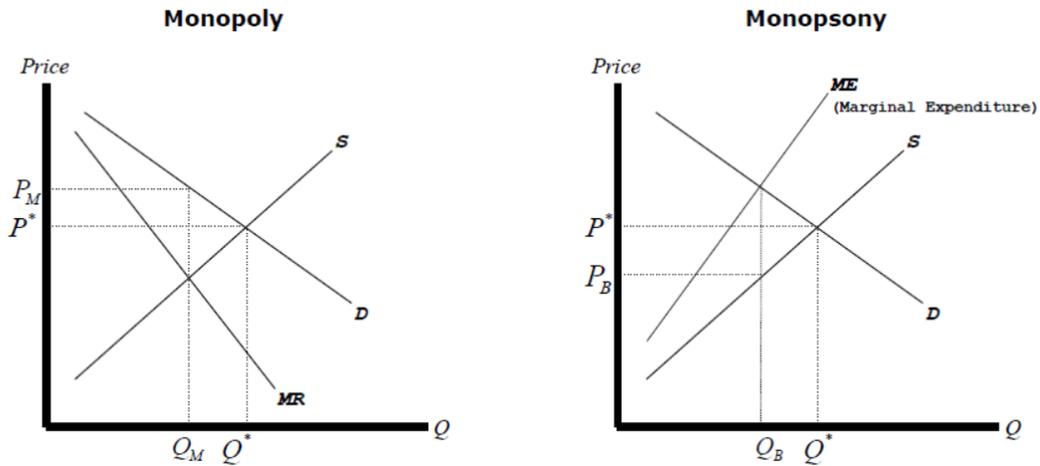


3.2: Imperfectly Competitive Markets

To prepare for this lecture, read Hirschey, chapters 12, 457 – 479; and 13, 501 – 524.

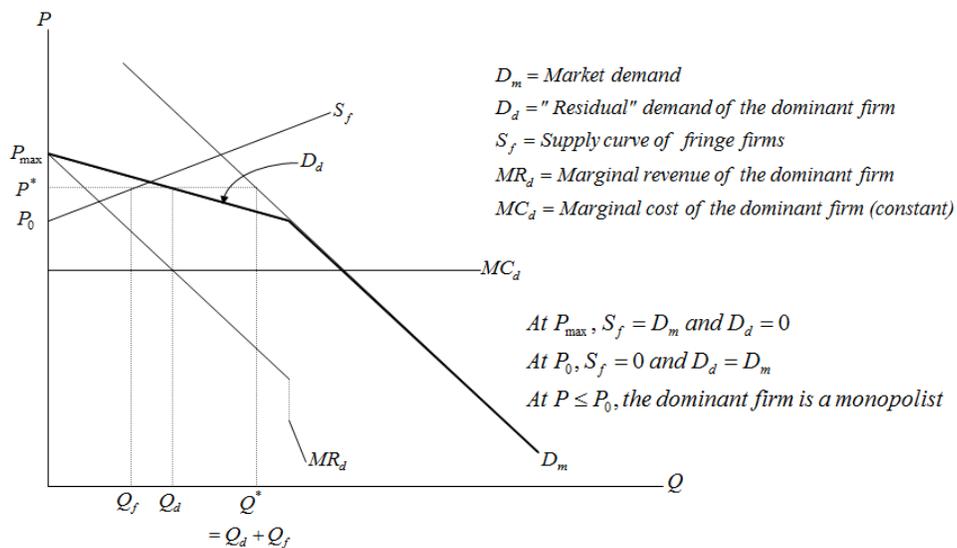
Monopoly and Monopsony

Monopoly power refers to the existence of seller power in a market. **Monopsony power** refers to the existence of buyer power in a market. **Bilateral monopoly** refers to a situation in which a seller with monopoly power is pitted against a buyer with monopsony power, in which case the price and output outcomes are indeterminate. A situation of bilateral monopoly is always subject to a bargaining outcome.



