ECON4820 – Strategic Competition: Term paper 2006

Note: This term paper is *not* mandatory.

Available online: Friday 24 March 2006
To be handed in at the Economics Department's reception in the 12th floor of the Eilert Sundt Building.
Deadline for handing in: Friday 7 April 2006, at 15:00.

Question 1
(similar to an exam question in 1998)

a) In a duopoly where firms produce homogeneous products and have identical and constant unit costs, equilibrium prices equal marginal costs. Explain why this is so.
b) The equilibrium in part (a) illustrates the Bertrand paradox, that prices may equal marginal costs and firms have zero profits even with only two firms in the market. Discuss some of the critical assumptions underlying this result and how relaxing them may lead to prices in excess of marginal costs. (Note: You are not asked to provide a full equilibrium analysis of the situation with an altered assumption, only to explain why it leads to prices greater than marginal costs.)

Question 2

Collusion among firms is possible if they are patient enough. Explain why this is so.

Question 3

In a market with product differentiation, will the product variants offered in equilibrium be too similar or too different, compared to the social optimum?