

C3A(10)
Eco-10

Top 8 Characteristics of a Oligopoly Market

Oligopoly is a market situation in which there are only a few sellers of a commodity. Under this, each seller can influence its price-output policy.

It is because the number of sellers is not very large and each seller controls a big portion of total supply.

Price-output policy of a firm does affect the rivals. The price which is fixed under oligopoly without product differentiation is indeterminate. In case of differentiated products, monopoly agreements are even less possible.

Characteristics:

1. Monopoly Power:

There is a clement of monopoly power in oligopoly. Since there are only a few firms and each firm has a large share of the market. In its share of the market, it controls the price and output. Thus an oligopoly has some monopoly power.

2. Interdependence of Firms:

Under perfect competition there are so many small firms and no single firm is strong enough to influence price or output. So the firms do not care about the actions and reactions of other firms. Under monopoly, the question of interdependence of firms does not arise because there is one single firm in the market.

Under oligopoly, there are only a few firms, each producing a homogeneous or slightly differentiated product. Since the number of firms is small, each firm enjoys a large share of the market and has a significant influence on the price and output decisions. Thus, there is interdependence of firms. No firm can ignore the actions and reactions of rival firms under oligopoly.

3. Conflicting Attitude of Firms:

Under oligopoly, two types of conflicting attitudes are found in the firms. On the one hand, firms realize the disadvantages of mutual competition and desire to combine to maximize their joint profits. This tendency leads to the formation of collusion. On the other hand, the desire to maximize one's individual profit may lead to conflict and antagonism, the firms come into clash with one another on the question of distribution of profits and allocation of markets. Thus, there is an existence of two opposing attitudes among the firms.

4. Few firms. In this market, only few sellers are found:

For example, the market for automobiles in India exhibits oligopolistic structure as there are only few producers of automobiles. If there are only two firms, it is called 'duopoly'.

5. Nature of product:

If the firm's product is homogeneous product, it becomes pure oligopoly. The firms with product differentiation constitute impure oligopoly.

6. Interdependence among firms:

In oligopoly market, each firm treats the other as its rival firm. It is for this reason that each firm while determining price of its product, takes into account the reaction of the other firms to its own action.

7. Large number of consumers:

In this market, there are large numbers of consumers to demand the product.

8. Indeterminate demand:

The demand curve under oligopoly is indeterminate because any step taken by his rivals may change the demand curve.

Cartels Types: Joint profit Maximisation and Market-Sharing Cartel!

Cartels Types: Joint profit Maximisation and Market-Sharing Cartel!

A cartel is an association of independent firms within the same industry.

The cartel follows common policies relating to prices, outputs, sales and profit maximization and distribution of products.

Cartels may be voluntary or compulsory and open or secret depending upon the policy of the government with regard to their formation. They are of many forms and use many devices in order to follow varied common policies depending upon the type of the cartel.

Here, we discuss two most common types of cartels:

- (1) Joint profit maximisation or perfect cartel; and
- (2) Market-sharing cartel.

1. Joint Profit Maximisation Cartel under Perfect Collusion:

The uncertainty is found in an oligopolistic market which provides an incentive to rival firms to form a perfect cartel. Perfect cartel is an extreme form of perfect collusion. Under it, firms producing a homogeneous product form a centralized cartel board in the industry.

The individual firms surrender their price-output decisions to this central board. The board determines for its members the output, quotes the price to be charged and the distribution of industry profits. The central board acts like a single monopoly whose main aim is to maximize the joint profits of the oligopolistic industry.

