

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]