THE RELATIVE RIGIDITY OF MONOPOLY PRICING pdf

1: Price Stability in Oligopoly | Economics Help

Weiss(,),Rotemberg(),andi'iankiw()www.enganchecubano.com
costsareusuallytakentoincludethephysicalcostsofchangingand.

In contrast to marginal costs, security rates are readily observable and may vary substan- tially in either direction in a relatively short time period. Thus, we focus on the role of security-rate changes in the following analy- sis. Before proceeding, it is useful to note that at least two frequently modeled aspects of price rigidity are excluded by our simpli- fying assumptions. The assumption that se- curity rates follow a random walk or martin- gale process, while tenable in this particular application, rules out the more complicated roles of expectations of future price changes considered by Steven G. The assumed linearity of the model is also of sig- nificance, since a number of studies have drawn implications regarding the nature of price rigidity that depend on other func- tional forms e. Thus, we offer this analysis "he gain and cost from changing price in equation 1 should be viewed as the present value of all current and future gains and costs associated with the change, respectively. It follows from 1 that any bank or mar- ket characteristic associated with a larger value of b, implying a flatter supply of deposits in Fig. By demonstrating that b, as it applies to demand relations is smaller for monopolists than for Bertrand duopo- lists, Rotemberg and Saloner employed this analysis to account for the previ- ously unexplained phenomenon of greater price rigidity in monopolies relative to tight oligopolies. Here, we employ it to suggest the determinants of deposit-rate rigidity. To the extent that firms in more concentrated markets exhibit higher price conjectures as a result of greater recognized interdependence, operation in a more con- centrated market implies a lower value of b, i. Note that while the gain from a price change [represented by the first three terms in 3] depends directly on size of the stimulus for the change Ar,I2, firm and market characteristics operate only in interaction with this stimulus. Coefficient predictions imply that higher levels of con- centration CR dampen the impact of a security-rate change, while a larger customer base MSiI enhances it. Because of the macroeconomic significance of an inflationary bias in price adjust- ments see Robert J. Gordon, , past studies of price rigidity have looked for and for the most part have failed to find con- vincing evidence of asymmetry between price increases and decreases see Arthur M. Okun, ; Carlton, A finite value of a, is guar- anteed by the assumption of product differentiation. See Hannan and Berger for a detailed deriva- tion. Their analysis involves trac- ing the overall speed of adjustment of deposit rates over time, rather than examining observed price-change decisions as in the current paper and in Carlton []. They find that the speed of adjustment, which is influenced by the size of price changes as well as the likelihood of their occurrences, differs between price increases and decreases. Consider first the possibility that price conjectures are greater for deposit-rate increases than for decreases-an assumption of the well-known kinked-demand in this case kinked-supply explanation of price rigidity. This implies that b, is smaller for deposit-rate increases than for decreases and that the marginal outlay curve has an indeterminate region and a steeper slope for values of r, -c, above this region than below it. This can be shown to imply sym- metric price rigidity for smaller security-rate changes but rigidity that is greater upward than downward for larger changes. Thus, this hybrid explanation of price rigidity, in contrast to the traditional kinked-demand theory, is consistent with the observation of asymmetric price rigidity. Other explana,tions of asymmetry rely on differences in the cost of adjusting prices F, between upward and downward changes. One such explanation emphasized by Okun and Rotemberg maintains that negative customer reactions - to unstable prices constitute a substantial part of the cost of a price change and that customers who value "dependable" pricing will react more negatively to unfavorable price changes than to favorable ones. This implies greater rigidity in the case of de- posit-rate decreases. Another explanation maintains that rigidity results from collusive price arrangements that are more likely to break down if prices are changed. Since the expected costs of such breakdowns should be greater for deposit-rate increases than decreases, this implies greater rigidity in the case of rate increases. Still another explana- tion concerns the timing of consumer de- positor reactions to price changes. To the extent that a lag exists between price changes and customer responses to them, this lag adds to the cost of a deposit-rate increase as extra interest is paid before the full reaction of depositors is realized and

