

Lecture 19

Factor Markets and Vertical Integration

- Competitive factor market
- Effect of monopolies on factor markets
- Vertical integration
- Monopsony

Long-Run Factor Demand

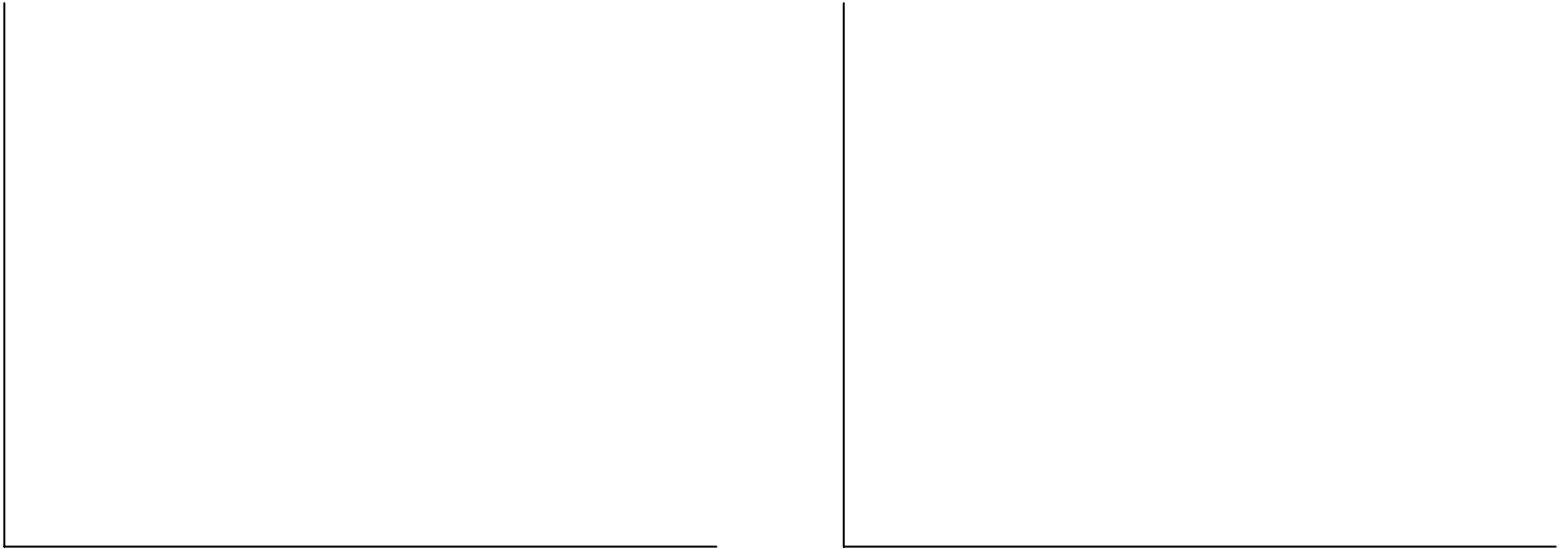
- Derived demand
- Factor market demand curve

- Marginal revenue product
- Market demand for labor

Labor Demand of a Thread Mill



Market Demand for Labor



Firm Demand for Labor



Market Demand for Labor



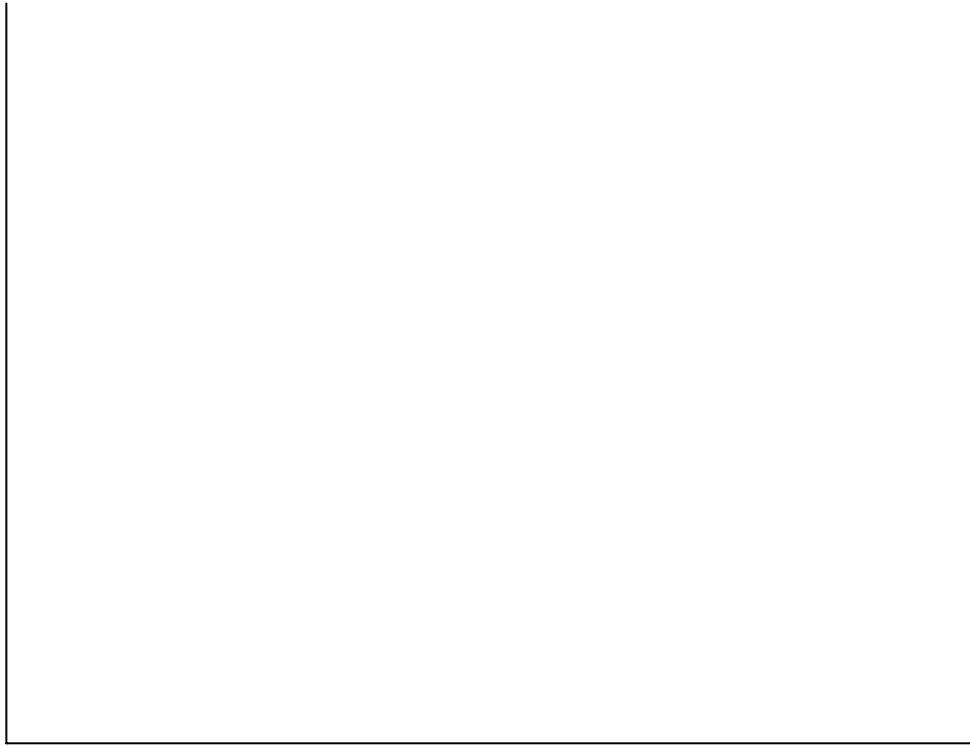
Monopolies and Factor Markets

- Role of market power
- $MRP_L = P(1 + \frac{1}{\varepsilon})MP_L$
- Competitive market model
- Monopolized factor market and competitive output market
- Monopolized factor and output markets

