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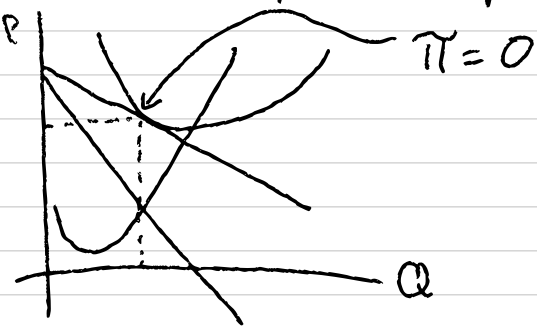
Lecture 16
Oligopoly + Review

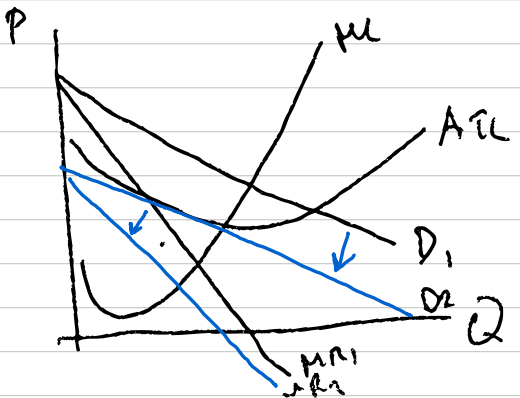
Monopolistic Competition, cont.
- Many firms
- No barriers
- Differentiated products ⇒ some market power

Oligopoly
- Few firms
- Barriers high
- Homogenous or heterogeneous products

Monopolistically Competitive firms produce where MR = MC



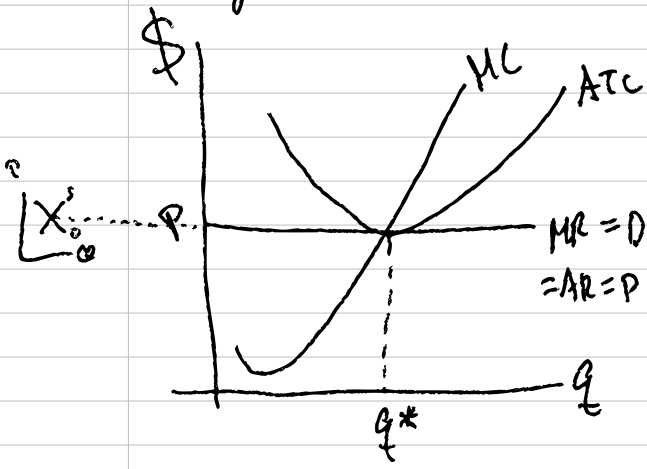
Long run in monopolistic competition



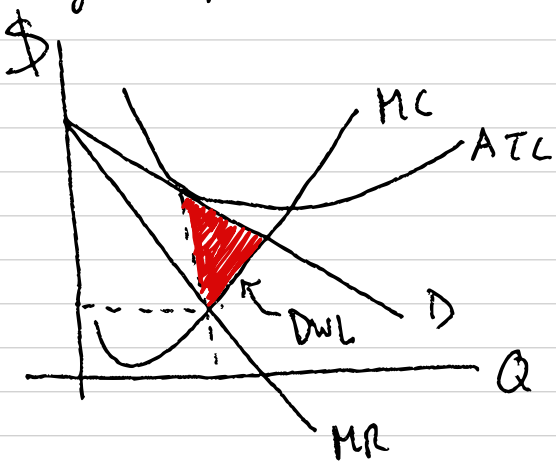
Long run adjustment
- π > 0
- Firms enter
- Competition drives D and MR down until ATC is tangent to D

Compare w/ Perf. Comp.

Long Run PC



Long Run MC



Oligopoly

- Duopoly Models
  - Bertrand - firms choose price simultaneously
  - Cournot - firms choose output simultaneously
  - Stackelberg - firms choose output sequentially

In oligopoly - no unconditional profit-maximizing strategy
  - firm's actions affect each other

Reaction function - chosen strategy
  - A firm assumes how much competitor will charge Q or P
  - sets Q or P accordingly

Nash Equilibrium - firms' reaction functions intersect
  - Both firms doing the best they can do

Bertrand Duopoly

- 2 firms, simultaneously choose price
- Compete in prices

Example: $MC_1 = MC_2 = 2$
identical products
→ What price do you charge in equilibrium?

$P = 2$ b/c of constant undercutting
↑ $P = MC \Rightarrow$ efficiency