Chamberlin Model of Oligopoly

ECOHOLICS

What did he suggest?

A stable equilibrium can be reached with the monopoly price being charged by all firms, if firms recognize their interdependence and act so as to maximize the industry profit (monopoly profit) without formally colluding

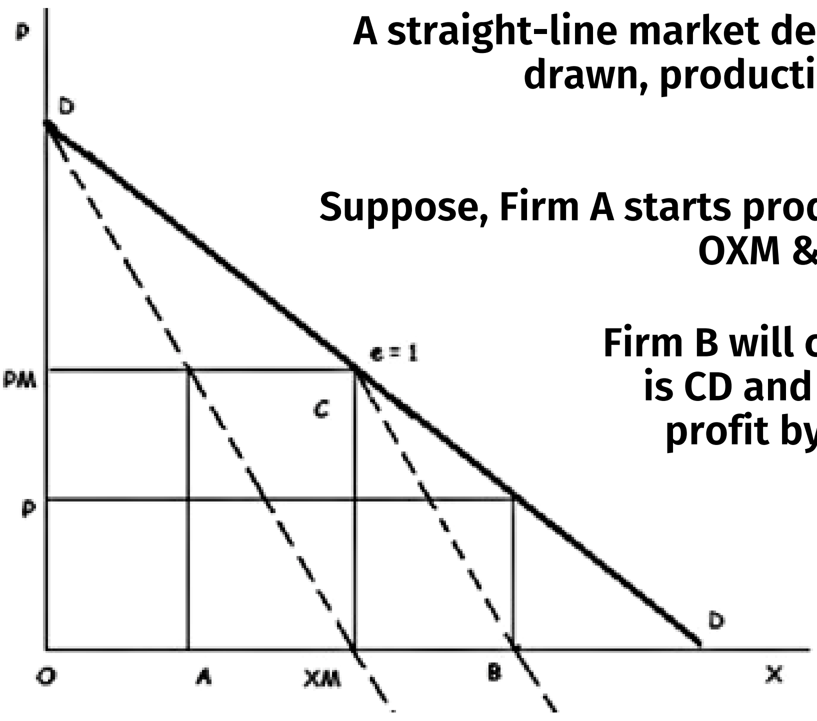
GIVEN BY: Edward Hastings Chamberlin

BOOK: "The Theory of Monopolistic Competition"

TIME PERIOD: 1933

When changing their price or output, firms recognise the direct and indirect effects of their decisions.

- Direct effects are those which would occur if competitors were assumed to remain passive
- Indirect effects are those which result from the fact that rivals do not in fact remain passive but react to the decisions of the firm which changes its price or output



A straight-line market demand with a negative slope is drawn, production is assumed to be costless.

Suppose, Firm A starts produce profit maximising output OXM & sells it at monopoly price PM

Firm B will consider that its demand curve is CD and will attempt to maximise its profit by producing one-half of this demand (XMB)

Total industry output becomes OB and price falls to P

- Firm A thus decides to reduce its output to OA which is equal to B's output
- The industry output now becomes OXM and price rises to monopoly level OPM.
- Both firms realise that it is best for both to equally share the market and recognise the interdependence of the firms to reach to monopoly solution

ISSUES?

- Closed model which ignores entry, when in reality, new firms are likely to enter the industry due to attraction of monopoly profits
- Assumption that firms have a good knowledge of the market demand curve, they learn from their mistakes etc.
- Assumption that oligopolists know fully the costs of production of their rivals which enables them to arrive at monopoly output & price