

# Market structure 3: dominant firm & a competitive fringe of N firms.

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- “Fringe” firms act as price takers.
- Dominant firm - why is it dominant?
  
- Can the dominant firm exercise market power forever?

# Market structure 3: dominant firm & a competitive fringe of N firms.

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- Would dominant firm want to produce at the monopoly output?
- Dominant firm: Since I cannot stop the fringe firms, let them sell as much as they want **at the price I set.**
- Except at the very high prices I have some demand left after the fringe produces.
- I face a *residual demand curve*, i.e., I have market power. I am a monopolist on the residual demand!

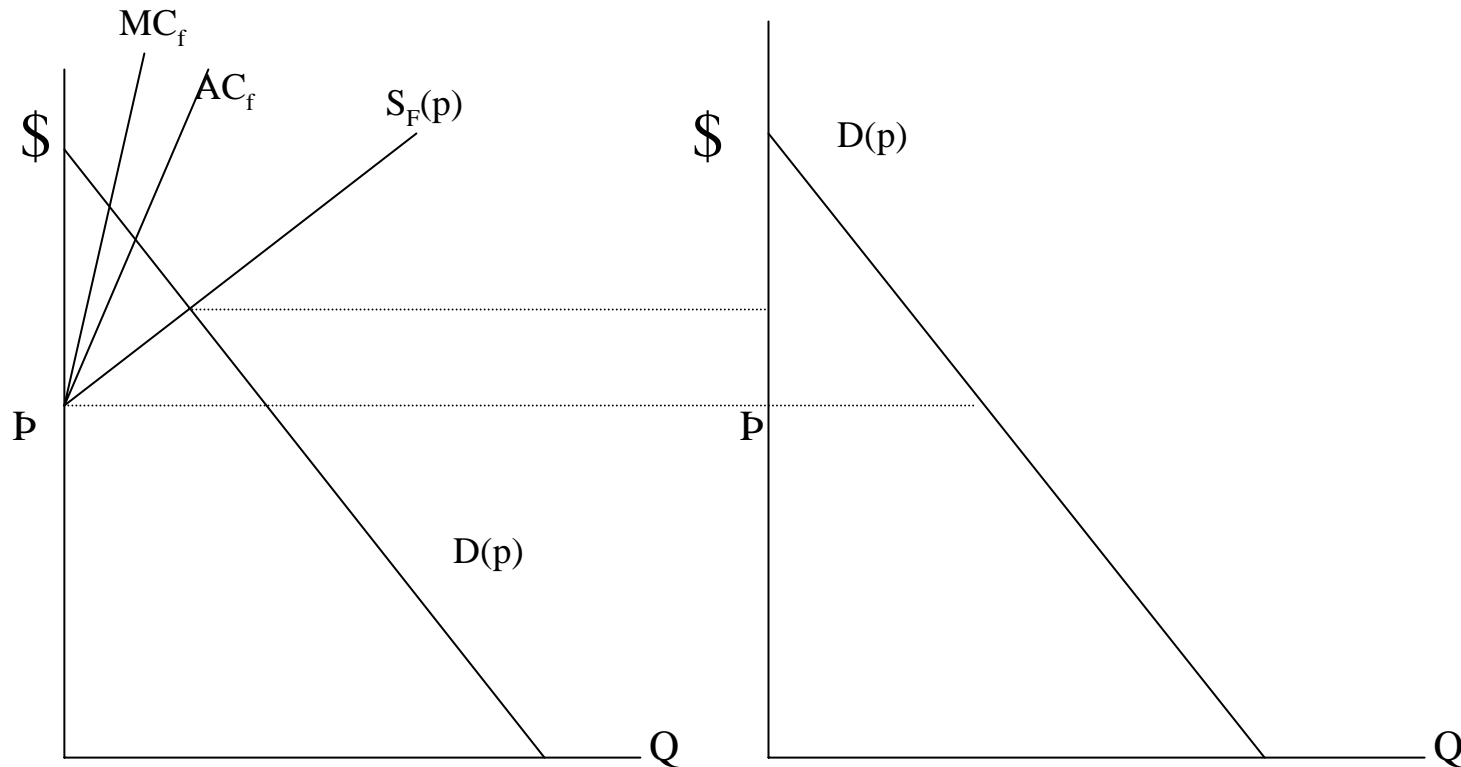
# Market structure 3: dominant firm & a competitive fringe pricing strategies:

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- Dominant firm maximizes profits on the residual demand curve.
  - Once we get residual demand we are in the monopolist case.
- Fringe firms produce until  $MC=P$ , where  $P$  is set by the dominant firm.