Assumptions:

The analysis of joint profit maximisation cartel is based on the following assumptions:

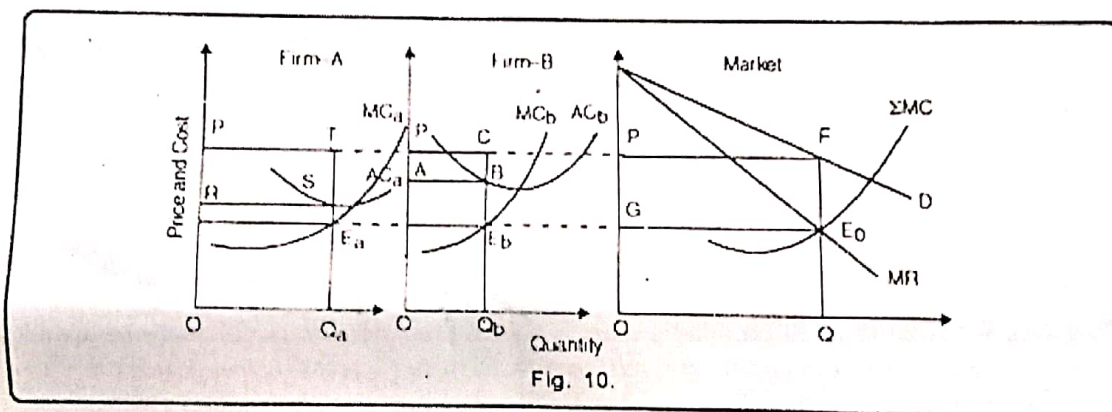
1. Only two firms A and B are assumed in the oligopolistic industry that form the cartel.
2. Each firm produces and sells a homogeneous product that is a perfect substitute for each other.
3. The market demand curve for the product is given and is known to the cartel.
4. The number of buyers is large.
5. The price of the product determines the policy of the cartel.
6. The cost curves of the firm's are different but are known to the cartel.

7. The cartel aims at joint profit maximisation.

Joint Profit Maximisation Solution:

Given these assumptions, and given the market demand curve and its corresponding MR curve, joint profits will be maximized when the industry MR equals the industry's MC. Figure 10 shows the situation where D is the market (or cartel) demand curve and MR is its corresponding marginal revenue curve. The aggregate marginal cost curve of the industry ΣMC is drawn by the lateral summation of the MC curves of firms A and B, so the $\Sigma MC = MC_a + MC_b$.

The cartel solution-that maximizes joint profit is determined at point Σ where the ΣMC curve intersects the industry MR curve. Consequently, the total output is OQ which will be sold at $OP = (QF)$ price. As under monopoly, the cartel board will allocate the industry output by equating the industry MR to the marginal cost of each firm. The share of each firm in the industry output is obtained by drawing a straight line from E_0 to the vertical axis which passes through the curves MC_b and MC_a of firms B and A at points E_b and E_a respectively.



Thus the share of firm A is OQ_a and that of firm B is OQ_b which equal the total output $OQ (= OQ_b + OQ_a)$. The price OP and the output OQ distributed between A and B firms in the ratio of $OQ_a : OQ_b$ is the monopoly solution.

Firm A with the lower costs sells a larger output OQ_b than the firm B with higher costs so that $OQ_a > OQ_b$. But this does not mean that A will be getting more profit than B. The joint maximum profit is the sum of $RSTP$ and $ABCP$ earned by A and B respectively. It will be pooled into a fund and distributed by the cartel board according to the agreement arrived at by the two firms at the time of the formation of the cartel.

Advantages:

Perfect collusion by oligopolistic firms in the form of a cartel has many advantages. It avoids price wars among rivals. The firms forming a cartel gain at the expense of customers who are charged a high price for the product. The cartel operates like a monopoly organization which maximizes the joint profit of firms. Generally, joint profits are high than the total profits earned by them if they were to work independently.

Problems of a Cartel:

The problems of cartels are stated below:

1. It is difficult to make an accurate estimate of the market demand curve.
2. The estimation of the market MC curve may be inaccurate because of the supply of wrong data about their MC by individual firms to the cartel.
3. The formation of a cartel is a slow process which takes a long time for the agreement to arrive at by firms especially if their number is very large.
4. The larger the number of firms in a cartel, the less is its chances of survival for long because of the distrust. The cartel will, therefore, break down.
5. In theory, the cartel-members agree on joint profit maximisation. But in practice, the seldom agree on profit distribution.
6. The price of the product fixed by the cartel cannot be changed even if the market conditions require it to be changed. This is because it takes a long time for the members to arrive at an agreed price.
7. Prices tackiness gives rise to 'chislers' who scarcely cut the price or violate the quota agreement.
8. Unless all member firms in the cartel are strongly committed to cooperation, outside disturbances, such as a sharp fall in demand, may lead to the breakdown of the cartel.
9. Some high-cost uneconomic firms may refuse to shut down or leave the cartel despite the cartel board's request.