subtracts from the cost of a deposit-rate decrease. This implies greater rigidity for deposit-rate increases than for decreases. Because of the structural similarities, our analysis will not necessarily allow us to dis- tinguish among all of these explanations. The Estimation Procedure The addition to 3 of an error term as- sumed to have a logistic cumulative distri- bution allows estimation of the resulting probability condition using logit maximum likelihood. Since prices may increase, de- crease, or remain unchanged, we employ a multinomial logit estimation procedure to estimate the following two relationships: Since it is the square of Ar, that accounts for the effects of security-rate changes in 3 , we distinguish between increases and decreases in Ar, by multiplying Ar,I2 by -1in the case of a decrease. To avoid the confusion of different sign predictions in the price-increase and price-decrease equations. The natu- ral log of bank assets, denoted In A,, is also included in one estimation to account for the possibility that the costs of changing prices or other aspects of the price-change decision differ systematically with bank size. The Data The data consist of monthly observations of deposit rates offered by banks lo- cated in local banking markets and cover the period from September to Decem- ber In all, the data include over 12, price-change decisions. These rates represent actual transaction prices paid during the week ending on the last Wednesday of the month. Because the survey is conducted on a monthly basis, we must assume as in all studies of price rigidity that when a greater, lower, or same price is observed for a suc- ceeding month, this implies that an increase, decrease, or no change, respectively, occurred during the period. Of the 12, observations, 2, involved price increases, 5, involved price decreases, and 4, involved no price change. Security rates are measured by the three- month Treasury-bill rate. Consistent with the above analysis, Ar, is measured as the difference between the current value of r, and the value of r, prevailing at the time of the last deposit-rate change. Thus, Ar, measures how far "out of line" security rates have become since the last deposit-rate change. To insure a close correspondence between observed rate-change decisions and market characteristics, banks with less than 75 per- cent of their deposits in one market are excluded from the sample. Asymptotic t statistics are in parentheses; In A denotes the log of the likelihood-ratio statistic. The Results Table 1 presents the results of two multi- nomial logit estimations obtained with and without the inclusion of the log of bank assets In A, to control for firm size. In both estimations, all intercept terms and coefficients have signs consistent with the underlying model, and in most cases they are highly significant. For both upward and downward price-change decisions, the inter- cept terms are significantly negative, while the coefficients of ArSl2 and the total derivatives of the price-change likelihoods with respect to ArJ2 evaluated at sample means are significantly positive. These re- sults are consistent with the underlying premise that security-rate changes provide a stimulus for bank deposit-rate changes and that this stimulus must be sufficient to over- come the costs of a price change. The negative coefficients of the interac- tion between the security-rate change and concentration, ArJ2CR, suggest that for a given change in the security rate, banks in more concentrated markets are less likely to change deposit rates. While this finding of greater price rigidity in more concentrated markets is not new e. The coefficients of bank size, In A,, are positive and highly significant for both price increases and de- creases. Possible explanations are that the costs broadly defined of changing prices are lower for larger firms or that larger firms are more aware of changing market conditions as a result of their closer orienta- tions to wholesale funds markets. Results presented in Table 1suggest strongly that deposit rates are more rigid for increases than for de- creases. Evaluated at sample means, estima- tion 1 yields a percent probability that the bank will reduce its deposit rate in response to a decrease of 29 basis points in the security rate the mean absolute change and only a percent probability that it will increase its deposit rate in response to the same-sized security-rate increase. The dif- ference is statistically significant at the 1- percent level. The sources of this asymmetry may be seen by noting that the intercepts in each estimation are more negative for in- creases than for decreases statistically dif- ferent at the 1-percent level and that the positive impact of security-rate changes on price-change likelihoods are less for deposit-rate increases than for decreases stat- istically different at the 1-percent level. Due in part to our finding of asymmetries in several parts of the model, it is difficult to distinguish among alternative explanations of asymmetric price rigidity. It does appear, however, that our results do not support explanations that focus on the role of nega- tive customer reactions as a major cost of he impact of r,, defined as the total derivative with respect to r,, is less for deposit-rate increases for all values of CR and MS,I in the

sample. Our results are also inconsistent with the pure kinked-demand supply explanation of price rigid- ity, since this well-known analysis by itself does not imply asymmetric rigidity. The robustness of these results with respect to numerous changes in variable mea- surement and sample selection was also ex- amined. The finding that the co- efficients of ArJ2CR and Ar, 2MS,I dif- fer between price increases and decreases has been noted to be sensitive to some of these changes. However, the findings of a greater price rigidity exhibited by firms in more concentrated markets, b less price rigidity on the part of larger firms, and c asymmetric rigidity, with deposit rates more rigid upward than downward, were found to be insensitive to virtually all of these changes. Conclusion This study has examined the setting of deposit interest rates by banks to investigate how price rigidity differs across firms and markets and between upward and downward price changes. We find that firms in more concentrated markets and smaller firms exhibit greater price rigidity, all else equal, and that deposit rates are significantly more rigid when the stimulus for a deposit-rate change is upward. This latter 10An exception was the finding of no effect of firm size for banks located in the few states that prohibit branching. We sus- pect that the advantages inherent in our data set, which contains numerous observa- tions of price decreases as well as increases, accounts for this difference. Finally, our re- sults allow us to distinguish among some, but not all, explanations of price rigidity. In particular, our findings are inconsistent with either negative customer reactions or the pure kinked-demand supply theory as the primary source of rigidity, since these expla- nations predict either no asymmetry or asymmetry opposite to the type found here. Yale University Press, Government Print- ing Office, January , 15, Board of Governors of the Federal Reserve System, Government Printing Office,