# Market structure 3: dominant firm & N firms competitive fringe (creating figure 4.6, p.114)

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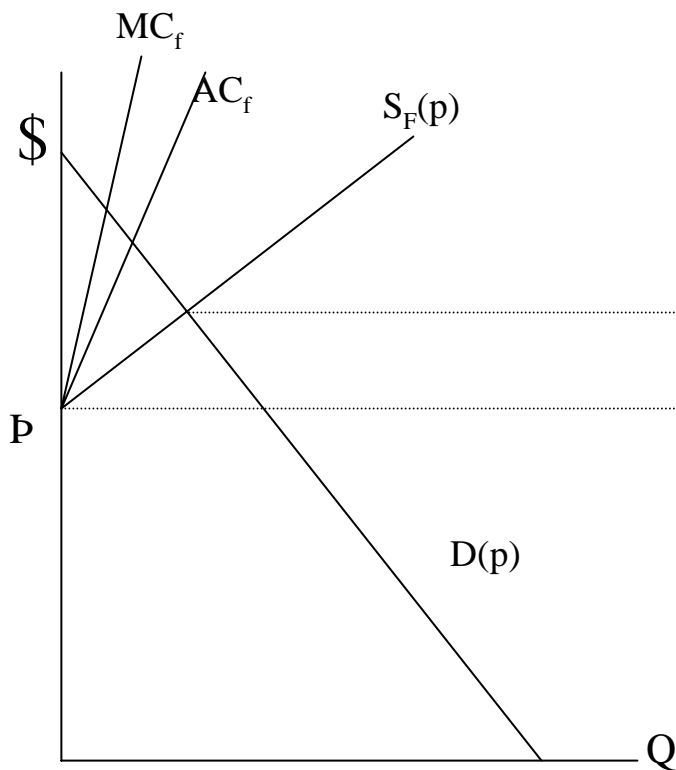
Fringe Firm and Fringe's total supply

Market

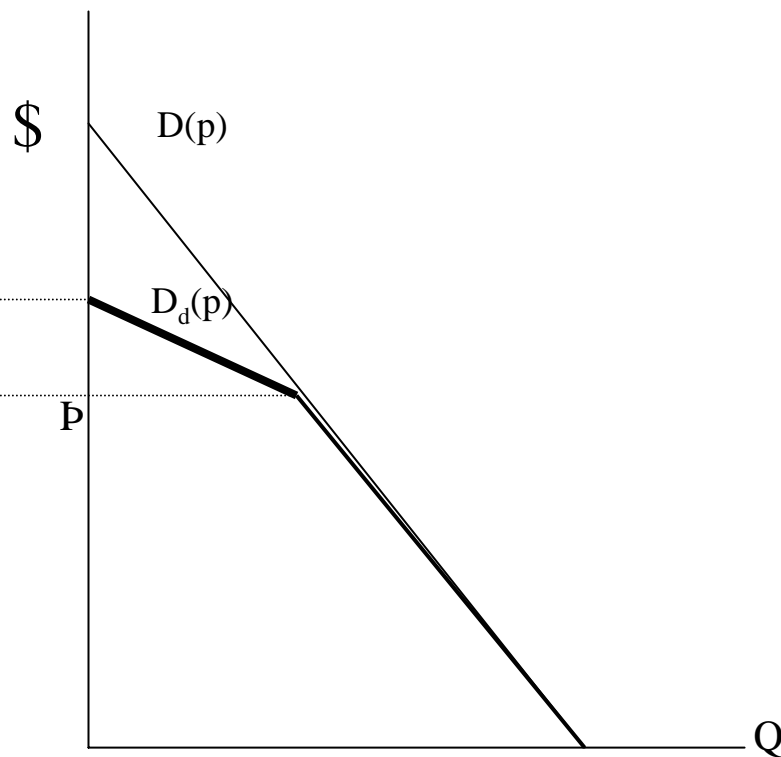
# Market structure 3: (creating figure 4.6, p.114)

