

AP[®] Microeconomics – The Nature and Function of Product Markets

Student activity: 2.21 Oligopolies



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2.21 OLIGOPOLIES: STUDENT LEARNING ACTIVITY

Answer the questions that follow.

1. DEFINITIONS/CONCEPTS

Define/outline the following terms/concepts:

[10 marks]

- Oligopoly
- Imperfect competition
- Product differentiation
- Elastic demand
- Inelastic demand
- Price competition
- Price war
- The profit maximizing rule
- Characteristics of oligopolistic markets
- Interdependence
- Collusion
- Cartel
- Game theory
- Prisoner's dilemma game
- Nash equilibrium
- Concentration ratios
- Collusive oligopoly
- Tacit collusion
- Formal collusion
- Price leadership
- Price rigidity
- Kinked demand curve model
- Non-price competition
- Price war

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2. SHORT-ANSWER QUESTIONS

1. Outline the main assumptions of oligopolies.

[2 marks]

2. Explain why oligopolies have conflicting incentives.

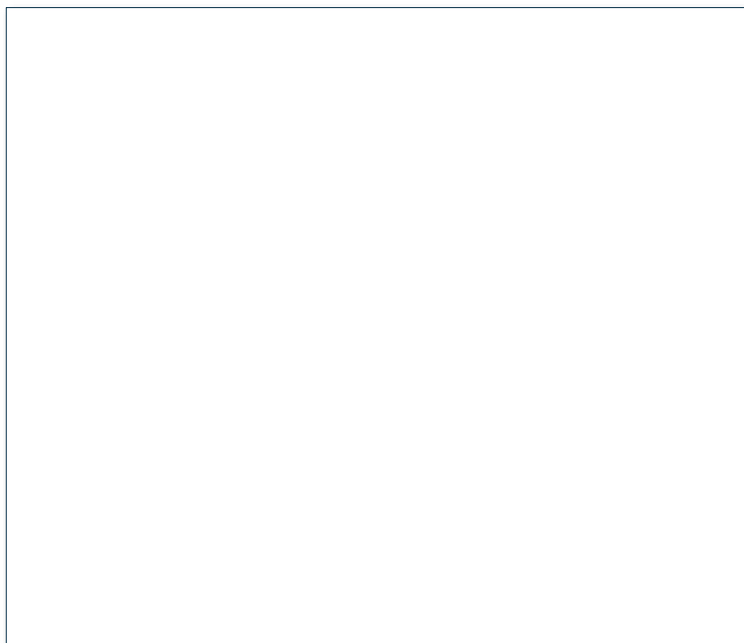
[6 marks]



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3. Explain how the interdependence of oligopolies leads to conflicting incentives.

[6 marks]





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- 4. Explain how the interdependence of oligopolies leads to outcomes that can be analyzed through game theory (e.g., the Prisoners' Dilemma game). **[6 marks]**



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A Co. and B Co. pay-off matrix

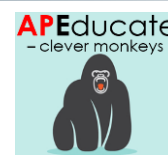
A Co. B Co.	B Co. high price	B Co. low price
A Co. high price	\$15m \$15m	\$25m \$3m
A Co. low price	\$3m \$25m	\$7m \$7m

5. The following questions refer to the “Oligopolists’ Dilemma” shown above. [10 marks]
- a. Explain why the payoff matrix below illustrates the conflicting incentives occurring in the Prisoners Dilemma game.

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b. Outline each of the profit outcomes which are possible for the two firms.

c. Explain how the profit outcomes are related to the interdependence of the two firms.



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6. Use examples to outline the concept of 'concentration ratio'.

[2 marks]

7. Explain why concentration ratios are calculated.

[3 marks]

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8. Outline two limitations of concentration ratios.

[2 marks]

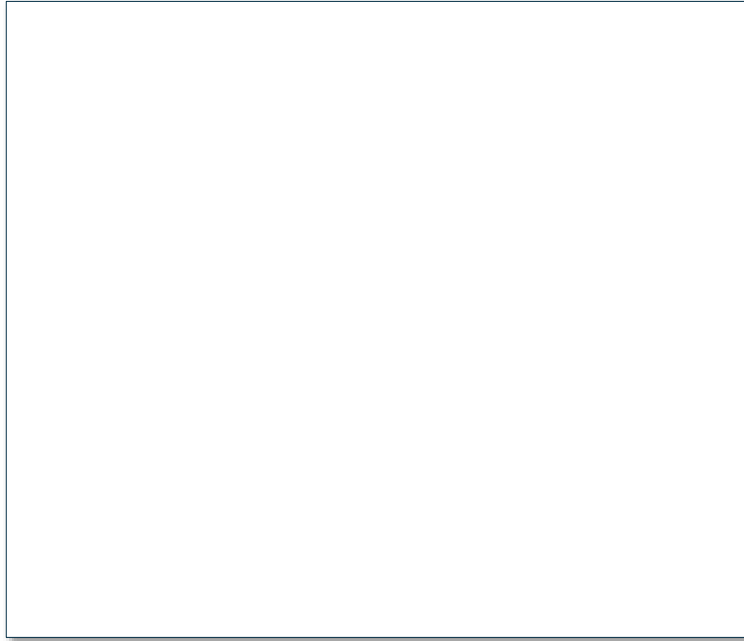
9. Outline the concept of oligopolistic collusion.