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2: Full text of "The relative rigidity of monopoly pricing"

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Pure competition and monopoly A large number of sellers: A large number of buyers: For example, we have a number of petrol pumps in the city. Here accessibility is likely to be an important factor. Free Entry and Exit: Nature of the Demand Curve The demand curve of the monopolistic competition has the following characteristics: Less than perfectly elastic: Demand curve slopes downward: In this case the price of the product of the firm is determined by its cost function,demand, its objective and certain government regulations, if there are any. Fresh entry will continue to enter as long as there are profits. Here it is assumed that the other firms in the market are also making profits. It can thus be said that in the long run the profits peter out completely. If there are only two sellers, we have a duopoly. If the product is homogeneous, we have a pure oligopoly. If the product is differentiated, we have a differentiated oligopoly. While entry into anoligopolistic industry is possible, it is not easy as evidenced by the fact that thereare only a few firms in the industry. Oligopoly is the most prevalent form of market organization in the manufacturingsector of most nations, including India. Some oligopolistic industries in India areautomobiles, primary aluminum, steel, electrical equipment, glass, breakfast cereals,cigarettes, and many others. Some of these products such as steel and aluminum are homogeneous, while others such as automobiles, cigarettes, breakfast cereals,and soaps and detergents are differentiated. Oligopoly exists also whentransportation costs limit the market area. For example, even though there aremany cement producers in India, competition is limited to the few local producers ina particular area. Since there are only a few firms selling a homogeneous or differentiated product inoligopolistic markets, the action of each firm affects the other firms in the industryand vice versa. For example, when General Motors introduced price rebates in thesale of its automobiles, Ford and Maruti immediately followed with price rebates oftheir own. Furthermore, since price competition can lead to ruinous price wars,oligopolists usually prefer to compete on the basis of product differentiation,advertising, and service. These are referred to as nonprice competition. Yet, evenhere, if GM mounts a major advertising campaign, Ford and Maruti are likely tosoon respond in kind. When Pepsi mounted a major advertising campaign in theearly s Coca-Cola responded with a large advertising campaign of its own inthe United States. From what has been said, it is clear that the distinguishing characteristic ofoligopoly is the interdependence or rivalry among firms in the industry. The sources of oligopoly are generally the same as for monopoly. They can be homogeneous or differentiated. All these differences exist in the oligopolistic market. This tends to be a distinguishing characteristic of anoligopolistic market. While this is also true for oligopoly firms, itneeds to be supplemented by other behavioural features of firm rivalry. This becomes necessary because the distinguishing feature of oligopolistic markets is interdependence. One model explaining why oligopolists tend notto compete with each other on price, is the kinked demand curve model of PaulSweezy. In order to explain this characteristic of price rigidity i. The kink in the demand curve arises from the asymmetric behaviour ofthe firms. The proponents of the hypothesis believe that competitors normallyfollow price decreases i. Let us start from P1 in Figure. If one firm reduces its price and the other firmsin the market do not respond, the price cutter may substantially increase its sales. This result is depicted by the relative elastic demand curve, dd. For example, aprice decrease from P1 to P2 will result in a movement along dd and increase salesfrom Q1 to Q2 as customers take advantage of the lower price and abandon othersuppliers. If the price cut is matched by other firms, the increase in sales will be less. The demand curve has two linear curves, which are joined at price P. Associated with the kinked demand curve is a marginal revenue function. Some of the ways include price, advertising, product quality, etc. In some countries this kind of collusive agreement is illegal e. The most extreme form of the collusive agreement is known as a cartel. Then suddenly the cartel seemed to collapse. The problem is regarding the allocation of output within the member firms. What would happen if all members did the same? The story is something like this. More seriously, suppose the KGB has actually arrested someone named Tchaikovsky and the conductor separately. Now consider the outcome.

