Criticisms of kinked demand curve: model doesn't indicate how price is originally arrived at, and price changes do occur in a competitive oligopoly.

Oligopolies compete using price strategies:

- **Predatory pricing**: Selling such a low price that competitor cannot meet, forcing them out of the market.
- **Cost-plus pricing:** Firm achieves desired profit level every time.
- **Price leadership:** Firm that is leader of product market determines price.

A Collusive Oligopoly is one where oligopolies formally or informally agree to match price (and sometimes output) to limit competition between themselves and make more abnormal profits in the long-run.

- Joint product development, reduced market uncertainty: raised consumer welfare.
- Reduces consumer choice, higher prices, loss of economic welfare.

3 types of collusion:

- **Overt** = Open and public agreement to collude.
- **Covert** = Firms try to hide agreement to fix prices from regulators.
- **Tacit** = Firms act together, but there is no formal / informal agreement. Difficult or almost impossible to prove.

Oligopolistic firms realise that price war is self-defeating for all firms - firms may agree to indulge in non-price competition: Marketing, Product Differentiation & Design, and competing on quality.

Monopoly

A monopoly is A single firm produces the whole of the output for a market. The monopoly restricts output and raises prices, generating abnormal profits.

- Monopoly power = The ability to set prices within a market of barriers to entry. (If you have 40% or more)

Monopoly

There are very high barriers to entry in monopolies - that's how the monopolies abnormal profits are protected.

- Monopolies aim to profit maximise.

Growth of Firms

- Market Share = Percentage of the total market held by firm.
- Growth = The process of increasing in size by generating more revenue by increased sales.

Firms want to grow because:
- Profit motive
- Market power motive
- Risk motive

Two types of growth: **internal (organic) and external growth.**
- **Internal Growth:** When a business expands existing operations. Profits are used to finance expansion. Innovation and creativity is central to organic growth.
  - Extending firm's geographic reach
  - Expanding into new products to increase size of available market.
  - Safer than external growth, maintains existing management style.
  - Slow process, potential for diseconomies of scale.
- **External Growth:** Occurs when firms join together, either through mergers or takeovers.
  - Types of merger:
    - **Horizontal:** Firms merge at same stage of production, e.g. 2 car producers.
    - **Vertical:** Firms merge at different stages of production, either vertically forward or backward. Backwards is firm combining with firm in previous process, and forward is firm combining with firm in next process.
    - **Conglomerate:** Firms merge with no obvious connection in order to diversify, e.g. car producer and a travel agency.

Advantages of External Growth	Disadvantages of External Growth
❖ Increases capital (exploitation of technical economies of scale). ❖ Quick and fast. ❖ Cheaper to buy firm rather than continuously invest in long-term.	❖ Lack of competition, could result in a private monopoly. ❖ Could result in monopsony power of labour, potentially results in lower wages and lower employment.

<u>Minimum Wage</u>

National Minimum Wage: Minimum wage rate that must, by law, be paid to employees.

National minimum wage is a solution to poverty and inequality.

- The idea is that the poorest people are paid more, reducing the gap between the rich and the poor, and reducing relative poverty.
- A national minimum wage also means higher productivity, and higher government revenue through income tax.

National Minimum Wage

- However, the introduction of a minimum wage could mean firms have less funds to use to innovate, cost-push inflation as firms costs of production rise and increasing unemployment could occur due to firms reducing the number of workers they employ because of having to pay them higher wages.

Competition Policy

Competition Policy is government policies to prevent and reduce the abuse of monopoly power, they are intended to make goods markets more competitive.

CMA (Competition and Markets Authority) took over from OFT (Office of Fair Trading) and Competition Commission to investigate collusive behaviour, abuse of market power and mergers:

- Collusive Behaviour = when firms agree to fix prices / output. Enables exploitation with higher profits at expense of consumers. Illegal behaviour.
- Abuse of Market Power = If a firm has more than 40% market share, it has market power. Abuse may include predatory pricing, charge too high prices or vertical restraints (pay too low to suppliers).
- Some mergers may not be in the public interest and are investigated.

The CMA measures 3 things: Structure (Concentration Ratios), Conduct & Performance Indicators. They use these things to monitor anti-competitive business behaviour. The 2002 Enterprise Act tests whether any features of the market prevent, restrict or distort competition.

Responses by the CMA:

- **Monopoly Busting -** Break up monopolies. For economic efficiency and consumer sovereignty the market needs to be as close to perfect competition as possible.

Main incentive of deregulation ties in with the contestable market theory. No rules promotes the element of contestability and competitiveness within markets. Deregulation may be a method of regulatory capture, and agencies may act in the firm's best interest rather than the public interest.

Regulation

<u>Equity & Poverty</u>

Equity = Fairness, fair distribution of goods and services, concerned with quality.
Equality = Goods and services are distributed the same, equally, concerned with quantity.
The degree to what is equitable is a normative issue.

Lorenz Curve

There are 2 types of equity:

- **Horizontal Equity** = Fair treatment of people whose circumstances are the same.
- **Vertical Equity** = Fair treatment of people whose circumstances differ.

2 ways of measuring equality: Lorenz Curve & Gini Coefficient:

- **Lorenz Curve** shows the % of income earned by the % of the population. A perfect distribution is the 45 degree line, further away the Lorenz is, the less equal the distribution is.
- **Gini Coefficient** = Measures area between the Lorenz Curve and the line of perfect equality as a ratio of total area under the line.

Best solutions are <u>subsidies</u> and <u>regulation</u>.

- Regulation can make the generation of positive externalities compulsory. It's illegal to not provide benefits for others.
- Subsidies are money paid by the government to firms undertaking certain activities, usually to make the good cheaper so consumption increases. There are producer subsidies given to firms to shift supply upward, and consumer subsidies given to consumers for spending on a particular good.
- **Public Goods**

Best solutions are <u>government provision</u> and <u>privatisation (contractualisation)</u>.

- Government provision provides the goods at zero price. The government provides the goods at zero price and then funds the provision of the goods through taxation. This allows the allocatively efficient level of consumption of the public good. Also, if government provides all public goods, they can benefit from economies of scale.
- Privatisation = Contractualisation can solve the issue of public goods. Contractualisation involves putting services out to private tender, e.g. road cleaning and waste disposal. Ultimately, the taxpayer pays for the service. Also, marketisation can be used. This is where markets are created but the sector remains publicly owned, e.g. education.

- **Income Inequality & Poverty**

Best solutions are <u>progressive taxation</u>, <u>transfers to the poor</u>, <u>minimum wage</u> and <u>training and education schemes</u>.

- Progressive taxation = When the proportion of a person's income paid in tax increases as income rises. This helps to redistribute income, not wealth. Can lead to brain drain.
- Transfers to the poor = Income paid by the state to benefit recipients and financed from taxation. Paid by state to people who fall into relevant category, e.g. pensions and unemployment benefits. Opportunity cost involved.
- Minimum Wage = Statutory minimum wage introduced to boost the earnings of the low paid. Reduces poverty by reducing gap between rich and poor and increases productivity (efficient wage theory). However, firms have less funds to innovate, and it can lead to unemployment as firms let workers go due to increased costs.
- Training and education schemes may be introduced by the government aimed at low income households, giving them better skills and making them more employable.