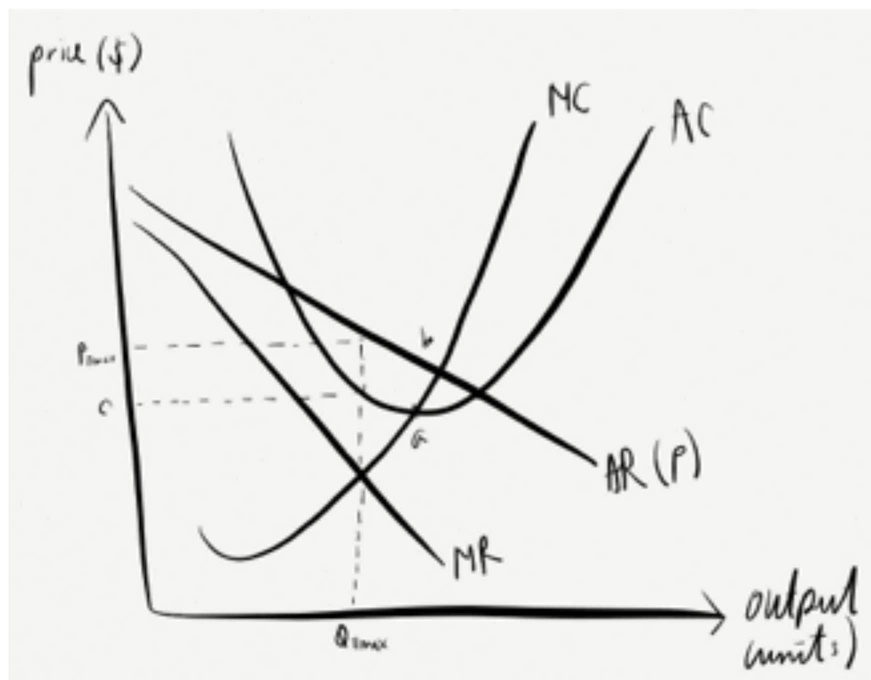
DISCUSS THE DIFFERENCES BETWEEN A COLLUSIVE AND A NON-COLLUSIVE OLIGOPOLY.

Collusion is an agreement, whether formal (like cartels) or informal (tacit collusion like price leadership, where one firm initiates price changes and smaller firms follow suit in an implicit agreement, usually because formal collusive practices are illegal due to the fact that they limit competition), between competitive parties to cooperate to limit competition and raise prices, increasing monopoly power and raising profits.

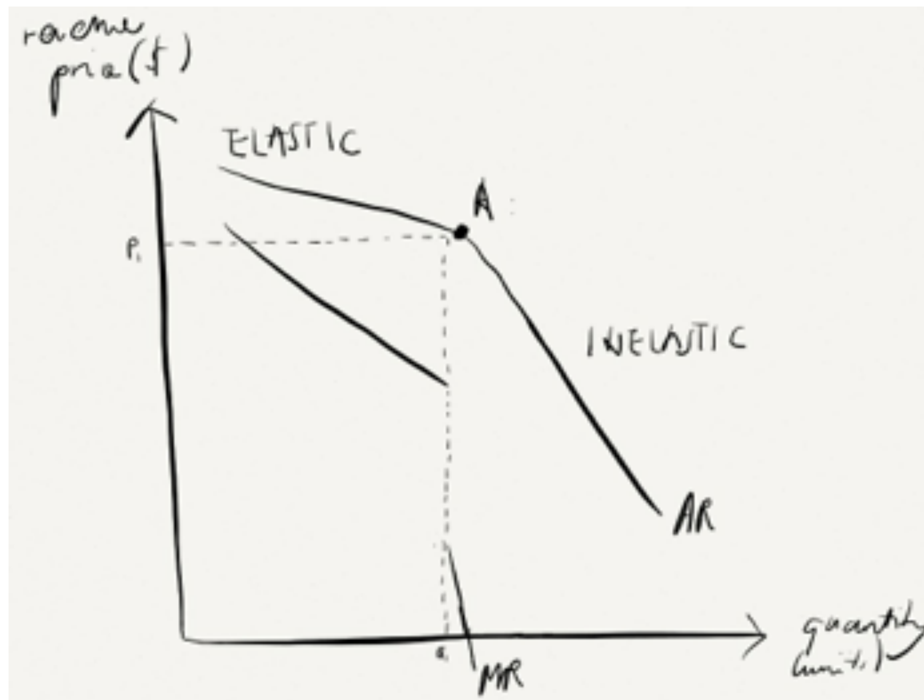
A cartel is a formal agreement between parties to limit competition and raise prices, like the OPEC cartel that comprises of 12 countries to dominate the oil market. Collectively they behave like a monopoly and are able to set their price and collectively maximise profits, as shown on the diagram below.



Acting as a monopoly, these firms are able to maximise their profits, increasing producer surplus. However, consumers may face increased prices of P rather than at the productively efficient level at *a* or the allocatively efficient level at *b,* facing lower consumer surplus.

Cartels face many problems: firstly, firms tend to have different costs of production, and are often of different sizes - it can be hard to determine how much each firm should produce. Also, there is the incentive for firms to cheat and lower their prices despite the cartel, which could trigger a price war, where firms keep lowering prices to force competition out of the market. This could result in lower prices for consumers in the short run, but in the long run, the firm with greater monopoly power can increase prices as there are less competitors in the market. The more parties there are in a cartel, the harder it is to maintain the structure of the cartel, especially during recessions when demand falls and firms have an even greater incentive to lower their prices.

Oligopolies can also be non-collusive, where firms do not cooperate or collude and therefore live in a strategic environment and have to take into account the possible actions of rival firms and how to react. However, there is still price inflexibility in non-collusive oligopolies, as seen on the diagram on the next page.



The price is stable at price A as the demand curve has different elasticities: if the price is increased, other firms do not have the incentive to put up the price and therefore customers easily switch consumption and there is a significant fall in output. If the price is decreased, the competition also lowers prices so there is only a small increase in output, as illustrated by the more inelastic part of the curve. Therefore prices have a tendency for stickiness and stays at price A.

Therefore, members of an oligopoly may look to non-price competition, such as product development to distinguish their products from that of competing firms, investing in research and development to increase their monopoly power and increase sales, giving them a competitive edge. This gives firms an incentive to invest in R&D and remain efficient.

In conclusion, both collusive and non-collusive oligopolies have a number of large firms that have quite significant market power. Collusive oligopolies tend to limit competition more than non-collusive oligopolies, but this can be limited by regulatory practices put in place by governments, such as the competition commission of Singapore that regulates monopoly power and prevents practices that may harm competition and take advantage of consumers.