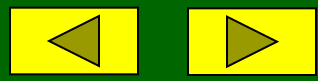


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Monopolistic Competition and Oligopoly

FOUR MARKET MODELS

Monopolistic Competition:

- Relatively Large Number of Sellers
- Differentiated Products
- Easy Entry and Exit



Market Structure Continuum

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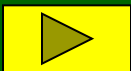
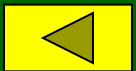
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CHARACTERISTICS

Relatively Large Number of Sellers

- Small Market Shares
- No Collusion
- Independent Action

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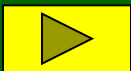
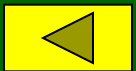
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CHARACTERISTICS

Differentiated Products

- Product Attributes
 - Service
 - Location
 - Brand Names and Packaging
 - Some Control Over Price
- ## Role of Advertising

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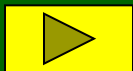
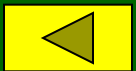
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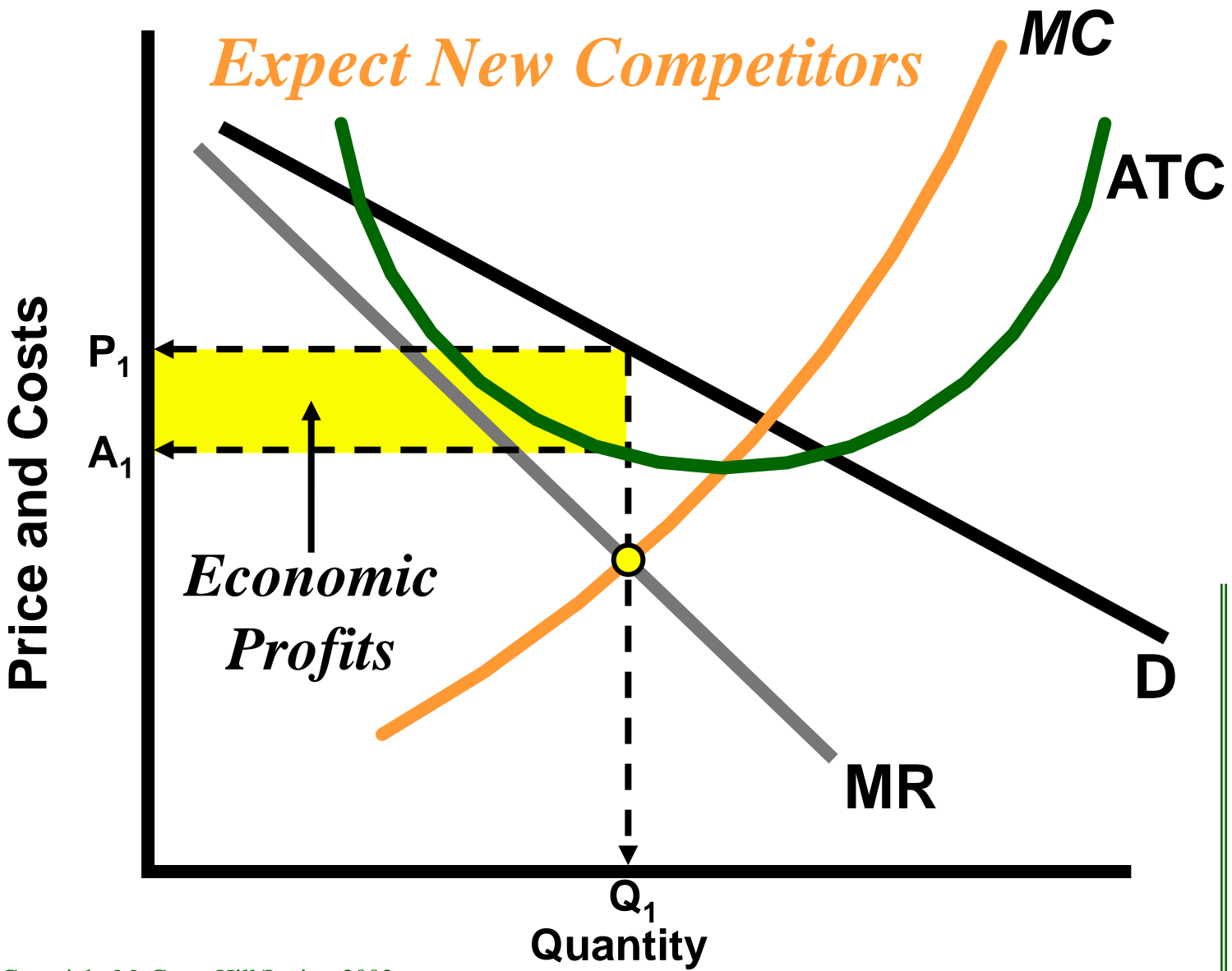


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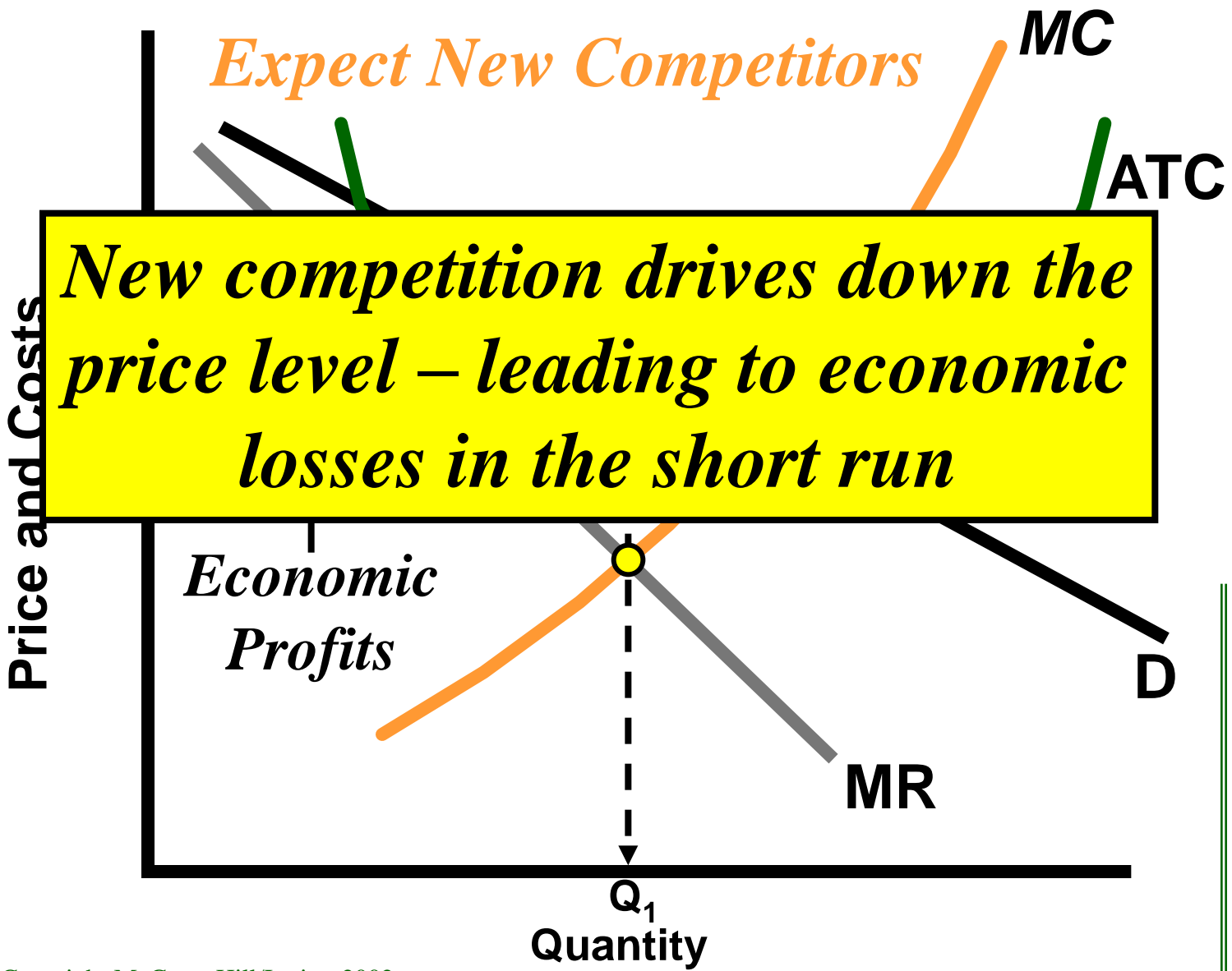


