Oligopoly

BETWEEN MONOPOLY AND PERFECT COMPETITION
• Imperfect competition refers to those market structures that fall between perfect competition and pure monopoly.
• Imperfect competition includes industries in which firms have competitors but do not face so much competition that they are price takers.
• Types of Imperfectly Competitive Markets
  • Oligopoly
    • Only a few sellers, each offering a similar or identical product to the others.
  • Monopolistic Competition
  • Many firms selling products that are similar but not identical.

MARKETS WITH ONLY A FEW SELLERS
• Because of the few sellers, the key feature of oligopoly is the tension between cooperation and self-interest.
• Characteristics of an Oligopoly Market
  • Few sellers offering similar or identical products
  • Interdependent firms
  • Best off cooperating and acting like a monopolist by producing a small quantity of output and charging a price above marginal cost
  • A duopoly is an oligopoly with only two members. It is the simplest type of oligopoly.
  • The duopolists may agree on a monopoly outcome.
• Collusion
  • An agreement among firms in a market about quantities to produce or prices to charge.
• Cartel
  • A group of firms acting in unison.
• Although oligopolists would like to form cartels and earn monopoly profits, often that is not possible. Antitrust laws prohibit explicit agreements among oligopolists as a matter of public policy.
• A Nash equilibrium is a situation in which economic actors interacting with one another each choose their best strategy given the strategies that all the others have chosen.
• When firms in an oligopoly individually choose production to maximize profit, they produce quantity of output greater than the level produced by monopoly and less than the level produced by competition.
• The oligopoly price is less than the monopoly price but greater than the competitive price (which equals marginal cost).
• Summary
  • Possible outcome if oligopoly firms pursue their own self-interests:
    • Joint output is greater than the monopoly quantity but less than the competitive industry quantity.
    • Market prices are lower than monopoly price but greater than competitive price.
  • Total profits are less than the monopoly profit.
GAME THEORY AND THE ECONOMICS OF COOPERATION

- *Game theory* is the study of how people behave in strategic situations.
- Strategic decisions are those in which each person, in deciding what actions to take, must consider how others might respond to that action.
- Because the number of firms in an oligopolistic market is small, each firm must act strategically.
- Each firm knows that its profit depends not only on how much it produces but also on how much the other firms produce.
- The *dominant strategy* is the best strategy for a player to follow regardless of the strategies chosen by the other players.
- Firms that care about future profits will cooperate in repeated games rather than cheating in a single game to achieve a one-time gain.
- Cooperation among oligopolists is undesirable from the standpoint of society as a whole because it leads to *production that is too low* and *prices that are too high*.

**Summary**

- Oligopolists maximize their total profits by forming a cartel and acting like a monopolist.
- If oligopolists make decisions about production levels individually, the result is a greater quantity and a lower price than under the monopoly outcome.
- Policymakers use the antitrust laws to prevent oligopolies from engaging in behavior that reduces competition.

**Reference**