How Labor Demand Varies with Market Structure



Effects of Output Market Structure on Labor Market Equilibrium



Application

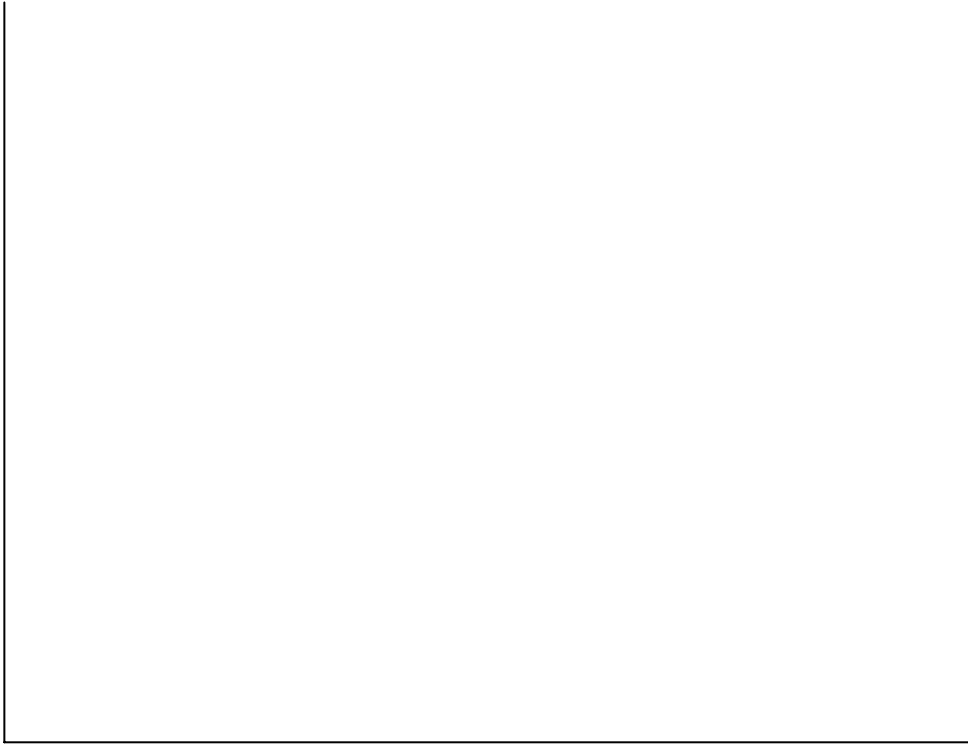
Union Monopoly Power

	1889–1890	1984	1990
Unskilled	25.2%	10.2%	7.2%
Semiskilled	17.4%	10.0%	6.3%
Skilled	19.3%	3.4%	1.5%