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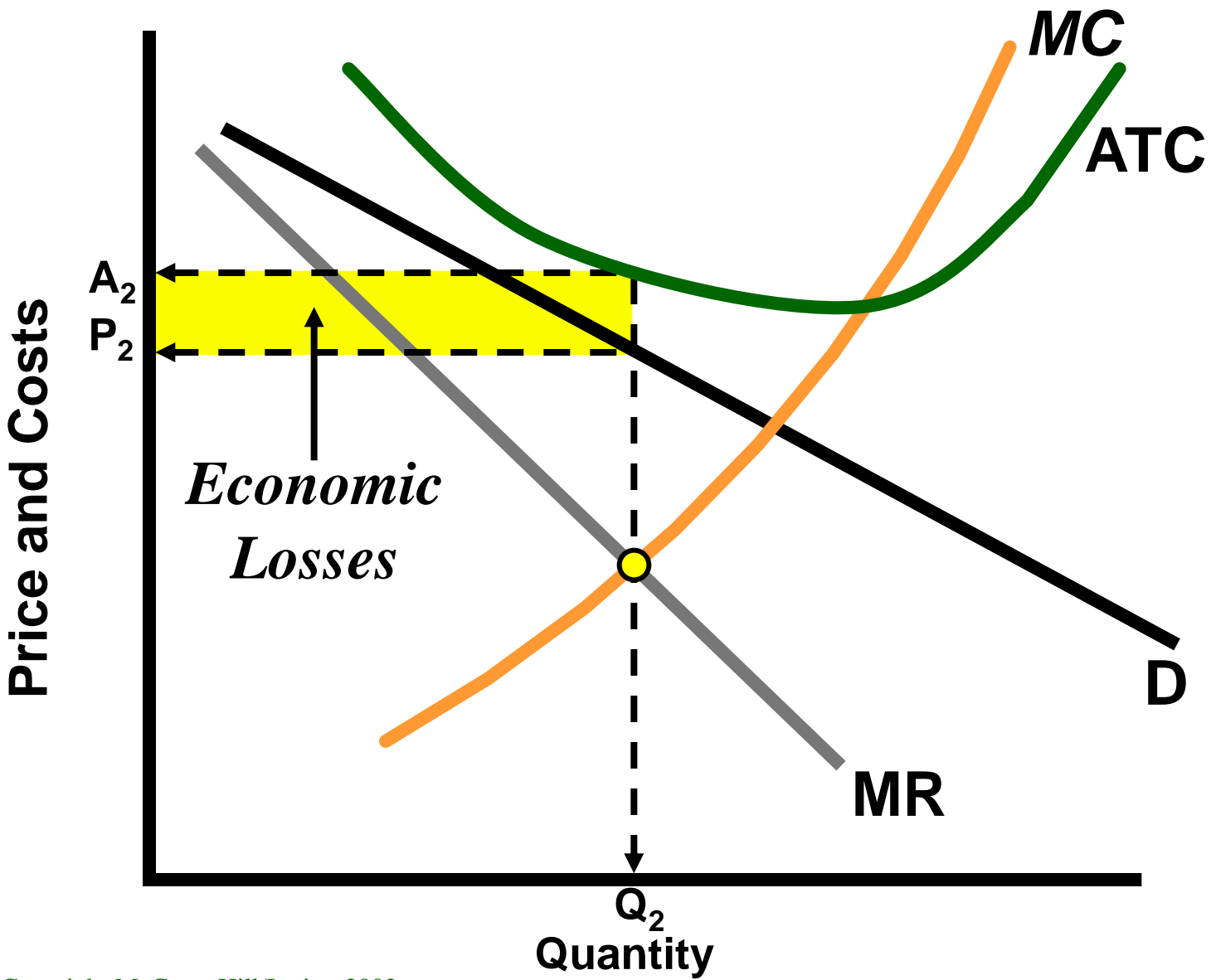
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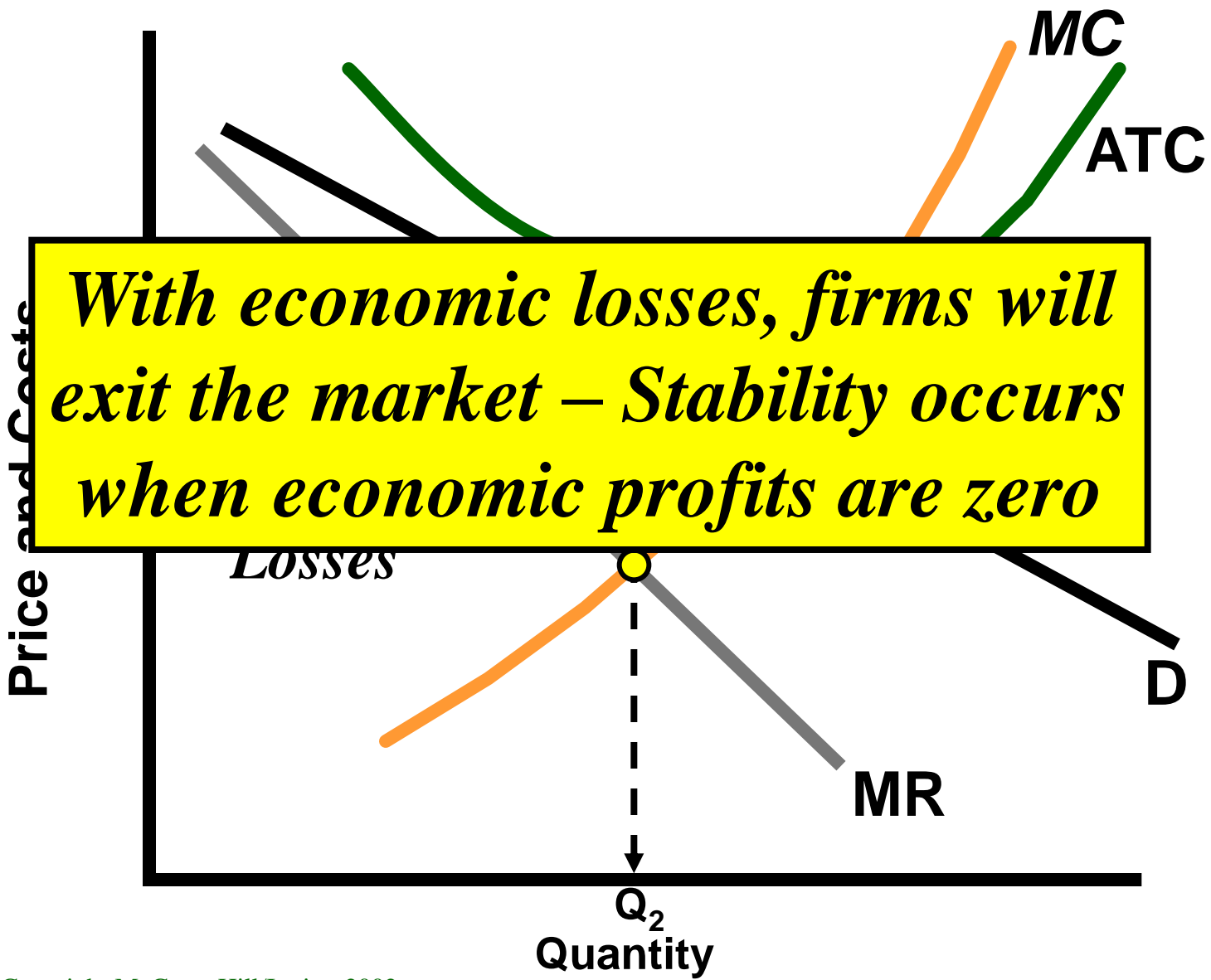
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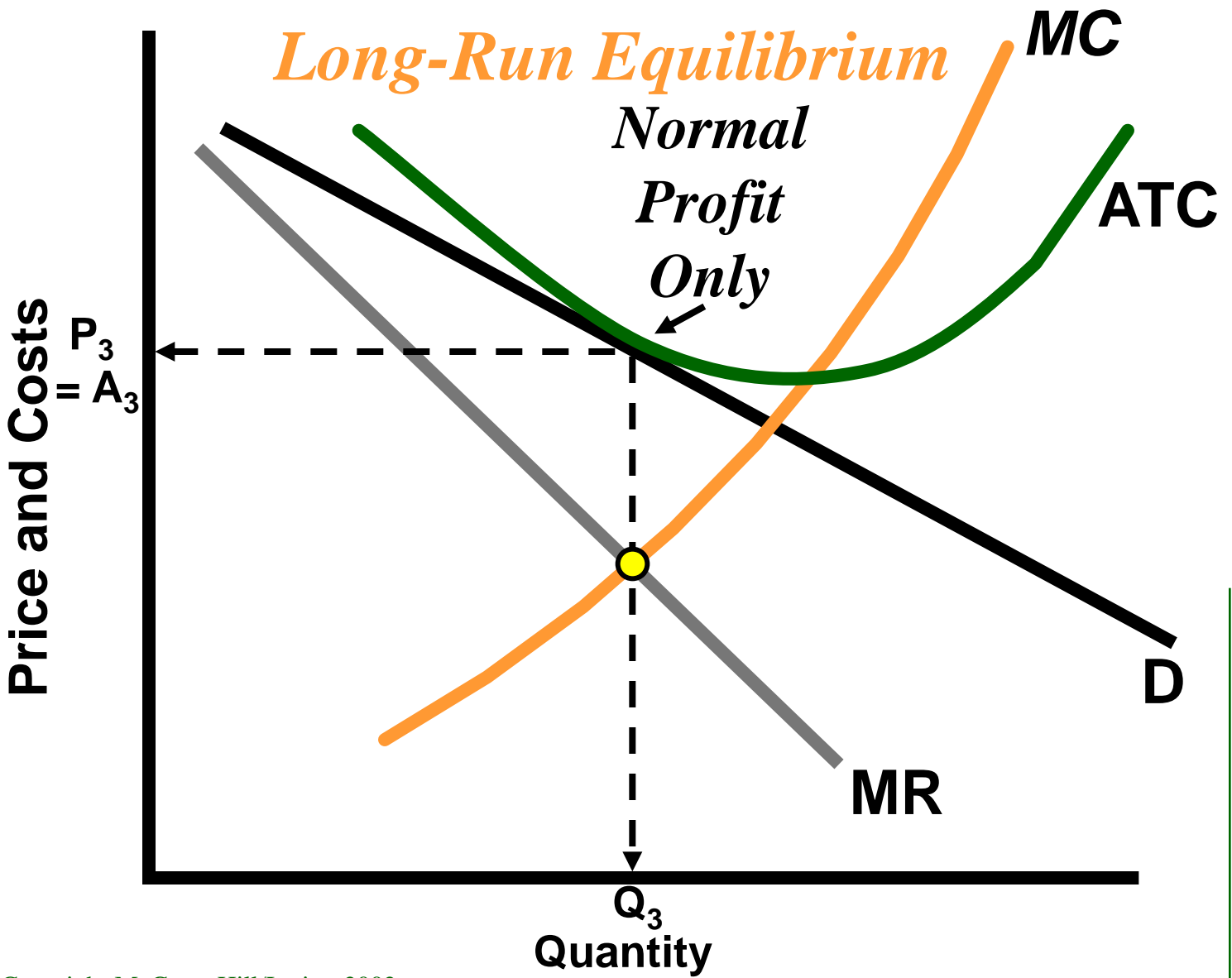
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MONOPOLISTIC COMPETITION AND EFFICIENCY