[3 marks]

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12. Explain the relationship between collusive oligopolies and cartels.

[6 marks]





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13. Explain how a cartel has an effect on the market resembling that of a monopoly.

[6 marks]

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14. Explain why cartels are illegal in most countries.

[6 marks]

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15. Outline obstacles faced by cartels in forming and maintaining the cartel.

[3 marks]

16. Explain the incentive to cheat among members of a cartel.

[6 marks]

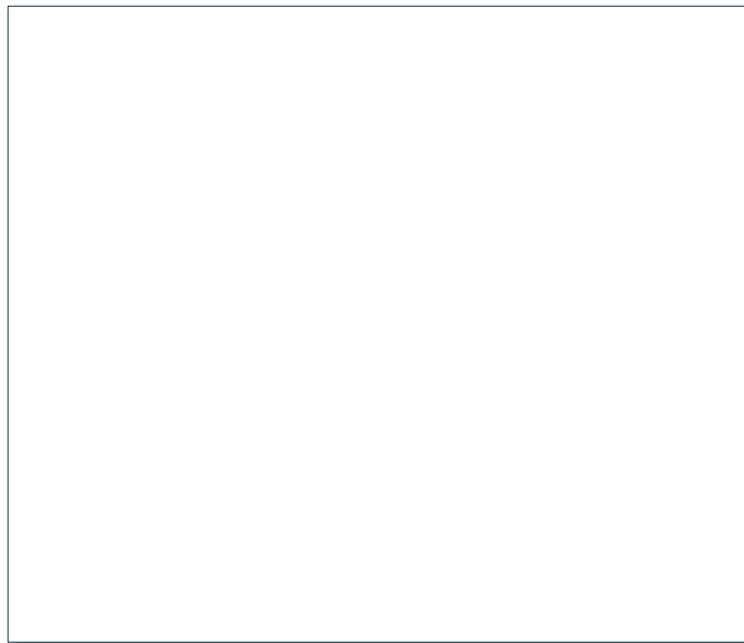
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17. Outline the concept of tacit collusion.

[3 marks]

18. Explain how price leadership is a form of tacit collusion.

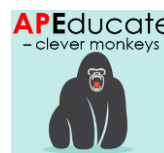
[6 marks]



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19. Distinguish between collusive and non-collusive oligopoly.

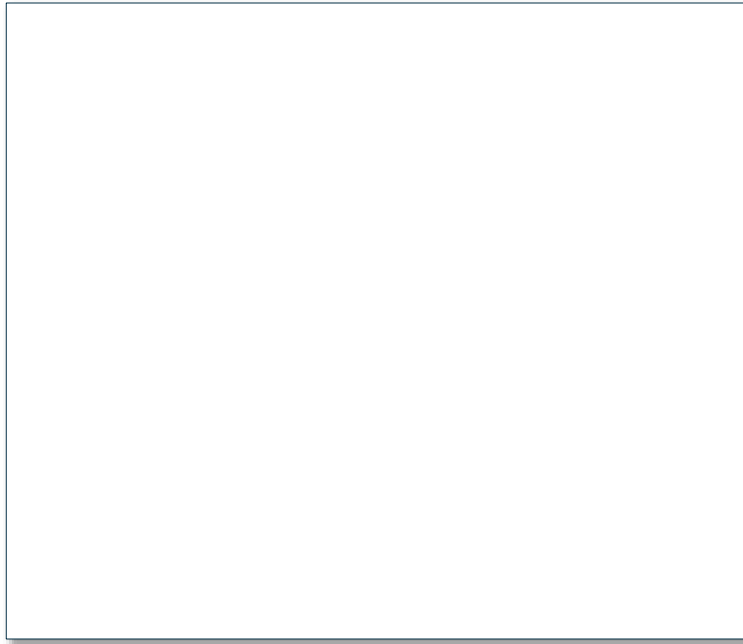
[6 marks]