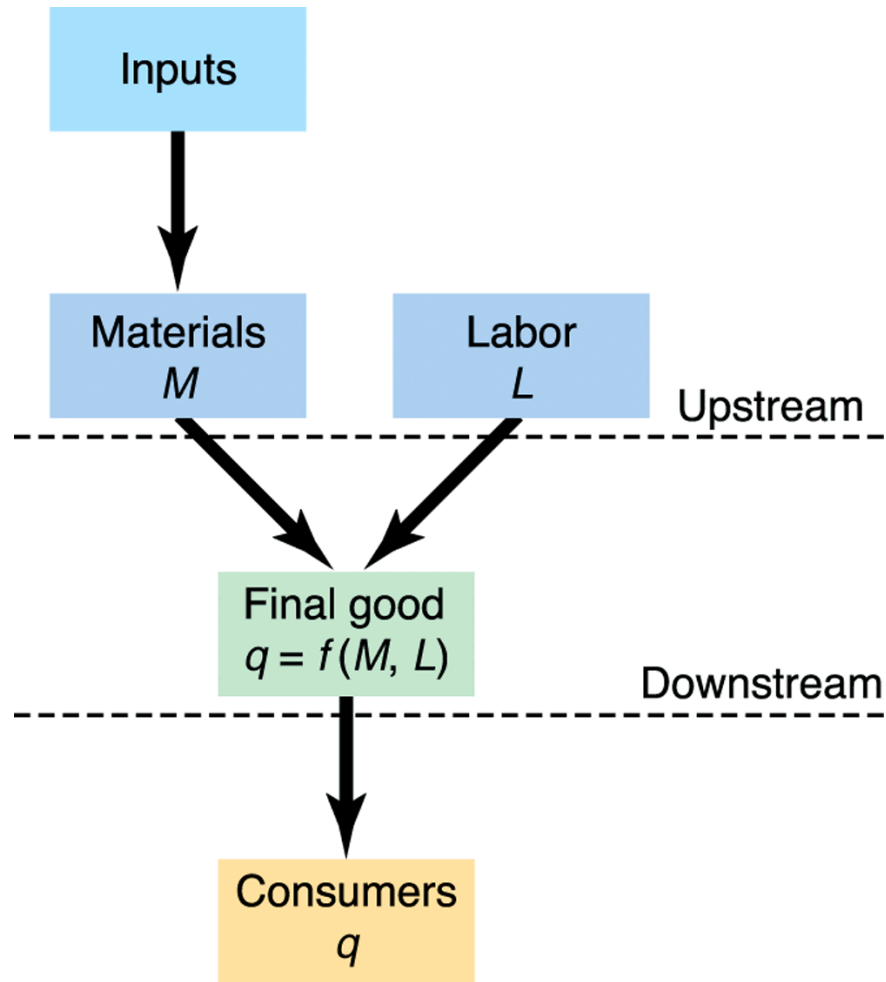
Monopoly in Related Markets

- Double monopoly markup
- Vertical integration
- Premerger and postmerger equilibrium

Double Monopoly Markup



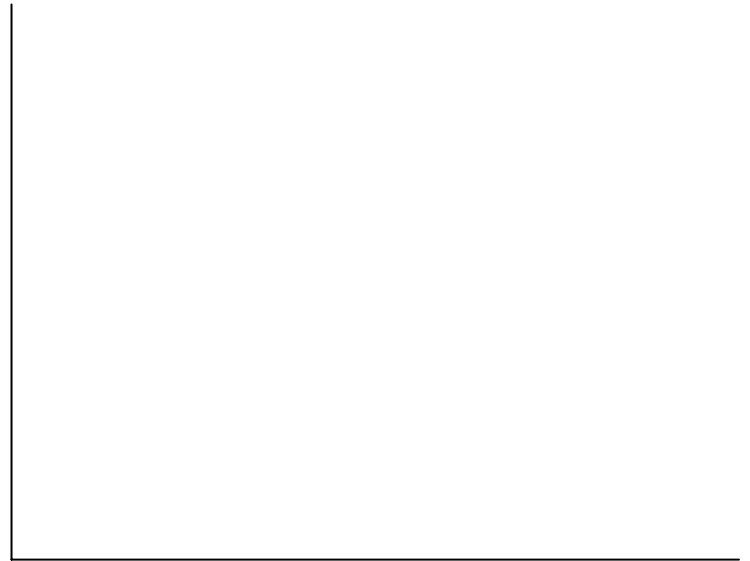
Vertical Organization



Monopsony

- Comparison to competitive price
- Derivation of M.E.
- Welfare effects of monopsony
- Monopsony price discrimination

Monopsony



Monopsony



Monopsony



Welfare Effects of Monopsony



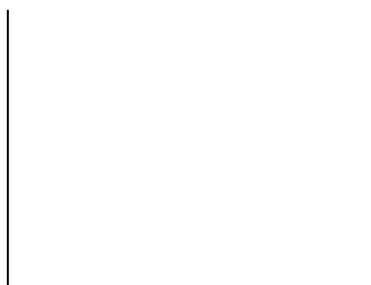
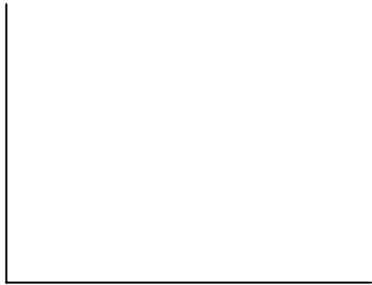
Weyerhaeuser

- Alleged foreclosure
- Alleged predatory pricing
- Is it rational?
- Is recoupment possible?

Welfare Measures in a Multimarket Framework

- Consumer surplus: intermediate market
- Producer surplus: intermediate market
- Market-, sector-, and economy-wide analysis

Distribution of Welfare in a Multimarket Model



Summary: Competitive Factor Market

- Firms maximize profit by ensuring that MRP equals factor price
- Marginal revenue = market price, so MRP is market price \times marginal product
- Long-run factor demand flatter than short-run demand
- Market demand for factor reflects output levels in product markets

Effect of Monopolies on Factor Markets

- Consumer demand falls when prices rise above marginal cost in an output market or factor market
- Reduction in input quantity reduces output; reduction in output reduces demand for inputs

Vertical Integration

- Companies may vertically integrate, quasi-vertically integrate, or buy from a factor market, usually based on profitability
- Vertical integration is costly, but potential benefits include—
 - lowers transaction costs
 - ensures steady supply
 - avoids government restrictions
 - extends market power to another market
 - eliminates market power

Monopsony

- Sets price so that marginal value equals marginal expenditure
- Results of monopsony paying price below the competitive level:
 - sells fewer units than in competitive market
 - producers of factors are worse off
 - monopsony earns higher profits
 - society suffers deadweight loss
 - (monopsony may also price discriminate)