- **Not Productively Efficient**

\neq Minimum ATC

- **Not Allocatively Efficient**

Price \neq MC

Graphically...

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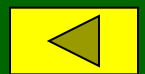
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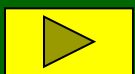
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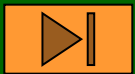
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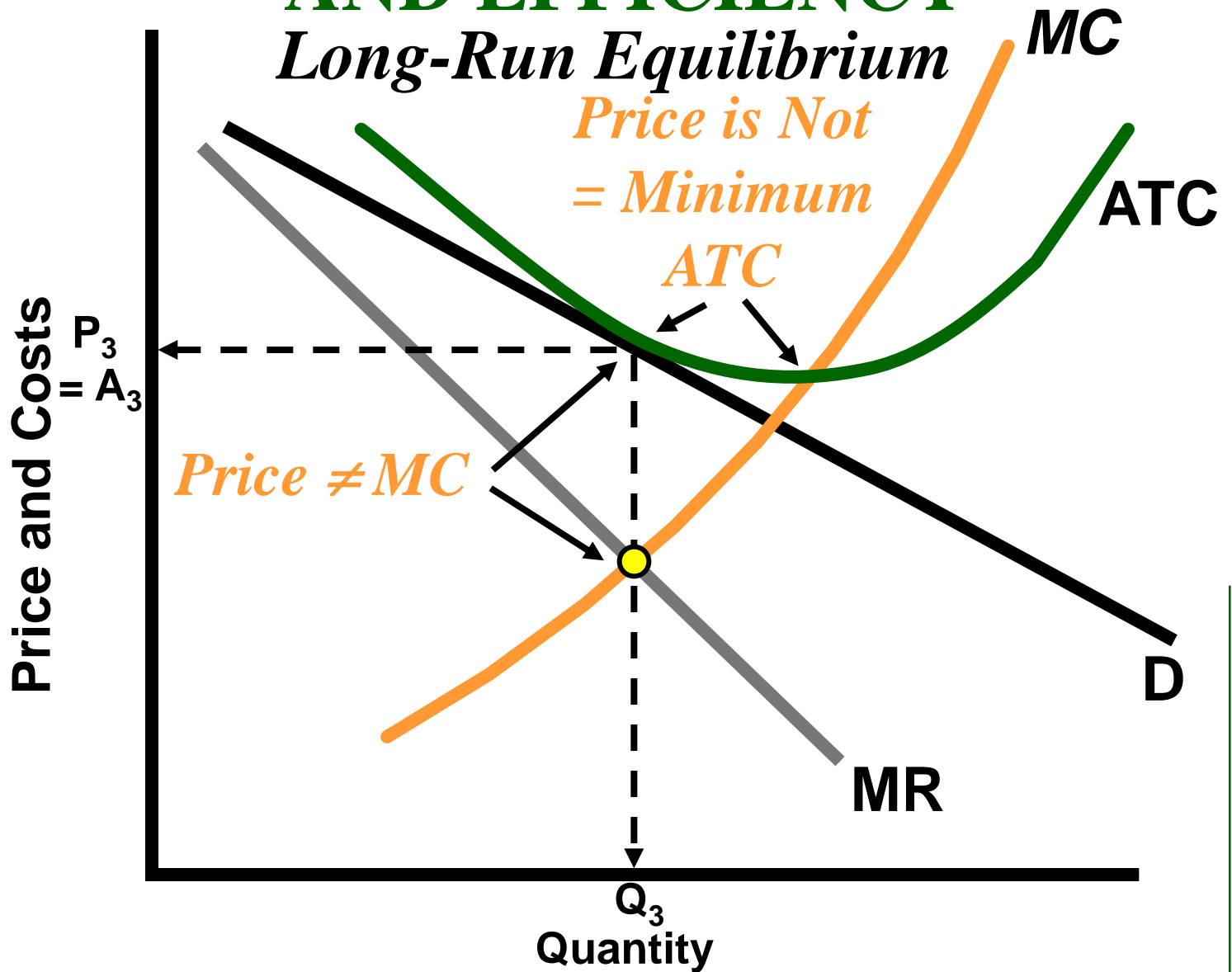
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MONOPOLISTIC COMPETITION

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Long-Run Equilibrium

Price is Not = Minimum



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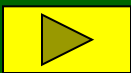
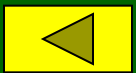
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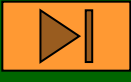
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MONOPOLISTIC COMPETITION AND EFFICIENCY

Product Variety

- **Benefits of Product Variety**
- **Nonprice Competition**
- **Advertising Role**
- **Trial & Error Search for Maximum Profits**

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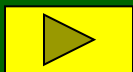
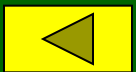
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FOUR MARKET MODELS



Oligopoly:


- **A Few Large Producers**
- **Homogeneous or Differentiated Products**
- **Control Over Price, But Mutual Interdependence**
- **Entry Barriers**



Market Structure Continuum

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OLIGOPOLIES AND MERGERS

Mergers

Measures of Industry

Concentration

- Concentration Ratio**
- Localized Markets**
- Interindustry Competition**
- World Trade**
- Import Competition**

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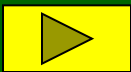
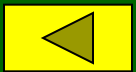
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OLIGOPOLIES AND MERGERS

Herfindahl Index

Sum of the squared percentage market shares for all firms in the industry – Places greater weight upon the larger firms

$$(\%S_1)^2 + (\%S_2)^2 + (\%S_3)^2 + \dots + (\%S_n)^2$$

A greater Herfindahl Index indicates a greater concentration of market power in the industry
(Pure competition is near zero)

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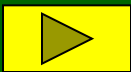
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OLIGOPOLIES AND MERGERS

Mutual Interdependence

Collusive Tendencies

- Collusion

Incentive to Cheat



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THREE OLIGOPOLY MODELS

No Standard Model due to...

