Ch 9 (Cartel) Review Questions: 4, 7, 8, 9, 10

Problem 4

For each pair of industries, which would you expect collusion to be easier to maintain?
A) Steel vs automobile
B) Cement vs wheat
C) Fast food vs airline service to one city

Collusion is less likely to occur when:
1) Cartels are illegal & penalties are steep
2) Many firms in the market
3) Differentiated costs & products
4) Demand & cost conditions unstable
5) Entry barriers low

Answer:
A) I would expect steel to be easier to maintain as steel is a more homogenous product
B) I would expect cement to be easier to maintain as there are far more wheat suppliers
C) I would expect airline service to be easier of the homogenous "product"

Problem 7

Office Depot, Office Max, and Staples compete in the office supply market by offering low-price guarantees (i.e., a meet-the-competition clause).
Are such guarantees beneficial or harmful to consumers? Explain.

Answer:
These are harmful to consumers as they prevent firms from differentiating through prices, and reduce customers willingness to shop around at different locations.

Problem 8

Assume that a market consists of three firms (1, 2, and 3) which form a cartel.
Firm 3 is a rogue firm that frequently undercuts the price of its competitors.
Could such behavior lead to even lower prices than would be found in competitive markets? Explain.

Answer:
Yes. In firm 3's attempt to gain control of the market, they could reduce their prices below their marginal costs. If firm 1 and 2 decide to punish firm 3, they could drop their prices in the short term until firm 3 is forced out of the market.

Problem 9

Suppose you were looking for an industry in which to form a cartel.
Given the empirical evidence, what would be the ideal set of conditions that would maximize the likelihood of cartel success?

Answer:

Collusion is MORE likely to occur when:
1) Penalties for antitrust aren't too steep
2) Few firms in the market
3) Homogenous costs & products

4) Demand & cost conditions stable
5) Entry barriers high

Problem 10

Provide a behavioral reason why it could be more difficult to establish and maintain an effective cartel among firms in different nations, such as the OPEC cartel, than among firms within a single nation, such as the steel cartel in the USA during the early twentieth century.

Answer:
Political tension. For example, oil importing countries were not happy with Egypt and Syria's invasion of Israel. This led to an "exporter vs importer" tensions. Countries who supported Israel (eg USA) faced much higher prices than they had before.