Economics of Strategy

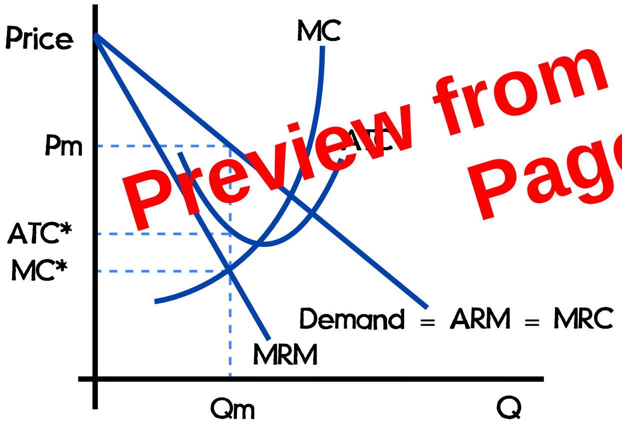
Topic 8
Mediation and Protection, Oligopoly and Strategic Rivalry

<u>Oligopoly</u>

OLIGOPOLY - a few large, interdependent players who strategy depends on assessment of actions on rivals (non-price competition)

High but not impossible barriers to entry
Common in OECD
ex. Cars, steel, pharmaceuticals
MNEs face lower national entry barriers as already have economies of scale in existing markets and production facilities
-> More oligopolies where previously monopolies
ex. Public utilities

COLLUSION
Collusion profitable as allows players to jointly charge monopoly price (Pm) and earn monopoly profits
Must have protocol for sharing profits to limit cheating



Incentive to cheat huge

At Pm, P > MC
Incentive to expand output to increase profits
-> Undermines collusive agreement
ex. Venezuela & OPEC in 1980s

PRISONER'S DILEMMA - fundamental problem in game theory that demonstrates why two people might not cooperate even if it is in both their best interests to do so

Originally framed by Flood & Dresher at RAND, 1950 Formalised by A W Tucker
Pareto-suboptimal as players defect but would gain more through cooperation

		Firm 1: Collude	Firm 1: Cheat
Firm 2	Collude	8	9
		8	6
	Cheat	6	7
		9	7

Best solution is to collude
-> Make profit of 8

If cheat can do better
-> If Firm 1 cheats make 9 while Firm 2 makes 6
-> Best independent strategy

Firm 1 also cheats and both worse off earning just 7