Diversity of Oligopolies

Complications of

Interdependence

Alternative Models:

- 1 - Kinked Demand Curve**
- 2 - Collusive Pricing**
- 3 - Price Leadership**

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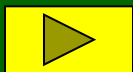
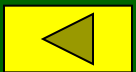
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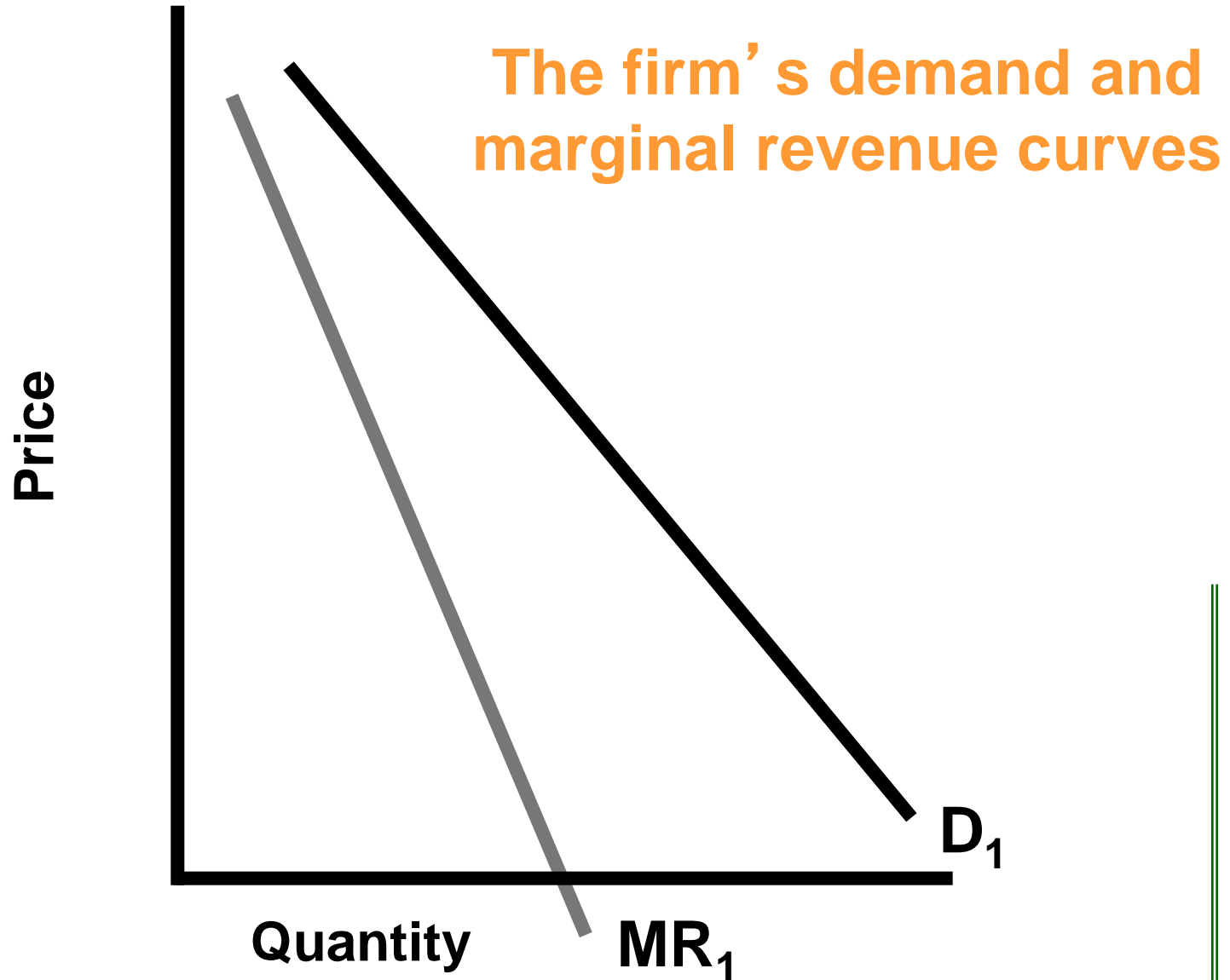
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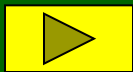
