competition and Product Differentiation

1. Product Differentiation

   • Production of unique product with close substitutes
     – Brand names
     – location
     – flavor
     – production practice (e.g., organic or fair trade)
     – labeling

2. Monopolistic Competition

   • Market where there are many similar but differentiated products
   • More product differentiation...firm can act more like a monopolist
   • Any monopoly power is limited over time
   • Advertising is important
   • Examples: Micro-brews, chips, cereal, etc.

[Insert exhibit 11.10]