Aggregate Demand Curve and Aggregate Supply

Aggregate Demand Curve:

The aggregate demand curve is the first basic tool for illustrating macro-economic equilibrium. It is a locus of points showing alternative combinations of the general price level and national income. It shows the equilibrium level of expenditure changes with changes in the price level.

Fig. 37.2 shows how the AD curve is derived by shifting the AE curves. In Fig. 37.2(a) we show three AE curves corresponding to three different price levels. In fact, each AE curve corresponds to a particular price level.

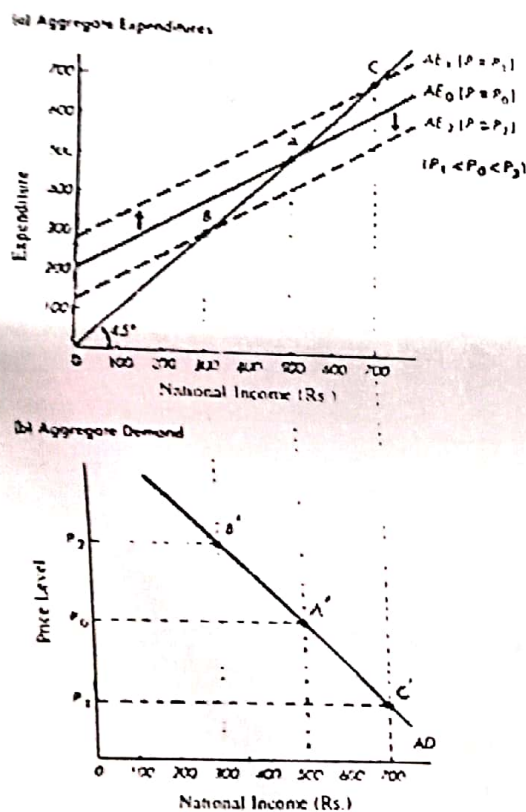


Fig 37.2 Deriving Aggregate Demand Curve from Aggregate Expenditure Curves

Here the initial equilibrium occurs at point A at which the 45° guideline intersects the AE_0 line (with price P_0). In this case equilibrium income and expenditures are Rs. 500 crores. If the general price level falls to P_0 , the AE line shifts upward to AE_1 (for reasons explained above).

Now a new equilibrium is established at point C, at which national income equals Rs. 700 crores. If, on the other hand, the general price level rises from P_0 to P_2 , the AE line shifts downward to AE_2 . Now a equilibrium is established at point B, with national income equal to Rs. 300 crores.

In the lower part of the diagram, i.e., in Fig. 37.2 (b) we plot the price level on the vertical axis and national income (in Rs. crores) on the horizontal axis. If we move vertically from points A, B and C in the top half of the diagram, we are able to locate three corresponding points in the lower half of the diagram (A^* , B^* and C^*).

The locus of these three points is the aggregate demand curve AD. The AD curve is a locus of all of the combinations of the price levels and corresponding equilibrium levels of income and aggregate expenditure.

The AD curve, like the ordinary demand curve of micro-economics is downward sloping for an obvious reason. When the price level decreases aggregate expenditures rise. The converse is also true. In other words, there is an inverse relation between the general price level and the level of aggregate expenditure.

In micro-economics we noted that the demand curve of a normal goods (say X) is downward sloping largely due to substitution effect (and partly due to income effect). If the price of X falls, X becomes relatively cheap.

As a result consumers will buy more X and less of other goods (even when the prices of other goods remain constant). In other words, the demand curve of X is downward sloping due to a change in relative price. As the price of X falls, the quantity of X demanded falls too, all other prices of X the price of Y, price of Z, etc.) remaining unchanged.