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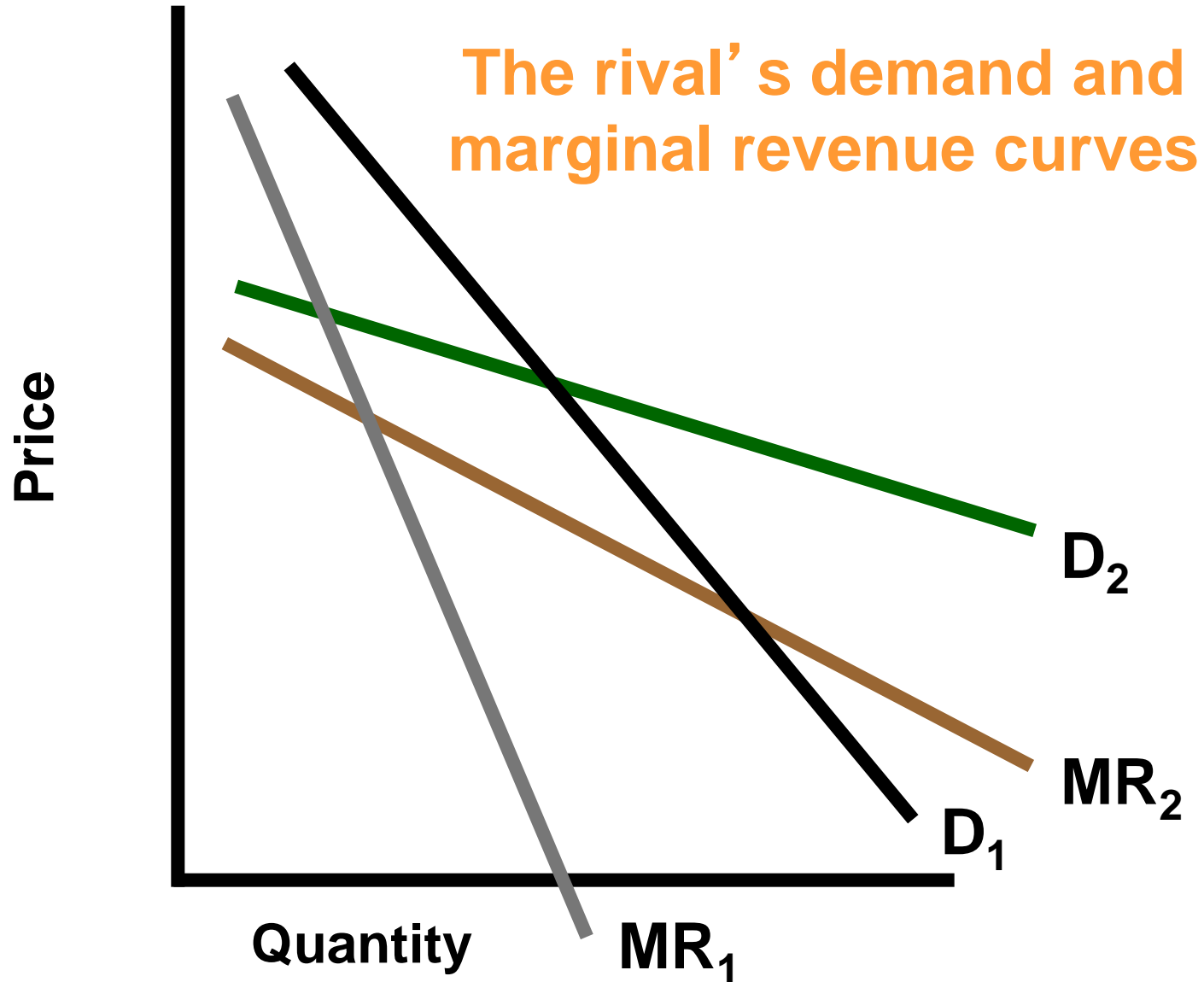
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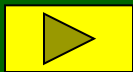
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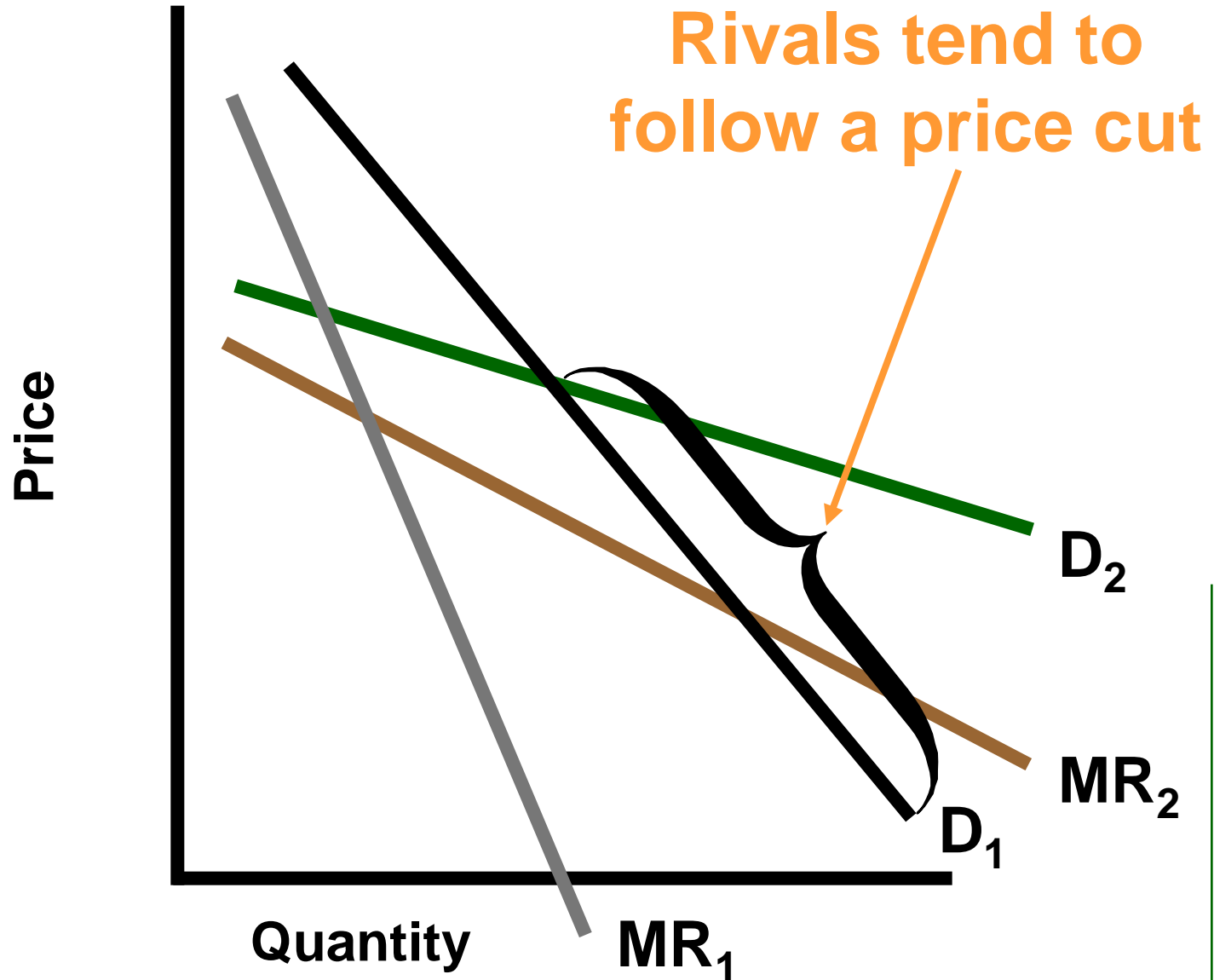
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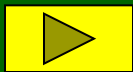
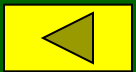
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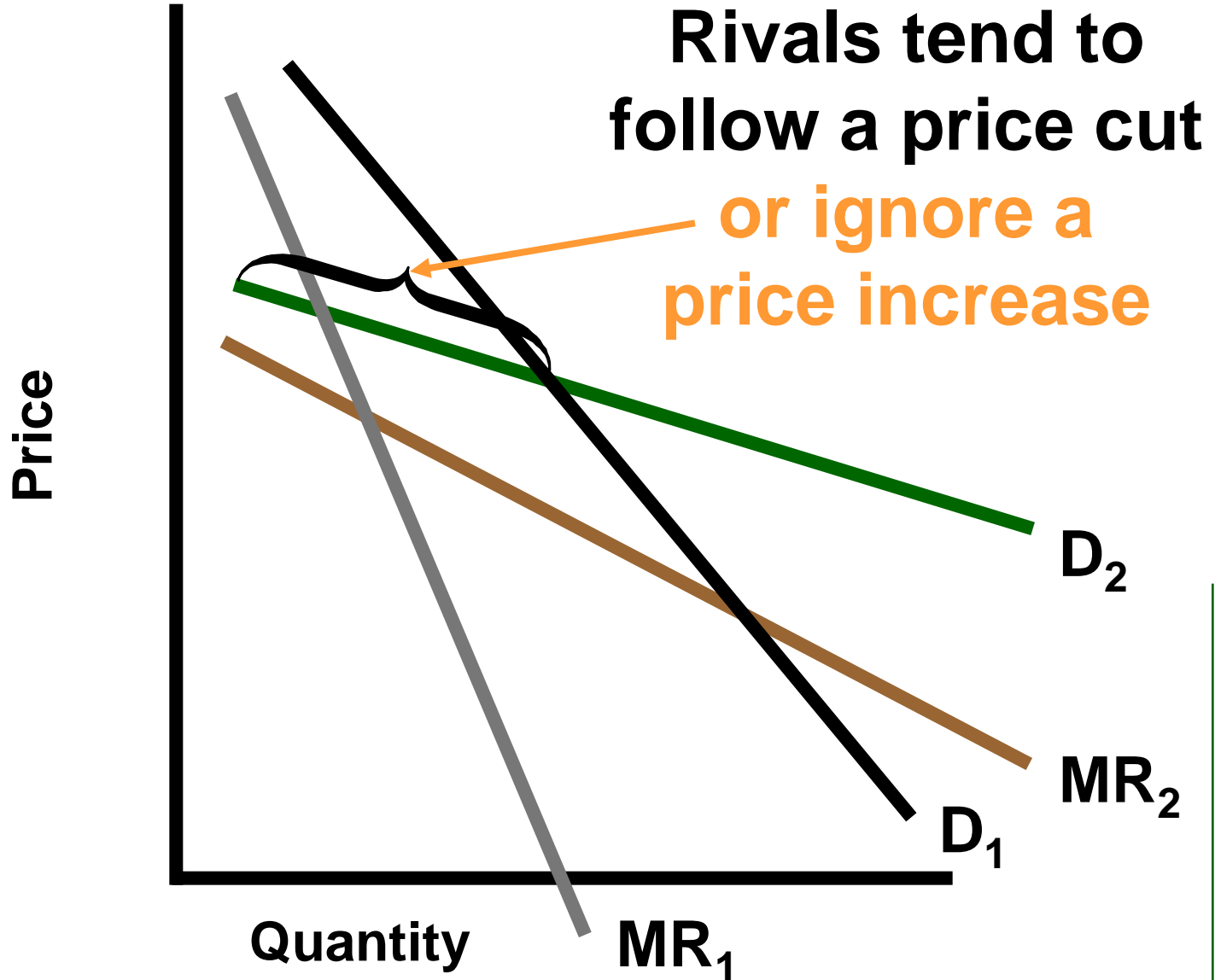