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Pursuit of their own self interests made each worse off. This scenario is easily transferred to the pricing decision of a company. A fascinating example of tit-for-tat in action occurred during the trench warfare of the First World War. It is quite popular in industries like cigarette industry. In dominant price leadership, the largest firm in the industry sets the price. Barometric price leadership is said to be the simpler of the two. Barometric price leadership has been seen in the automobile sector. Steel was the leader in setting prices in the steel industry. However, in , a price increase announced by U. Kennedy, that the firm became less willing to act as the price leader. Steel either confirming or rejecting the change by its reaction. Steel found that its market share was declining. Within three weeks, all of the other major producers, U. The lower industry price was not profitable for the industry members. Steel was once again willing to play by industry rules. Peterson and Lewis, These give the percentage of total industry sales of 4, 8, orPricing Under Monopolisticand OligopolisticCompetition largest firms in the industry. An industry in which the four-firm concentrationratio is close to is clearly oligoplistic, and industries where this ratio is higherthan 50 or 60 percent are also likely to be oligopolistic. The four-firm concentrationratio for most manufacturing industries in the United States is between 20 and 80percent. Another method of estimating the degree of concentration in an industry is theHeirfindahl index H. This is given by the sum of the squared values of themarket shares of all the firms in the industry. The higher the Heirfindahl index, thegreater is the degree of concentration in the industry. This points to the advantage of the Heirfindahl index over theconcentration ratios discussed above. Specifically the Heirfindahl index usesinformation on all the firms in the industry- not just the share of the market by thelargest 4, 8, 12 firms in the market. Furthermore, by squaring the market share ofeach firm, the Heirfindahl index appropriately gives a much large weight to largerthan to smaller firms in the industry. The Heirfindahl index has become of greatpractical importance since when the Justice Department in the US announcednew guidelines for evaluating proposed mergers based on this index. An example of this might be an airline that establishes a service between two citiesalready served by other airlines if the new entrant faces the same costs as existingairlines and could subsequently leave the market by simply reassigning its planes toother routes without incurring any loss of capital. When entry is absolutely free andexit is entirely costless, the market is contestable. Firms will then operate as if theywere perfectly competitive and sell at a price which only covers their average costs so that they earn zero economic profit even if there is only one firm or a few ofthem in the market. Powered by Create your own unique website with customizable templates.

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price,www.enganchecubano.comindsthattheaveragenumber ofyearsinwhichanindividualfirm'spricechanges is monotonically increasingin the numberofcompetitors it has.

To what extent does the kinked demand curve model explain price rigidity in oligopoly? Often prices appear to be relatively stable in oligopolistic markets. There are different models to explain periods of price stability. The most predominant one being the kinked demand curve model, though this has received substantial criticism and economists have put forward other explanations. Kinked Demand Curve The Kinked demand curve suggests firms have little incentive to increase or decrease prices. If a firm increases the price, they become uncompetitive and see a big fall in demand; therefore demand is price elastic for a higher price. This means increasing price would lead to a fall in revenue. However, if firm decreases price, they would gain market share. Therefore, for a price cut, demand is price inelastic. Because every firm is cutting prices so they receive no increase in market share. Kinked demand curve model The model of the kinked demand curve suggests prices will be stable. Therefore, in theory, the kinked demand curve suggests an explanation for why prices are stable. Problems with Kinked demand Curve Model Empirical evidence to support this model is very weak. Prices do change in Oligopolistic markets much more often than this model suggests. Oligopoly makes assumptions about the behaviour of firms in response to price changes that firms, in reality, may not make. If costs change only slowly, then prices will remain fairly stable. In an oligopoly market like petrol retail. A change in the price of oil will often lead to all firms changing prices by a similar amount. Game Theory looks at the behaviour of firms when there is interdependence. But, in the real world, there may be situations which explain why firms wait to see how other firms react. Psychological pricing suggests in the real world firms seek to set prices which are psychologically attractive to customers. Firms are not Short-Term Profit maximisers. In the kinked demand curve model, it is assumed firms wish to maximise profits. However, firms may wish to maximise other objectives such as creating goodwill amongst stakeholders. This may encourage them to absorb cost increases rather than pass it straight on to customers. In some oligopolies, there may be an element of price leadership. Firms look up to one dominant firm to set prices. If the dominant firm keeps prices stable, other firms are reluctant to change. Related This entry was posted in economics.