## Residual Demand $D_d(p) = D(p) - S_F(p)$

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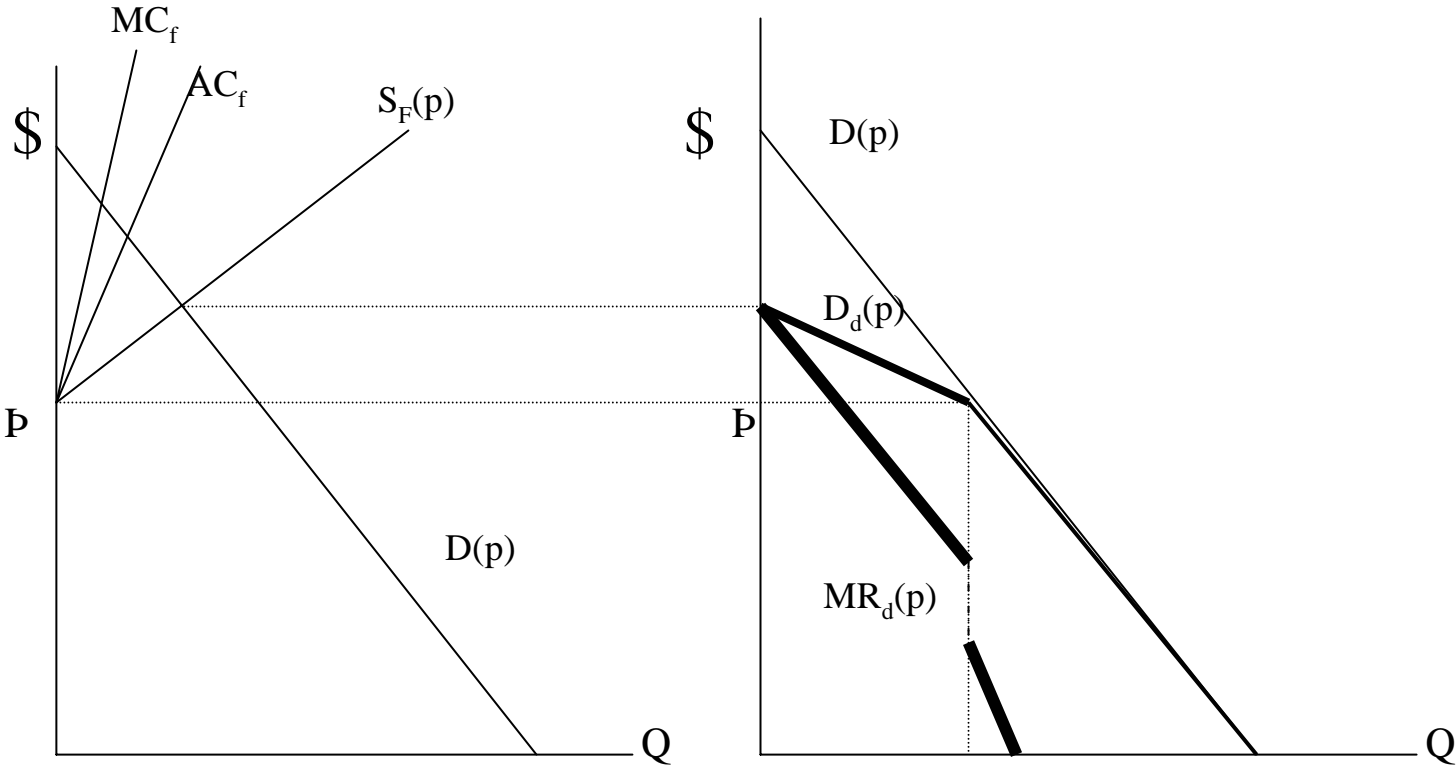