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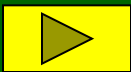
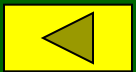
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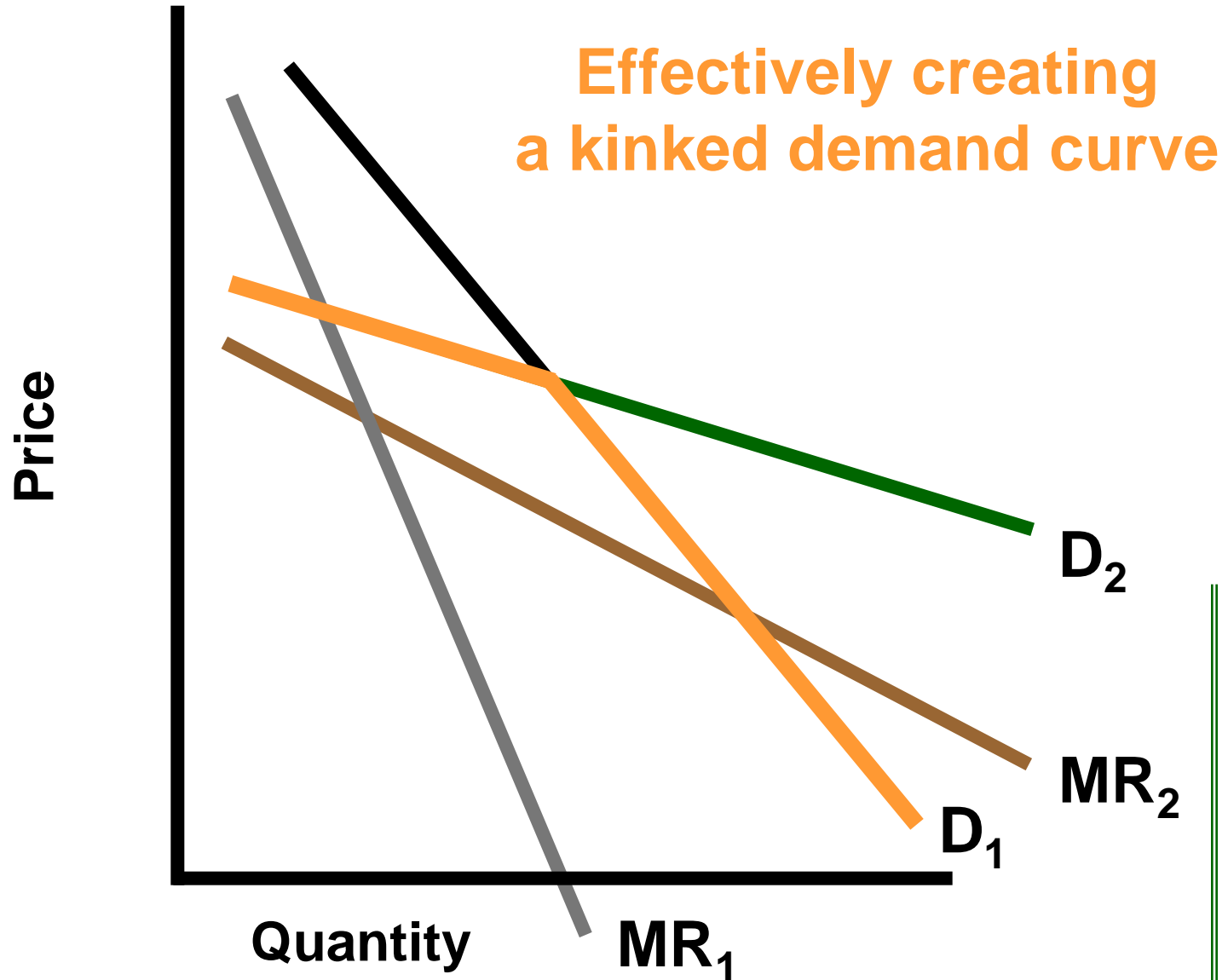
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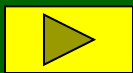
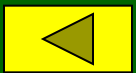
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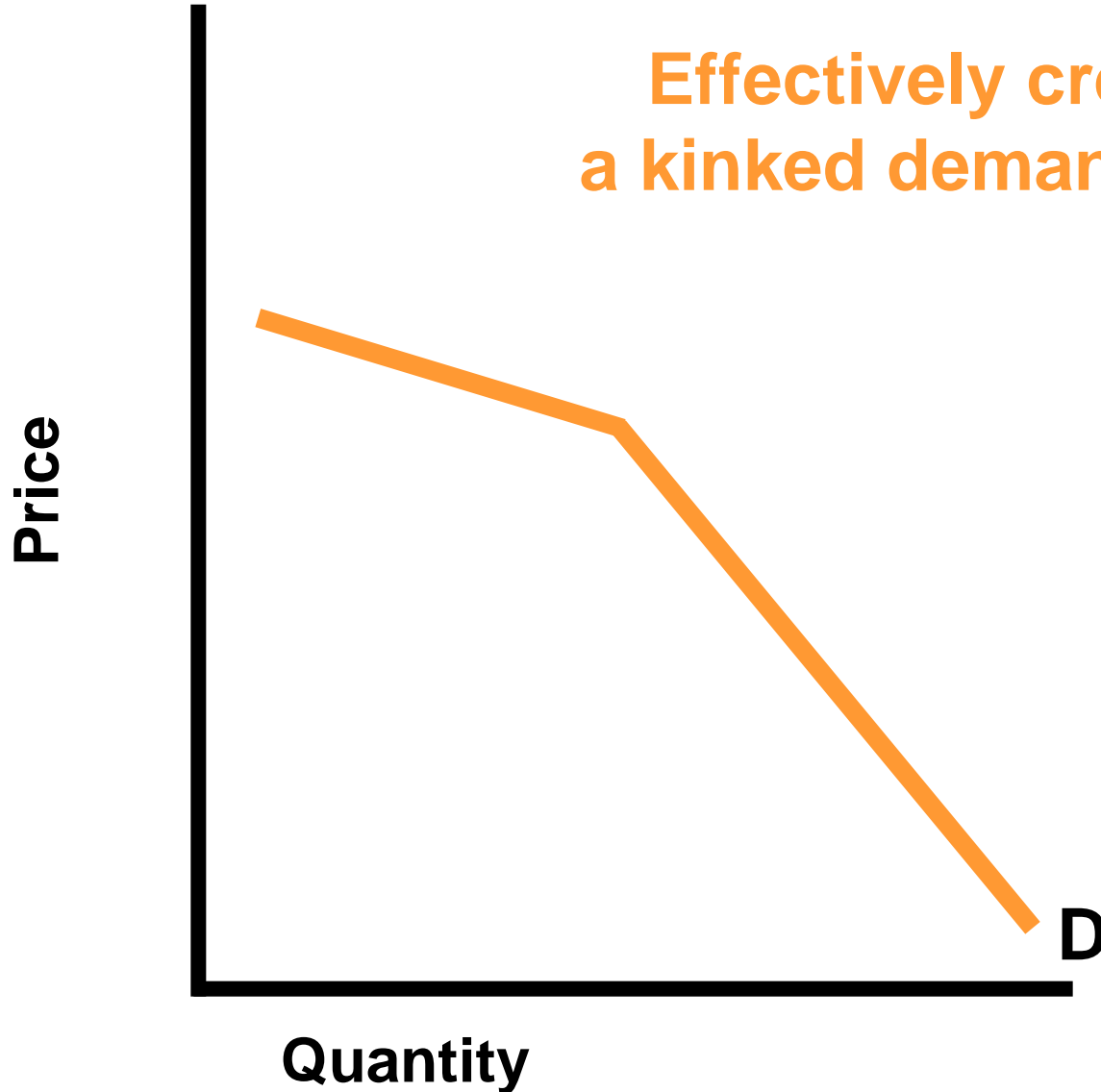
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**Effectively creating
a kinked demand curve**