Dominant Firms

In a dominant firm market, a large firm coexists with a **competitive fringe**. Dominant firms sometimes take on the role of price leaders, with the seeming acquiescence of the fringe firms.



Oligopoly

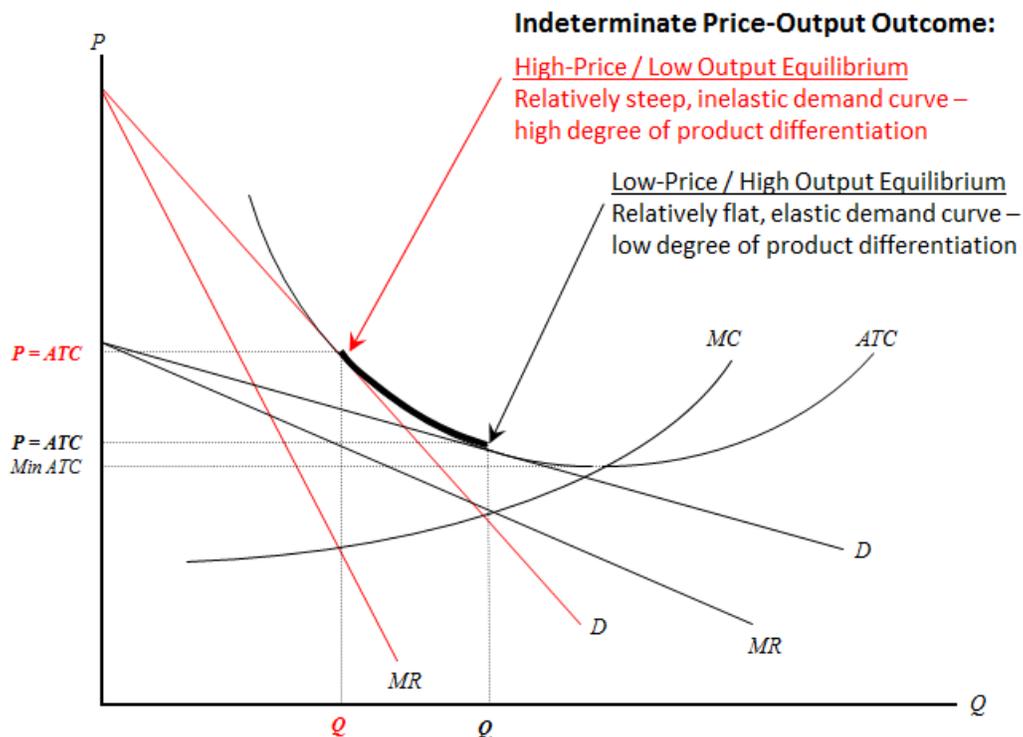
Markets in which a small number of large firms dominate the market landscape are called oligopoly markets. The hallmark of oligopoly markets is **strategic interaction** among the firms. This means that firms can be expected to take into consideration the reactions of rival firms when they are implementing business policy. While competition can be very intense among oligopoly firms, the possibility of collusion also exists, so oligopoly markets are a key concern of antitrust policy makers.

Economists have traditionally modeled oligopolistic competition in one of two ways:

1. Deterministic models that make use of reaction functions to specify how one firm will respond to another firm's output decisions. **Cournot**, **Stackelberg**, and **Bertrand** outcomes are examples of deterministic models of oligopoly.
2. Game theory, which is the subject of lectures 3.4 and 3.5.

Monopolistic Competition

Monopolistic competition exists when firms have moderate influence over product prices because each firm in a market is able to establish some degree of **product differentiation**. It seems to be a realistic description of competition in a wide variety of markets. Unlike perfect competition or monopoly, the exact nature of the equilibrium is indeterminate, and depends on the degree to which firms attempt to establish differentiation. From an economic perspective, there is a clear tradeoff between this level of differentiation and productive efficiency. In monopolistically competitive markets, there is a low degree of strategic interaction among the competing firms.



Relevant Textbook Problems: 12.5, 12.6, 12.8, 12.9, 12.10, 13.4, 13.6, 13.7, 13.8