Fringe Firm and Fringe's total supply



Market

# Market structure 3: (creating figure 4.6, p.114) Residual Demand and Marginal Revenue

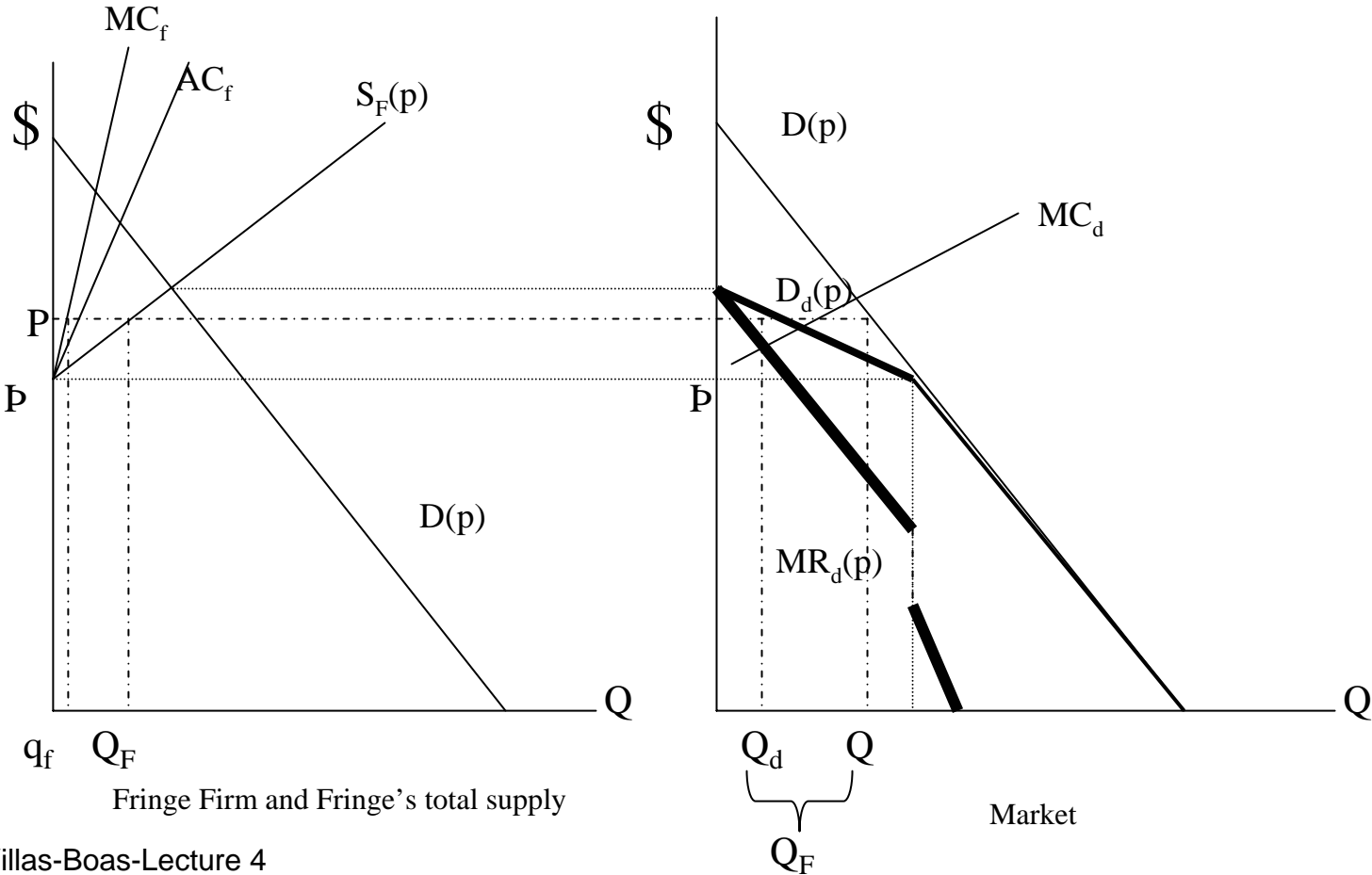


Fringe Firm and Fringe's total supply

Market

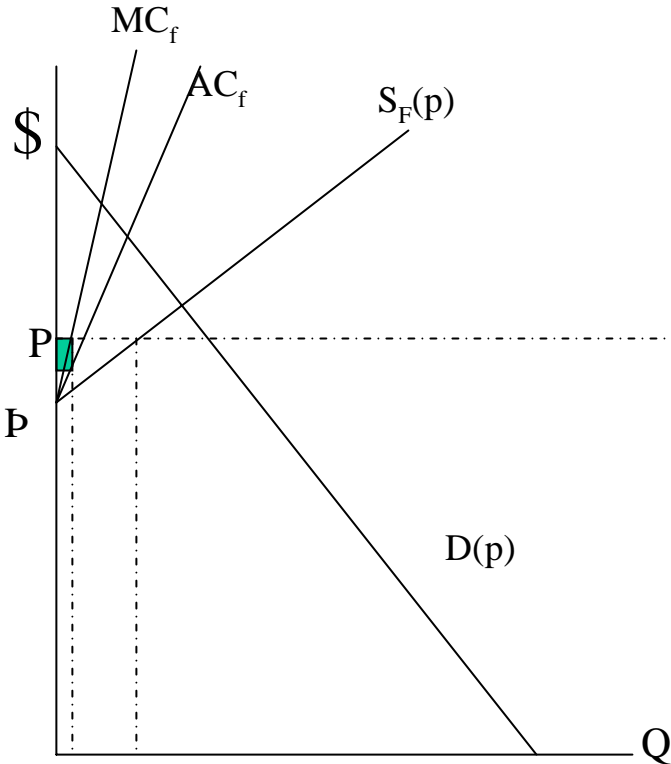
# Market structure 3: (creating figure 4.6, p.114)

