Oligopoly 4

Midterm 2

• Answer key will be posted today
• Graded exams not yet ready; I hope for Thursday
  – Question 3(c) seemed problematic
  – Two equations:
    • profit maximization
    • zero profits
What the data say

• More competitors, lower concentration mostly seems to lower markups
• But lots of “noise”
• Much of the correlation comes at highest levels of concentration
  – Three major rivals often “almost enough”? Four?
• Much due to high profitability of leading firm
  – Intra-industry correlation between share and profitability

Look at Price not Profit?

• Look for markets where can compare price, concentration
  – Local markets: retailing, banking, hospitals…
  – Changes over time
  – Airlines
• Again, higher concentration raises prices, but often less so than Cournot model would suggest
“Modern Methods” in SCP

• Read CP chapter 8 on this
• Why I’m skeptical
  – Relies heavily on strong assumptions about consumer and firm optimization
    • Recall our calculations about profit function
  – Ignores dynamics
    • So does a lot of oligopoly theory, but might hope the econometrics wouldn’t
• Remember CP using “performance” to mean low profits

Bresnahan-Reiss

• CP page 78
• Entry against a monopoly or duopoly lowers price very noticeably
• Entry into oligopoly with 3+ firms doesn’t do nearly so much
  – “Workable competition” with 3+ firms?
  – Statistical significance
  – “Very big” markets
• Is subsequent entry wasteful?
Endogenous Sunk Costs

• What if F rises with market size?
• Especially likely if fierce competition
  – Fierce competition can encourage high concentration—contrast reverse causation
• Innovation, product quality, network effects
• Big markets more competitive or higher quality or both?
  – Contrast traditional economics of “trade”

Welfare Economics of Entry

• Externality (usually good) on consumers
• Externality (usually bad) on incumbents
• Balance?
  – Price effect; other consumer benefits
  – “Business-stealing” effect
  – Monopolistic competition
    • Is muted price effect due to real variety?
• Policy on entry
What’s Next

• Enough (for now) on simple imperfect competition
• CP part 3
  – Business practices: Strategies and Conduct
  – Read Chapter 9: price discrimination
  – CP stress monopoly case: why?