However, while deriving the AD curve we show the general price level, i.e., the price level for the entire economy on the vertical axis. Here the question of changes in relative price does not arise. Instead a price level change here implies that, on average, all prices in the economy move up or down.

Since there is no change in relative price, the possibility of substitution among domestic goods is not considered here. In fact, the negative slope of the AD curve is the combined result of three effects, viz., the wealth effect, the interest rate effect, and the international trade effect (see Fig. 37.3).

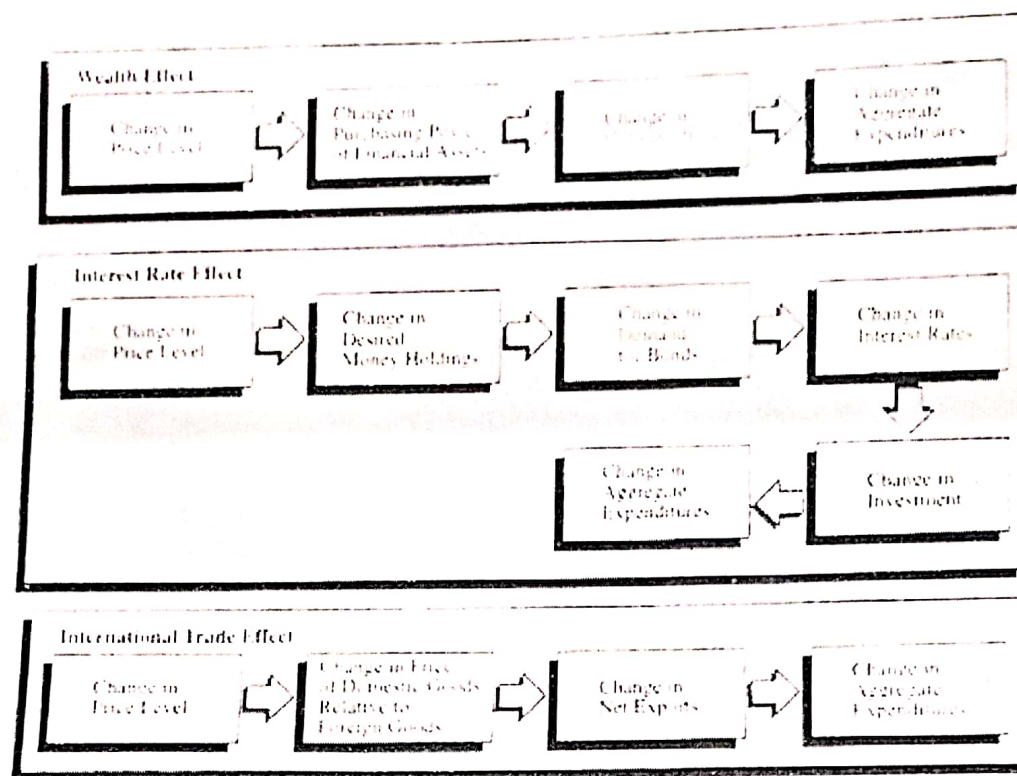


Fig 37.3 Explaining the Downward Slope of the AD curve

Shifts in Aggregate Demand:

The AD curve shows equilibrium values of aggregate expenditure at different price levels. While deriving this curve from the aggregate expenditure lines we hold all other variables, viz., the non-price determinants of AD such as expectations, foreign income, price levels, and government policy, constant.

Should there be a change in any of these variables, the AD curve will shift to a new position. We may now consider possible shifts of the AD curve due to changes in these 'other things'.

Foreign Income and Price Levels:

The exports are autonomous (i.e., independent of national income). But if foreign income increases, exports will rise. We may now analyse the effect of changes in the level of foreign prices, i.e., the impact of prices in the rest of the world on the net exports of the domestic economy.

When foreign income increases foreigners spend more. And a portion of this increased spending is on domestic goods. If, for example, USA's national income rises, a portion of the increased income will be spent on Indian goods (if, however, India is having a trading relation with the USA).