## Profit maximizing dominant firm $MC_d=MR_d$

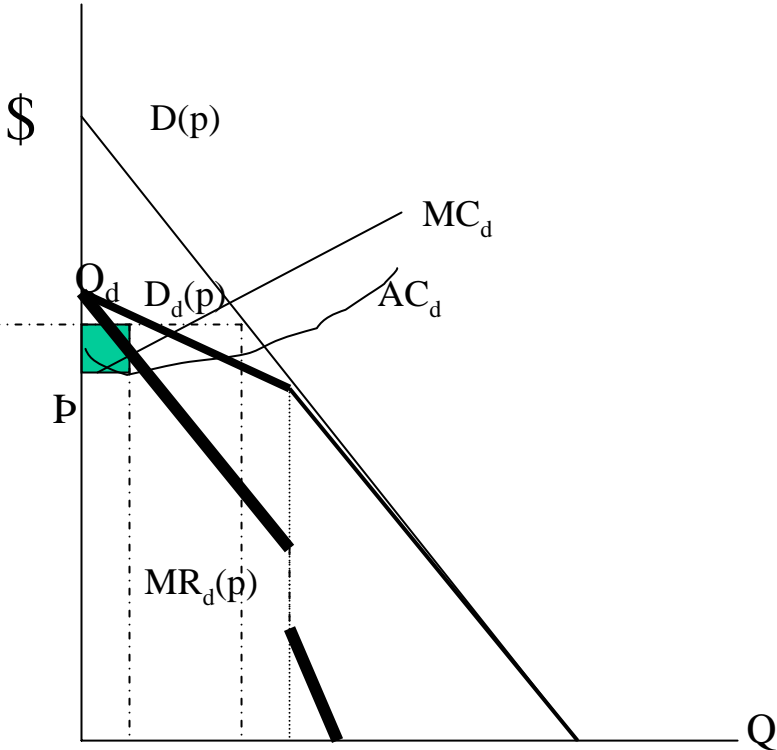


# Market structure 3: (creating figure 4.6, p.114)

## Profits

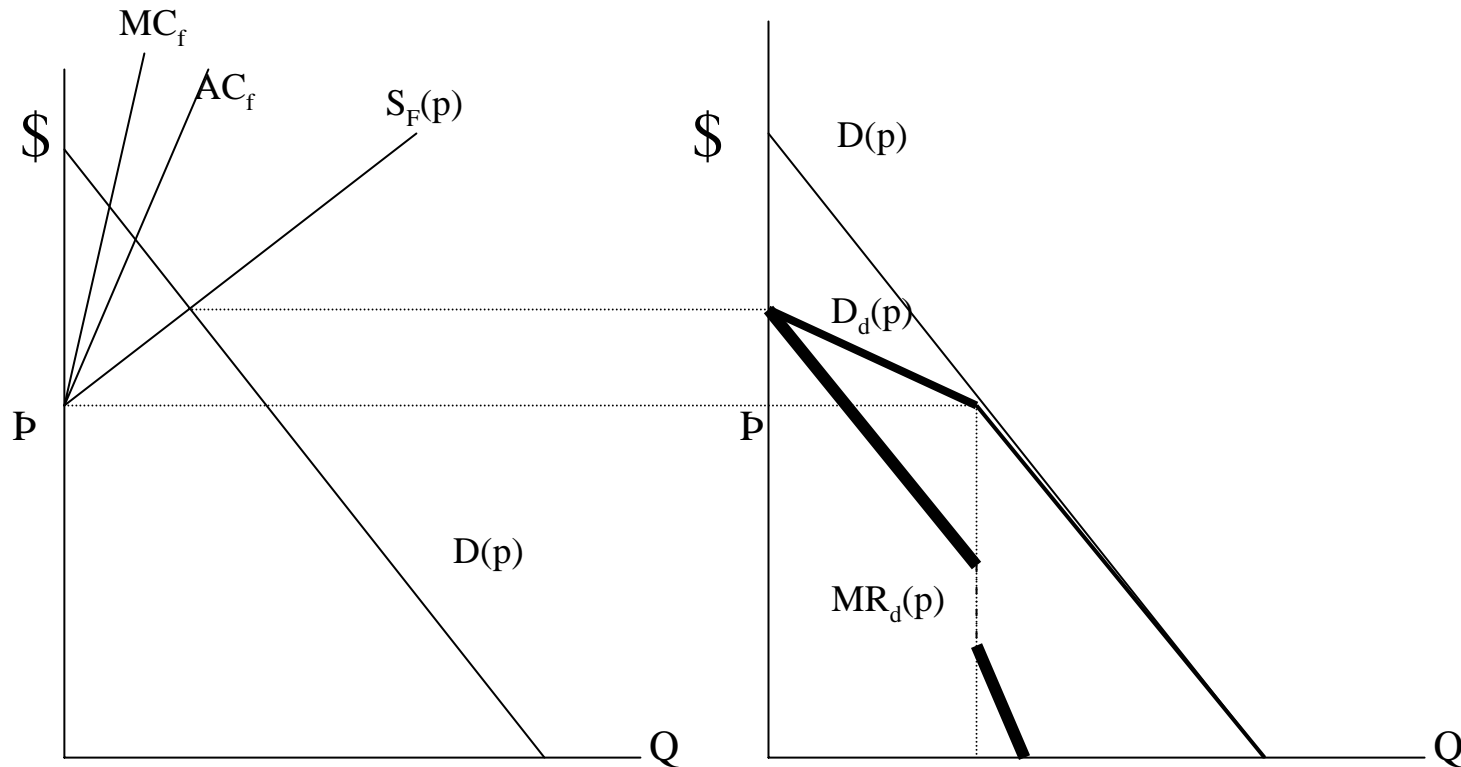