THE RELATIVE RIGIDITY OF MONOPOLY PRICING pdf

4: Pricing under monopolistic and oligopolistic competition - JBDON

This paper seeks to explain why monopolies keep their nominal prices constant for longer periods than do tight oligopolies. We provide two possible explanations. The first is based on the presence of a small fixed cost of changing prices. The second, on small costs of discovering the optimal price.

See other formats HD Although tne first evidence in this regard was presented by Stigler almost forty years ago, no theoretical explanations have been offered. The objective of this paper is to develop models capable of explaining these facts. It was widely regarded to be an implication of that theory that duopolists would not change their prices in response to small changes in their costs. Instead of comparing oligopoly pricing with pricing in unconcentrated industries he simply compared the relative rigidity of monopoly and oligopoly prices. If it is the kink that leads to inflexible oligopoly prices, monopolists should have more flexible prices since monopolists do not face a kinked demand curve. It is now well-recognized, nowever, that the kinked demand curve implies multiple equilibria. When cost conditions change one might well expect the equilibrium to change as well. It is only if the current price is somehow "focal" that the price will not change. In his study, Stigler tabulated tne nunber of price changes for two monopolistically supplied commodities aluminum and nickel and 19 products which were each supplied by a small number of firms. The finding has been replicated on other price data for different periods. Primeauz and Bomball compare pricing of electric power when it is supplied by a duopoly versus a monopoly. Their data cover 17 duopolies and 22 monopolies from to Also, list prices are transactions prices since deviations from printed schedules are illegal for public utilities. Their results show that when there are two firms in the market they each change their prices more often than a corresponding monopolist. This is true for all levels of power usage. The effect is more pronounced for lower levels of power usage where the duopolists changed their prices two or three times more frequently than it is for nigher power usages where they change their prices roughly one-and-a-half times as often. For the most part the monopoly prices they report are those for drugs about to go off patent. If monopolists have a tendency to change their prices in anticipation of the competition that is likely to ensue when the patent runs out, this mignt explain why the results here are weaker than in the cases reported above. There thus seems to be a general tendency for monopolists to change their prices less frequently than oligopolists. We focus on the comparison between duopoly and monopoly and show that whether the products of the duopoly are homogeneous or differentiated, the duopolists have a greater incentive to change their prices than does a monopolist facing the same configuration of demand. So, if there are other forces leading to price rigidity that are of roughly comparable magnitudes across industry structures, there will be a general tendency for duopoly prices to change more frequently. There are a variety of reasons why prices may be unresponsive to changes in underlying conditions. We focus on two. The first reason is that there may be a fixed cost of changing prices. These costs are usually taken to include the physical costs of changing and disseminating price lists and the possibility of upsetting customers with frequent price changes. In the electric utility industry they also capture the costs of obtaining permission from regulatory authorities for changing tariffs. The second reason is that while firms may be aware that underlying conditions nave changed , it may be costly for them to ascertain precisely how they have changed. On the cost side, labor and material costs may have to be reestimated. At least when it is believed that only moderate changes in conditions have occurred, firms may then prefer not to change their prices to incurring tnese costs. Of course, absent a fixed cost to changing prices as well, this would only explain tne reluctance of firms to change prices when their best estimate of the optimal price given the information they have is the current price itself. Given the general reluctance of firms to change their prices, the question then is how the gains to the firms of changing their prices compare with the costs, and more importantly, how the gains differ accross market structures. To see why duopolists in general have a greater incentive to change prices, consiaer the following simple case. Suppose that two firms competing in Bertrand style and charging price equal to constant marginal cost unexpectedly discover that costs have increased. If neither firm increases its price, the firms share the loss of supplying the entire market demand at a price below costs. The firms obviously have a large incentive to change their prices. Furthermore, if either

