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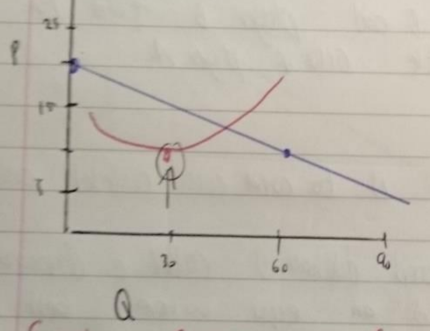
12/12/16 Economics Chapter 16 - Oligopoly

What is Oligopoly?

- lies between perfect competition and monopoly
- Might produce indentical product and compete on price or produce differentiated products and compete on price
- Market structure where - Natural/legal barrier to entry
  - Small number of firms compete

Barriers to entry



Natural duopoly → efficient scale for one firm is 30q so two firms satisfy with 30 each - same for 3 firms etc.

Small number of firms:

Interdependence - each firms actions influence the profit of all other firms

Temptation to cooperate - can increase their profits by forming a cartel and collude
- Cartels illegal

OLigopoly Games:

Game theory is a set of tools for studying strategic behaviour.

What is a game - Rules, strategies, payoffs outcome.

The prisoners Dilemma

Bank robbers
- Both confess   Both denny
- A confesse, B denies,   A denies, B confess

We construct a payoff matrix

A.

		Confess	Deny
B	Confess	3 / 3	10 / 1
	Deny	1 / 10	2 / 2

Outcome:

In a Nash equilibrium player A takes the best possible action given the action of player B and player B takes the best possible action given the action of player A.

Finding Nash equilibrium

- Each player's best action is to confess, each confesses and gets 3-years each
- Nash equilibrium for prisoners dilemma is called a dominant strategy equilibrium which is an equ where best strategy is to confess regardless of strategy of other player.

OLIGOPOLY Price-Fixing Game

- Cost and demand conditions
- Collusion - an agreement to form a cartel to raise price and increase profits - can comply or cheat.
  Collusion achieve monopoly profits

Repeated games:

Strategy combined tit for tat or trigger approach