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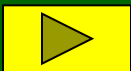
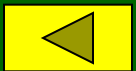
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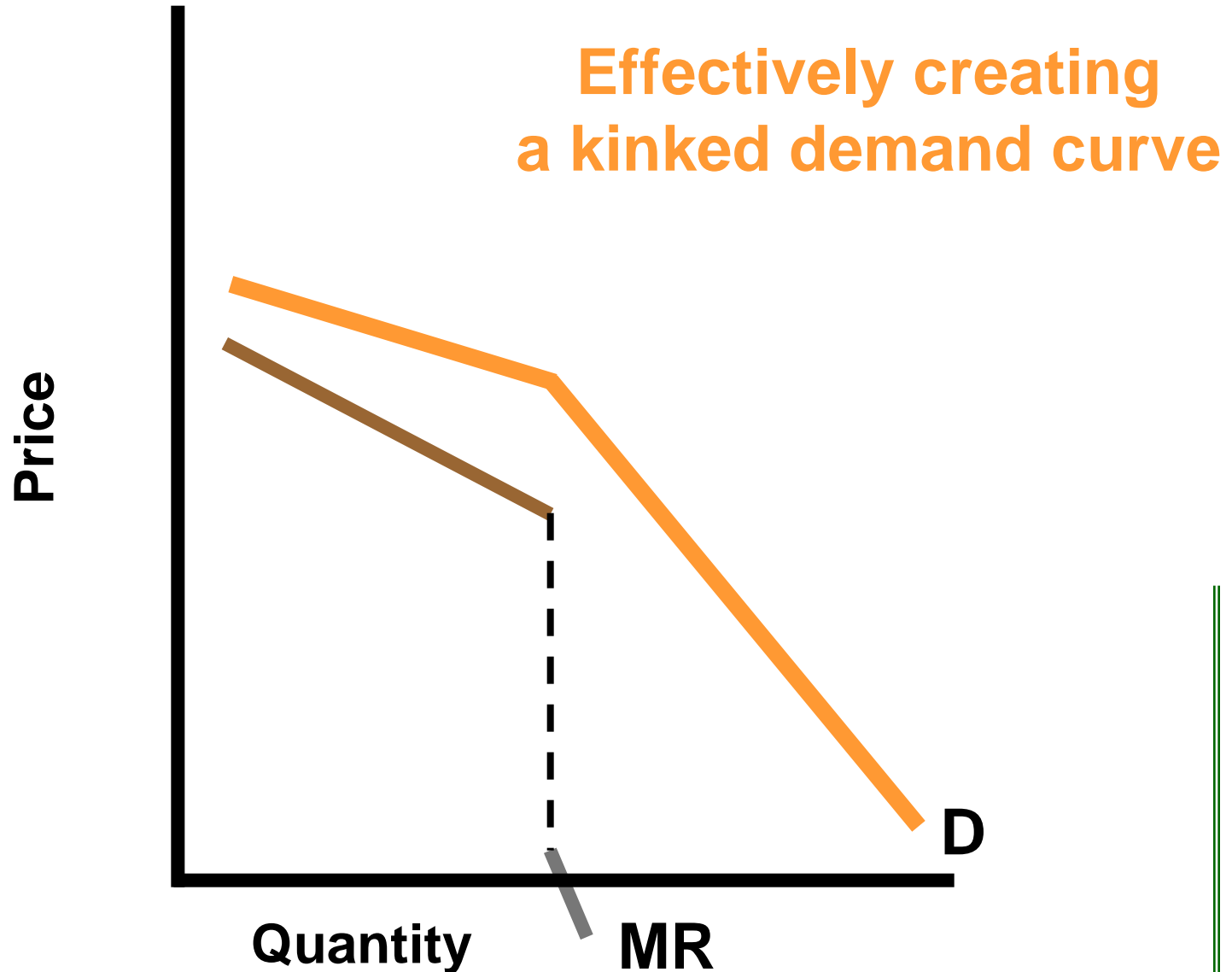
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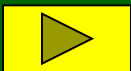
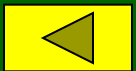
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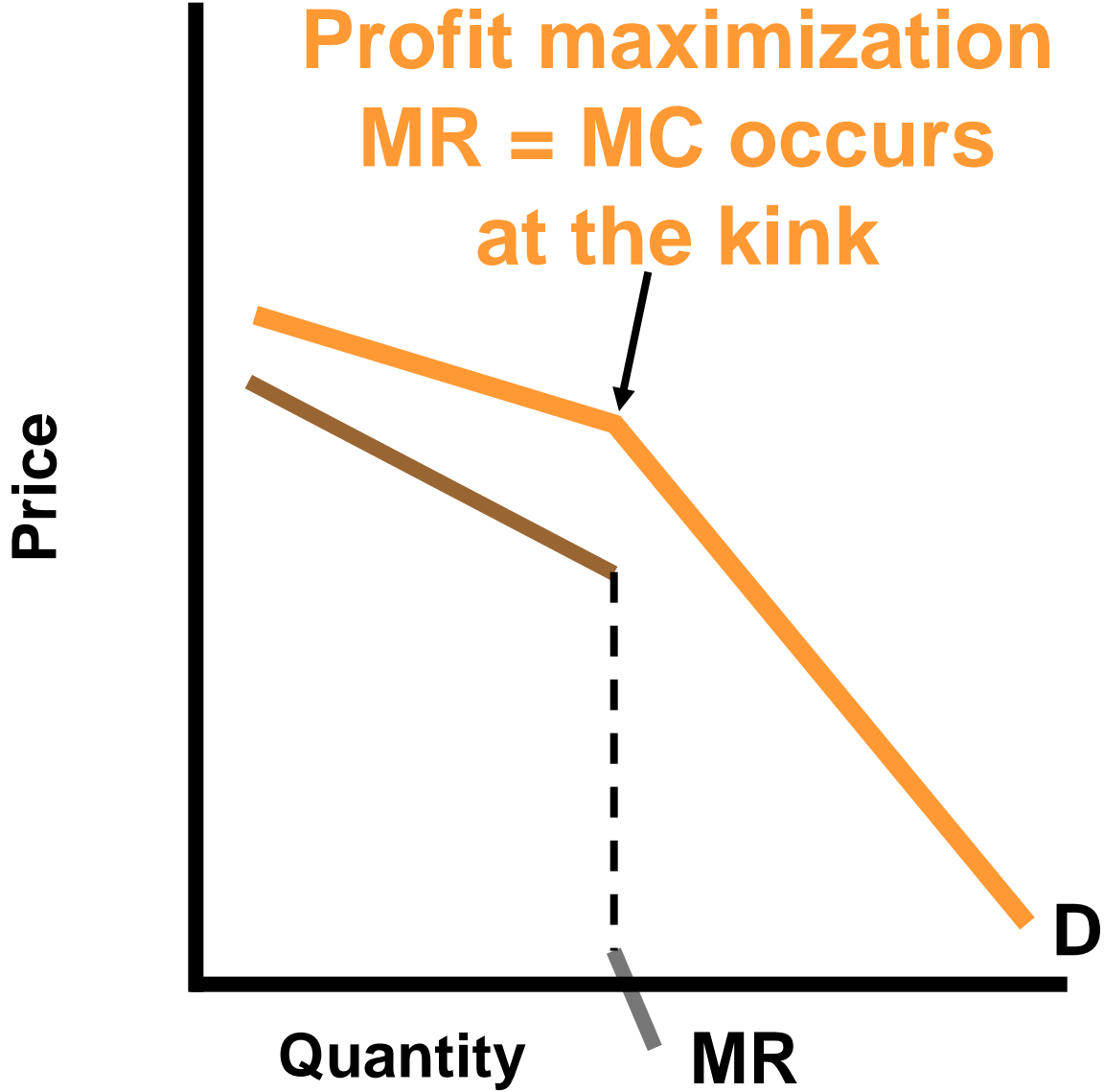
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KINKED DEMAND THEORY: *NONCOLLUSIVE OLIGOPOLY*

