OLIGOPOLY II

SWEEZY’S KINKED DEMAND CURVE MODEL

- **IN THIS MODEL SWEEZY TRIES TO EXPLAIN WHY PRICES DO NOT CHANGE EVEN IF COSTS CHANGE i.e. PRICE RIGIDITY**
- **CONSIDER PERCEIVED DEMAND CURVE AND SHARE OF THE MARKET DEMAND CURVE.**
- **SUPPOSE A SELLER REDUCES HIS PRICE BELOW THE EXISTING PRICE THINKING ALL THE OTHER SELLERS WILL NOT CHANGE THEIR DECISION. PRICE OF HIS PRODUCT BECOMES RELATIVELY CHEAPER THAN THE PRICE OF OTHER SELLERS. HE WILL ATTRACT CUSTOMERS FROM OTHER SELLERS , HIS SALE AND HENCE PROFIT WILL INCREASE. BUT THIS DOES NOT HAPPEN. WHEN ALL THE OTHER SELLERS SEE THAT HIS PROFIT IS INCREASING, THEY WILL FOLLOW HIM IN REDUCING THEIR PRICE. SO MARKET PRICE FALLS, MARKET DEMAND INCREASES. THIS INCREASE WILL BE DISTRIBUTED AMONGST ALL THE SELLERS SO THAT INCREASE IN DEMAND FOR EACH SELLER'S PRODUCT WILL BE MUCH LESS THAN WHAT IT WOULD HAVE BEEN HAD THE OTHER SELLERS NOT REDUCE THE PRICE. IN THIS CASE SHARE OF THE MARKET DEMAND CURVE WILL BE THE RELEVANT CURVE.**
- **BASED UPON THE ABOVE EXPERIENCE THE SELLER NOW INCREASES THE PRICE OF HIS PRODUCT. NOW THE OTHER SELLERS DO NOT FOLLOW HIM. PRICE OF HIS PRODUCT BECOMES RELATIVELY EXPENSIVE AS COMPARED TO THAT OF THE OTHER SELLERS. THIS SELLER WILL LOOSE HIS CUSTOMERS. IN THIS CASE PERCEIVED DEMAND CURVE IS THE RELEVANT CURVE.**
- **AT THE POINT OF INTERSECTION OF THE TWO CURVES THERE IS A SHARP POINT- KINK.**

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- AT THE KINK MR DOES NOT EXIST.
- SO THERE IS A GAP. (SEE FIGURE)
- THE EXTENT OF THE GAP DEPENDS UPON THE DIFFERENCE IN ELASTICITIES OF share of the market demand curve (DD) AND THE PERCEIVED DEMAND CURVE(dd).
- THE GREATER THE FIFFERENCE THE WIDER IS THE GAP
- SUPPOSE MC1 IS THE COST CURVE BASED ON THE COST OF PRODN
- EQUILIBRIUM WILL BE AT POINT A, OUTPUT WILL BE Q0
- SUPPOSE COST OF PRODN INCREASES AND MC SHIFTS UP TO MC2 . STILL EQUILIBRIUM OUTPUT WILL BE AT Q0
- SO LONG AS MC PASSES THROUGH THE GAP, EQUILIBRIUM WILL REMAIN THE SAME EVEN IF COST INCREASES.
- **LIMITATIONS**
- MODEL DOES NOT EXPLAIN HOW PRICE IS DETERMINED. ONLY FOCUSES ON PRICE RIGIDITY.
- DOES EXPLAIN AT WHICH PRICE PROFIT WILL BE MAXIMISED.
- NO STRONG EVIDENCE REGARDING KINKED DEMAND CURVE
- DUTING RECESSION NO FIRM WILL RAISE PRICE, DURING INFLATION ALL FIRMS WILL RAISE PRICE. SO THE BEHAVIOUR THAT LEADS TO THE KINK IS NOT JUSTIFIED.

NON PRICE COMPETITION

- FEW SELLERS IN OLIGOPOLY MARKET. HENCE THERE EXISTS A HIGH LEVEL OF MUTUAL INTERDEPENDENCE. SO THERE IS PRICE RIGIDITY
- SELLERS ARE ENGAGED IN NON PRICE COMPETITION- THEY GIVE MORE QUANTITY, BETTER
- QUALITY OF PRODUCT, A GIFT, FREE SERVICES WITH THE PRODUCT
- UNDER NON PRICE COMPETITION ALL FIRMS CHARGE THE SAME PRICE
- THE SELLERS MAKE AN UNDERSTANDING, IMPLICITLY OR EXPLICITLY, ABOUT THE FIXED PRICE TO BE CHARGED- COLLUSION
- WHEN SELLERS COLLECTIVELY FORM AN ORGANISATION WITH THE OBJECTIVE OF CREATING A MONOPOLY LIKE SITUATION- CARTEL
- EXAMPLE OF CARTEL- OPEC i.e. ORGANISATION OF PETROLEUM EXPORTING COUNTRY
- WHEN AGREEMENT IS OPEN -FORMAL COLLUSION
- PERFECT CARTEL- AN EXTREME FORM OF COLLUSION WHEN MEMBER FIRMS AGREE TO SURRENDER COMPLETELYTHEIR RIGHTS OF PRICE DETERMINATIONTO A CENTRAL ADMINISTRATIVE AGENCY FOR SECURING MAXIMUM PROFITS
- THOUGH NOT ILLEGAL PERFECT CARTEL IS RARE.
- IN PRACTICE LOOSE TYPE OF CARTEL SEEN. HERE MARKET SHARING OF FIRM OCCURS.

- **IN PRACTICE LOOSE TYPE OF CARTEL SEEN. HERE MARKET SHARING OF FIRM OCCURS. TWO METHODS FOLLOWED a) NON-PRICE COMPETITION b) QUOTAS**
- **a) FIXED PRICE IS SET. SELLERS ARE FREE TO PRODUCE AND SEEL THE AMONTS OF OUTPUTS WHICH WILL MAXIMISE THEIR PROFITS**
- **b) MARKET SHARING QUOTAS ARE FIXED FOR VARIOUS FIRMS. QUOTA DEPENDS UPON THE BARGAINING POWER OF FIRMS IF COST DIFFERENCES EXIST.**
- **ADVANTAGES OF CARTEL**
- **COMPETITOR FIRMS CAN AVOID UNNECESSARY PRICE COMPETITION**
- **FIRMS CAN DETERMINETHE PRICE AND QUANTITY OF THE PRODUCTS**
- **FIRMS CAN EXERCISE CONTROL OVER MARKET**
- **FIRMS CAN AVOID UNCERTAINITY WHICH IS PRESENT IN OLIGOPOLY MARKET**

- **DIS ADVANTAGES OF CARTEL**
- **CARTEL FUNCTIONS ON MUTUAL TRUST. IF MEMBER FIRMS DO NOT FURNISH CORRECT INFORMATION CORRCT DECISION WITH RRESPECT TO PRICE AND OUTPUT CANNOT BE TAKEN**
- **SOME ECONOMICALLY POWERFUL BIG FIRMS SELL AT A PRICE LOWER THAN THAT DETERMINED BY THE CARTEL. THE SMALLER FIRMS SUFFER. CARTEL MAY BREAK**

OLIGOPOLY-II

SWEEZY'S MODEL