Fringe Firm and Fringe's total supply



Market

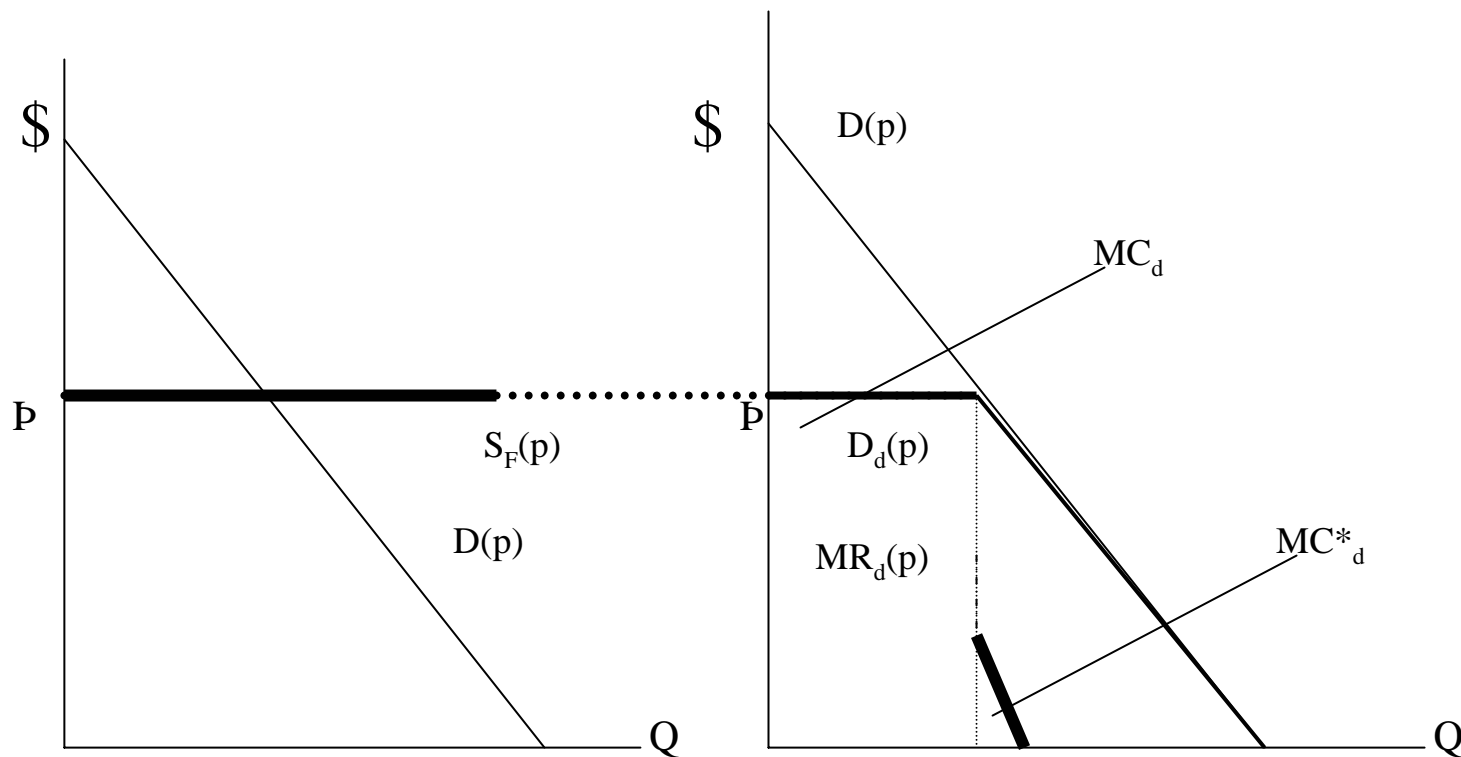
# When does the dominant firm control the N firms in the fringe?