firm believes its rival will change its price then it has an even greater incentive to raise its own price in order to avoid suffering the entire loss itself. Put differently, when a firm changes its own price it imposes a negative externality on its rival: A similar phenomenon arises for cost decreases. In that case there is no incentive for the firms to make a combined price decrease. However there are substantial incentives for either firm to make a unilateral price decrease to undercut the rival. Here again there is an externality: Therefore, as Akerlof and Yellen l show, the loss m profits from not changing its price is second oraer. One might believe, therefore, that the result that monopolists change their prices less frequently than duopolists would not hold in this case. We show that it does. Consider duopolists producing differentiated products and, as above, suppose that costs increase slightly. Now if one firm raises its price slightly It no longer yields all of its customers to its rival. Profits are no longer discontinuous at the point of equal prices. However, it does lose some of Its customers to its rival, and if the degree of substitutability is high it loses them at a rapid rate. In other words, the externality that the duopolist inflicts on its rival is increasing m the degree of substitutability between the products. Thus although the increase in profits from adjusting its price is second order, it may be large. For purposes of comparison, suppose that the monopolist offers both products. Now when it changes the price of either one it bears the full consequences: Thus in the presence of fixed costs of changing prices the monopolist may adjust prices more sluggishly. In order to compare the relative frequency of price adjustments, it is important not to stack the deck against the monopolist by having it incur a fixed cost for changing each of its prices. Rather, to bias the conclusion away from our result we suppose that the monopolist can change both of its prices for what it costs each of the duopolists to do so. Even then we find that provided the cross-elasticity of substitution is high enough, the duopolists change their prices more frequently. Similar motives tend to luake duopolists more keen to discover changes in underlying conditions when discovery is costly. Alternatively if it discovers that costs have increased it is able to increase its price and the rival suffers from having a large demand at an unremunerative price. These incentives do not apply to monopolists: We begin by examining the case of a fixed cost to changing prices. In Section II we develop intuition via a homogeneous goods example. This model is generalized to differentiated products and an inflationary environment m Section III. In section IV we study the case where it is costly to discover the exact magnitude of a change in costs. We conclude with Section V. A Model with Homogeneous Products and Fixed Costs of Changing Prices In oraer to demonstrate now the incentives for a monopoly to change prices differ from those of a duopoly we begin with a very simple model. In particular, we will assuiae that the duopolists proaace a homogenous good witn I. As we shall see below, tnis formulation is useful for expository purposes since the incentives for changing prices are most apparent when the model is stripped down m this way. Unfortunately, we will also see that this formulation is too stark in the sense that duopolists earn zero profits given of any fixed costs. Thus, they must bear any such costs, their participation becomes unprofitable. However, any niinber of modifications in the direction of realism such as differentiated products or increasing marginal costs would provide the firms with sufficient profits to cover small fixed costs. We begin with the simplest model and later snow how product differentiation guarantees tne willingness of the firms to participate. We will refer to the periods before and after the cost change as periods 1 and 2 respectively. Inverse demand is given by? The monopolists, on the other hand, changes P. We consiaer what happens when the new level of marginal costs, c , is known to both firms before they select their period two prices, but where each firm must incur a a fixed cost, f, to change its price. If the monopolist leaves its price unchanged at P it sells a-c. Suppose that firm 2 does not change its price. To do so it must incur the cost, f, and then it goes out of business. Thus firm 1 loses f if it raises its own price and firm 2 keeps its price unchanged. Thus if 2 nolds, changing price is a dominant strategy and tne unique equilibrium involves both firms changing price. If 5 holds but 2 does not, each firm is willing to change its price only if tne other also aoes. Tnere are then two equilibria: Finally, if 5 does not hold then the unique equilibrium is that neither firm changes its price. To make the comparison unfavorable to frequent price changes by the auopoly, we concentrate on the case m which changing price is the unique equilibrium. Then the duopoly changes prices if 2 holds while the monopoly changes prices if I holds. Thus tne duopolists would always change the price if the monopolist would. The intuition for these results is clear from Figure 1 which illustrates the effect of a cost increase. The monopolist is willing to change its price if this area exceeds

f. Now consider the duopolists. Thus the duopolist always has a greater incentive to increase its price. This is not true for Bertrand duopolies and indeed 2 is of first order in the change in costs while l is of second order. However, as soon as we let the duopoly produce differentiated products, the profit functions become differentiable and both losses are ol second order. Yet we show m the following section that as the two goods become better and better substitutes the analysis in this section becomes more relevant. Note that while Bertrand duopolists respond more to changes in costs they respond less to changes in demand with constant marginal costs the duopoly never changes its price when a changes. Instead by not changing its prices the monopolists loses an amount quadratic in the change in a. This analysis has two shortcomings. First, the duopolists lose money in equilibrium. If they do not change their prices, they sell at a price less than marginal cost.

5: The Relative Rigidity of Monopoly Pricing

The Relative Rigidity of Monopoly Pricing This paper examines wlzy monopolies change their rzominal prices less often than do tight oligopolies.

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Instead of comparing oligopoly pricing with pricing in unconcentrated industries he simply compared the relative rigidity of monopoly and oligopoly prices. If it is the kink that leads to inflexible oligopoly prices, monopolists should have more flexible prices since monopolists do not face a kinked demand curve.

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