**Profit maximization
MR = MC occurs
at the kink**



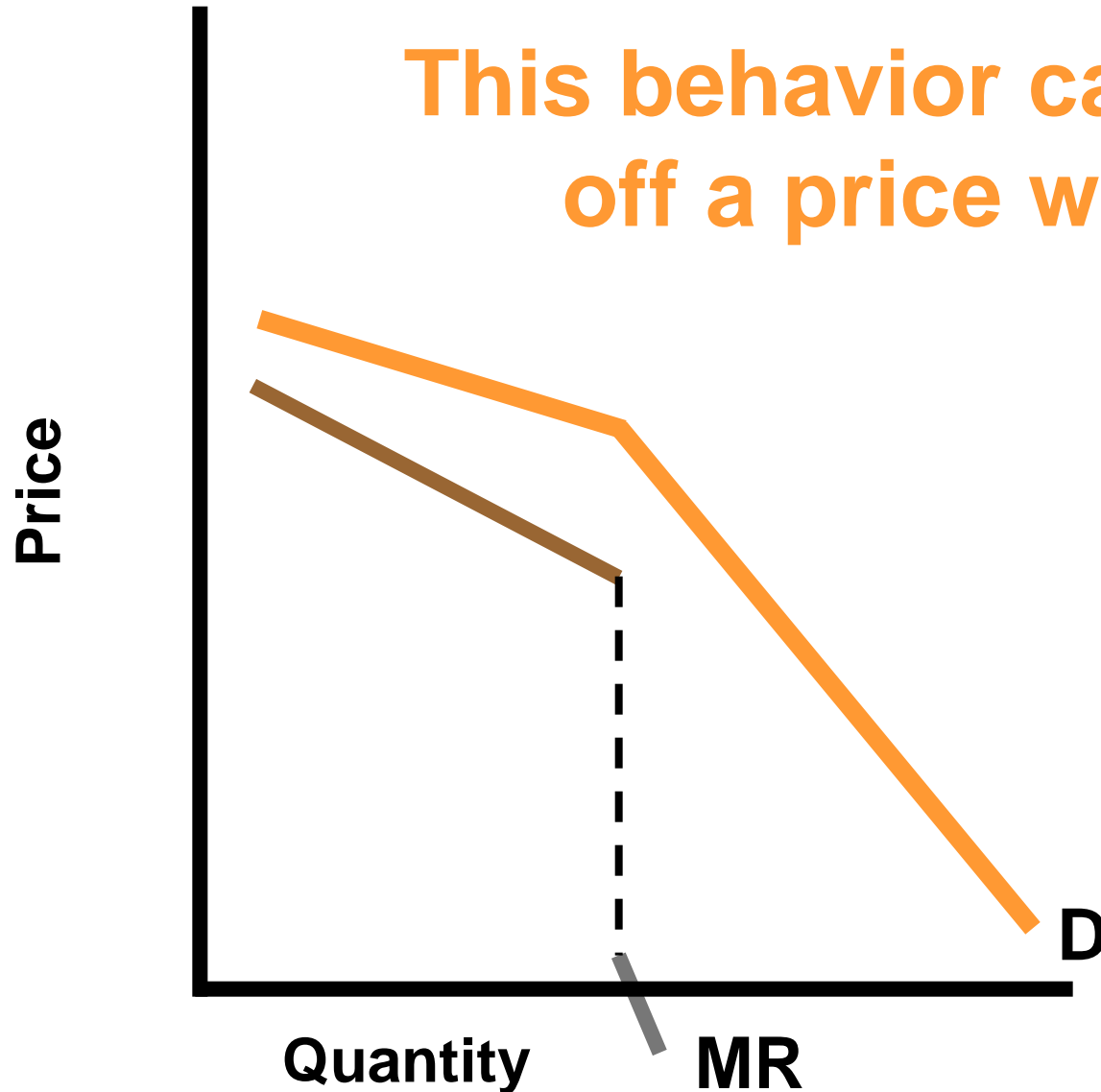
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This behavior can set off a price war



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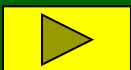
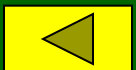
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CARTELS AND OTHER COLLUSION

Oligopoly is conducive to collusion

If a few firms face identical or highly similar demand and costs...

They will tend to seek joint profit maximization...

Graphically...

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Oligopoly

Oligopolies and Mergers

Three Oligopoly Models

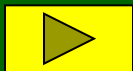
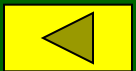
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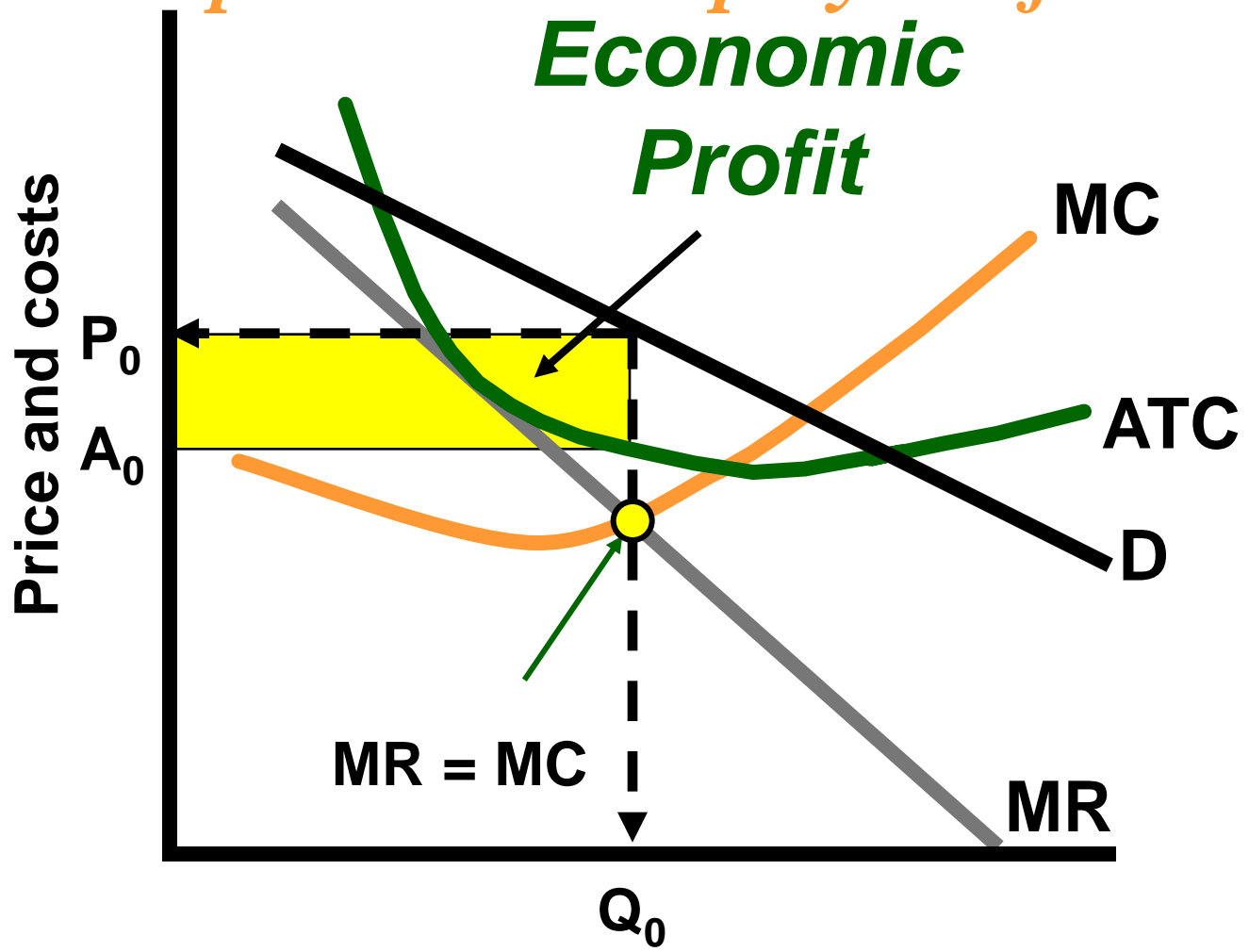
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CARTELS AND OTHER COLLUSION

Colluding Oligopolists Will Split the Monopoly Profits
Economic Profit



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Overt Collusion



- Cartel
- OPEC

Covert Collusion

- Recent Examples
- Tacit Understandings

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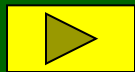
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Obstacles to Collusion

- Demand and Cost Differences
- Number of Firms
- Cheating
- Recession
- Potential Entry
- Antitrust Law

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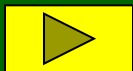
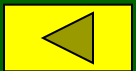
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PRICE LEADERSHIP MODEL

Leadership Tactics

- Infrequent Price Changes
- Communications
- Limit Pricing

Breakdowns in Price Leadership

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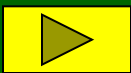
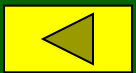
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OLIGOPOLY AND ADVERTISING

**Less Easily Duplicated
Adequate Resources
Positive Effects of
Advertising
Potential Negative
Effects of Advertising
Brand Development**

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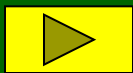
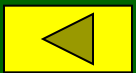
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OLIGOPOLY AND EFFICIENCY

• **Not Productively Efficient**

\neq Minimum ATC

• **Not Allocatively Efficient**

Price \neq MC

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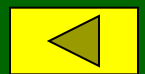
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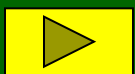
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