Fringe Firm and Fringe's total supply

**What if free entry of fringe firms could happen (remember fringe firms are earning positive profits in our example)?**

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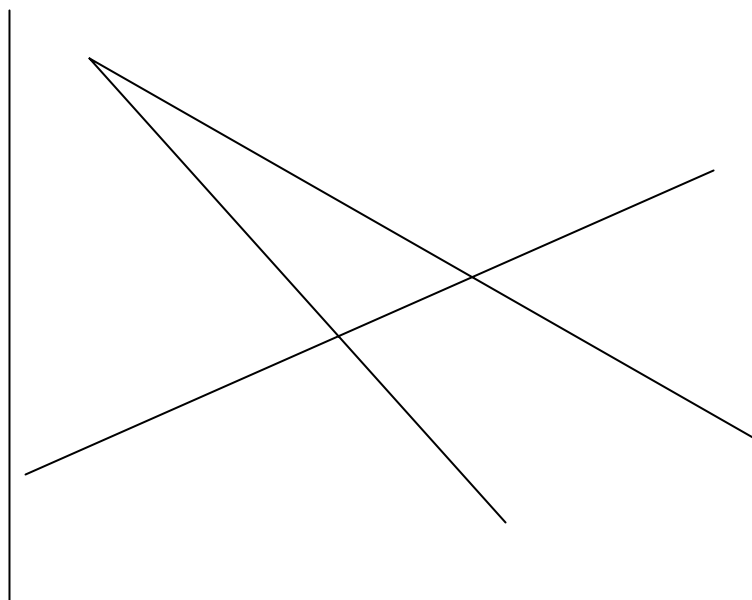


Fringe Firm and Fringe's total supply

# Recap: Monopoly vs Competition

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**Deadweight Loss ?**

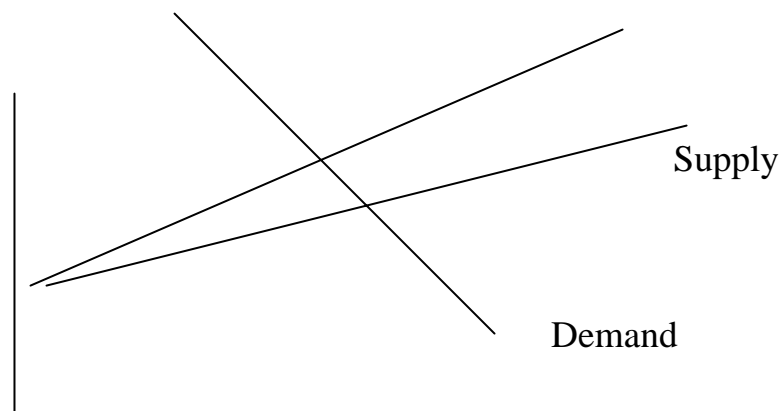


**Rent Seeking** - how much would a firm want to pay to become a monopolist in this market?

# Market Structure 4: Monopsony

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- Flip side of monopoly
- Decides to buy one more unit as long as the additional benefit from one more unit consumed exceeds or equals the marginal cost of extra unit.
- Evidence: agricultural and natural resource markets
- Deadweight loss:



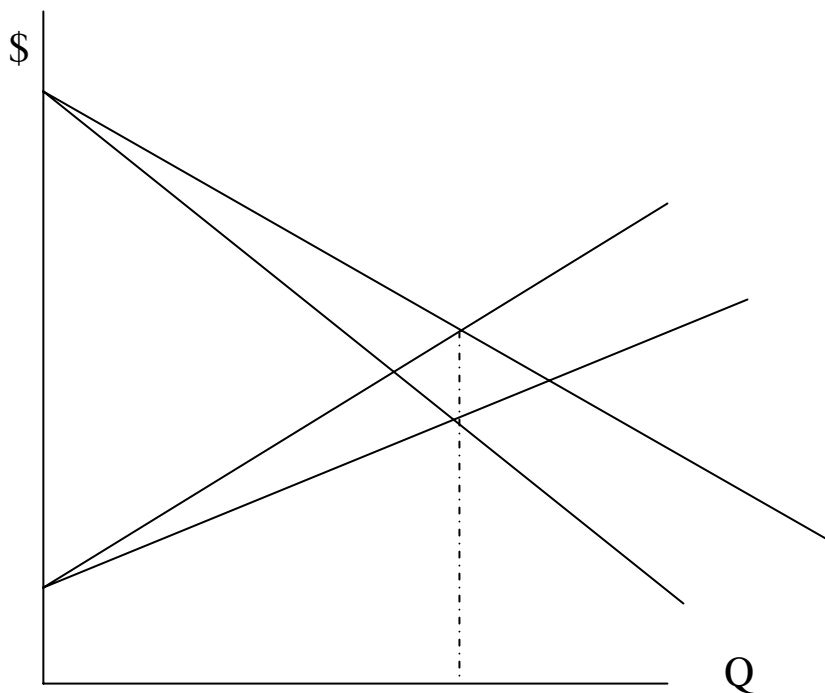
# Market Structure 4: Monopsony

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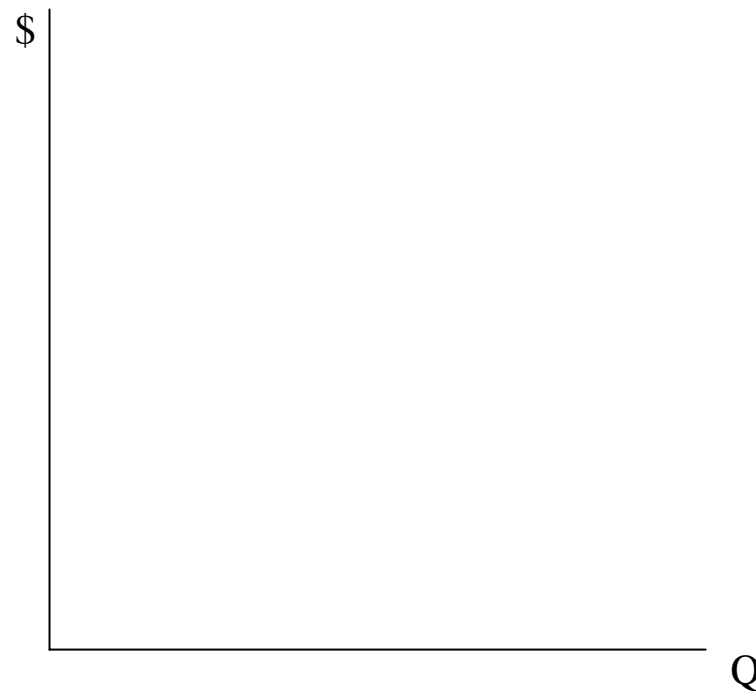
- Price and output are lower than competitive levels.
- More likely in markets with resources that are specialized to a few uses:
  
- Is monopsony sustainable in the long run?

# Do tomato processing firms have monopsony (oligopsony) power?

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- Knowing the supply curve and observing equilibrium prices and quantity is not enough to determine market structure

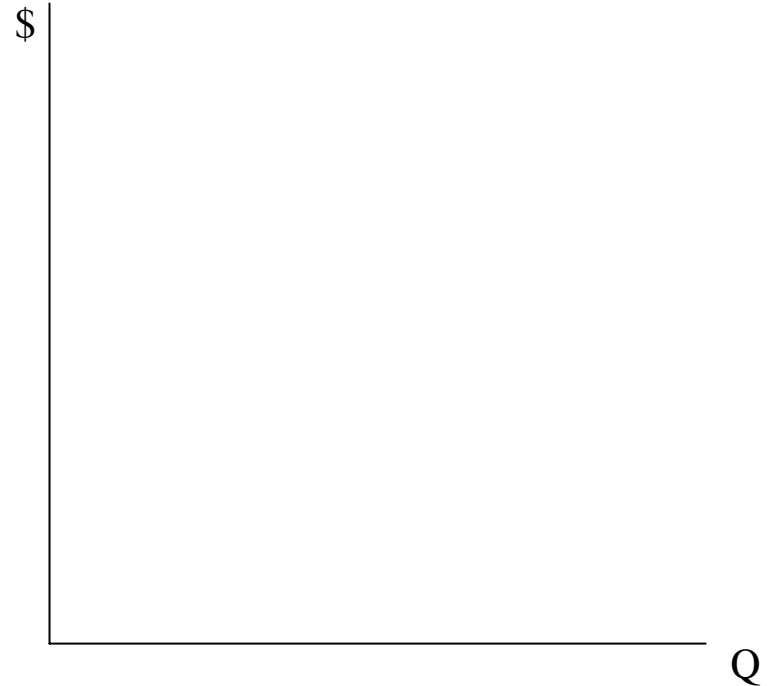


- Changes in shape of supply - yes

# Do tomato processing firms have monopsony (oligopsony) power?

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- Just and Chern (1980)



- Monopsony power vs competition

# Next Lecture 5:

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- Hand in problem set
- Collusion classroom experiment
- Introduction to Cartels - Oligopoly joint decision making
- Examples