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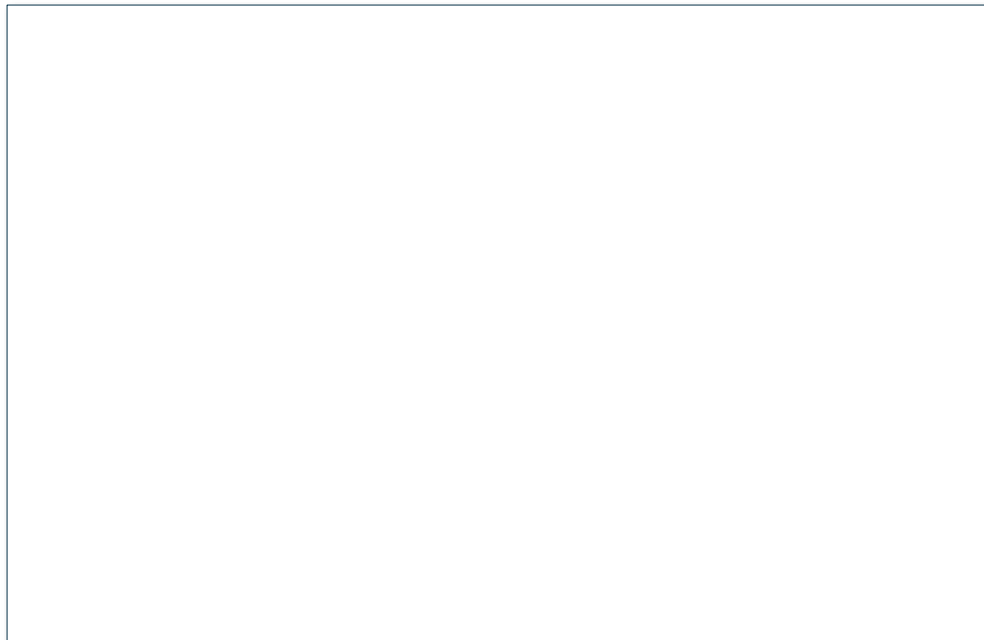
20. Draw the non-collusive oligopolist's demand curve.

[2 marks]



21. Using the concept of price elasticity of demand, explain the shape of the kinked demand curve.

[6 marks]



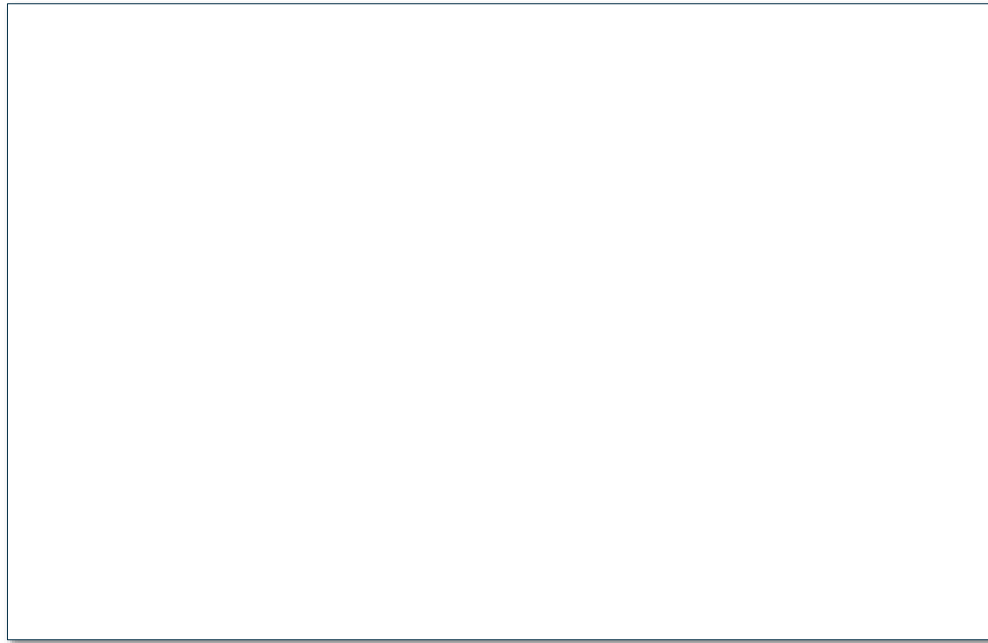
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22. Outline what the kinked demand curve attempts to explain.

[4 marks]

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23. Explain the following statement: The kinked demand curve model describes the strategic behavior of oligopolistic firms. **[6 marks]**





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24. Identify examples of non-price competition.

[2 marks]

25. Explain why non-price competition is important for oligopolistic firms.

[4 marks]

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26. Explain why oligopolies will avoid price competition if at all possible.

[4 marks]

27. Outline the concept of price wars.

[2 marks]

